Morgan Lewis

review

2009 Year in Review:
Selected Federal Securities Litigation Developments

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Morgan Lewis is pleased to present our second annual review of selected decisions from the United States Courts of Appeal addressing private actions under the federal securities laws.

We summarize below key decisions analyzing claims by private litigants under Sections 10(b), 14(a), 16, 20(a), and 20(A) of the Securities Exchange Act of 1934 and Sections 11, 12, and 15 of the Securities Act of 1933.[1] Our review includes 64 opinions, organized by topic and, within each topic, by circuit in chronological order, allowing you to quickly identify the most recent authority on particular issues in any jurisdiction.[2]

We have focused on the following topics, which are often dispositive in high-stakes private securities litigation: scienter, loss causation, SLUSA, class certification; *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 128 S. Ct. 761, 169 L. Ed. 2d 627 (Jan. 15, 2008); statutes of limitations; materiality; falsity; and several other miscellaneous topics. We have spotted the following trends.

First, as in 2008, scienter was this year's hottest topic. We have identified at least 20 appellate decisions addressing scienter, including 9 decisions by the Second Circuit. These cases reflect the following:

- Under *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 127 S. Ct. 2499, 168 L. Ed. 2d 179 (June 21, 2007), the Circuit Courts are applying a "dual inquiry," first examining whether, standing alone, any of the allegations are sufficient to create a strong influence of scienter. If no one individual allegation is sufficient, the courts are then reviewing all of the allegations holistically to determine whether the allegations combine to create a strong inference. *See Zucco Partners, LLC v. Digimarc Corp.*, 552 F.3d 981 (9th Cir.

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[1] We have not included certain decisions where securities law issues are neither central to the case nor analyzed in a substantive manner. For a review of enforcement actions, please see Morgan Lewis's 2009 Year in Review: SEC and SRO Selected Enforcement Cases and Developments Regarding Broker-Dealers.

[2] Cases containing significant discussions of more than one of the topics highlighted in this outline have duplicative listings under each relevant topic heading.

Feb. 10, 2009); *see also Avon Pension Fund v. GlaxoSmithKline PLC*, No. 08-4363, 2009 WL 2591173 (2d Cir. Aug. 24, 2009).

- Nonetheless, a number of appellate decisions have held that the scienter requirement was not met through application of the second-level, holistic inquiry. Rather, the Circuit Courts have held that the allegations, even when viewed together, are insufficient. As the Second Circuit put it in the unpublished decision *Malin v. XL Capital, Ltd.*, 312 Fed. Appx. 400, 402 (2d Cir. Feb. 26, 2009): "[H]aving concluded that none of plaintiffs' allegations showed even a weak inference of scienter, there is no logical way that the District Court could have determined that the combined effect of the allegations would have a *strong* inference of scienter." *See also ECA and Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co.*, 553 F.3d 187 (2d Cir. Jan. 21, 2009); *Avon Pension Fund*, 2009 WL 2591173 at *2 ("[P]laintiffs' circumstantial pleadings, even when considered in the aggregate, do not permit an inference of defendants' 'conscious misbehavior or recklessness.'"); *Zucco Partners*, 552 F.3d at 1007 ("Although the allegations in this case are legion, even together they are not as cogent or compelling as a plausible alternative inference.").

- The Second Circuit continues to hold that scienter may be established either by allegations of facts demonstrating that defendants had the motive and opportunity to commit fraud *or* by alleging strong circumstantial evidence of conscious misbehavior or recklessness. *See ECA*, 553 F.3d at 198-99; *Condra v. Pxre Grp. Ltd.*, No. 09-1370, 2009 WL 4893719 (2d Cir. Dec. 21, 2009). By contrast, the Third Circuit has concluded that, after *Tellabs*, "'motive and opportunity' may no longer serve as an independent route to scienter." *Inst'l Investors Group v. Avaya, Inc.*, 564 F.3d 242, 277 (3d Cir. Apr. 30, 2009).

- In recent years, plaintiffs have attempted to use Sarbanes-Oxley certifications as evidence of scienter. Several Circuit Courts have rejected this argument. *See*, *e.g.*, *Konkol v. Diebold, Inc.*, No. 08-4572, 2009 WL 4909110 at *9 (6th Cir. Dec. 22, 2009); *Horizon Asset Mgmt. Inc. v. H&R Block, Inc.*, 580 F.3d 755, 766 (8th Cir. Sept. 9, 2009); *Zucco Partners*, 552 F.3d at 1002-04.

- The Circuit Courts appear reluctant to accept the claims that alleged insider stock transactions are evidence of scienter. Insider trading "is suspicious only when it is dramatically out of line with prior trading practices at times calculated to maximize the personal benefit from undisclosed insider information." *Konkol*, 2009 WL 4909110, at *6 (quoting *Zucco Partners*, 552 F.3d at 1005). In addition, plaintiffs "must provide a 'meaningful trading history' for purposes of comparison to the stock sales within the class period." *Id.*

- The Circuit Courts remain cautious of the use of confidential witnesses to establish scienter. For example, the Ninth Circuit reiterated that a complaint

relying on such statements must pass two hurdles: first, the confidential witnesses "must be described with sufficient particularity to establish their reliability and personal knowledge," and second, those statements which are reported "must themselves be indicative of scienter." *Zucco Partners*, 552 F.3d at 995.

- Importantly, only four scienter decisions were truly favorable to plaintiffs. *See Inst'l Investors Group v. Avaya, Inc.*, 564 F.3d 242 (3d Cir. Apr. 30, 2009); *Brunig v. Clark*, 560 F.3d 292 (5th Cir. Feb. 17, 2009); *Huberman v. Tag-It Pacific Inc.*, 314 Fed. Appx. 59 (9th Cir. Feb. 11, 2009); *Siracusano v. Matrixx Initiatives, Inc.*, 585 F.3d 1167 (9th Cir. Oct. 28, 2009).

On loss causation, the most defense-friendly decision was *Fener v. Operating Engineers Construction Industry and Miscellaneous Pension Fund (Local 66)*, 579 F.3d 401 (5th Cir. Aug. 12, 2009), where the Fifth Circuit affirmed a denial of a motion for class certification, based on a failure adequately to establish loss causation. The press release where the "truth" emerged was coupled with other negative news unrelated to the alleged fraud. In such circumstances, "plaintiffs must prove that the fraudulent disclosure caused a significant amount of the decline." *Id.* at 409.

SLUSA continues to be a useful tool for defendants to attack state law claims. In *Segal v. Fifth Third Bank, N.A.*, 581 F.3d 305 (6th Cir. Sept. 17, 2009), the Sixth Circuit made clear that SLUSA is triggered where the complaint alleges a misrepresentation or omission, and does not require that the misrepresentation be an element of plaintiff's state law cause of action: "The Act does not ask whether the complaint makes 'material' or 'dependent' allegations of misrepresentation in connection with buying or selling securities. It asks whether the complaint includes these types of allegations, pure and simple." *Id.* at 311.

However, the SLUSA decisions were not all positive. In *In re Lord Abbett Mut. Funds Fee Litig.*, 553 F.3d 248 (3d Cir. Jan. 20, 2009), the Third Circuit rejected the District Court's conclusion that SLUSA precludes an entire action, notwithstanding the fact that a part of the claim may not fall within SLUSA's scope. "Allowing those claims that do not fall within SLUSA's preemptive scope to proceed, while dismissing those that do, is consistent with the goals of preventing abusive securities litigation while promoting national legal standards for nationally traded securities." *Id.* at 257.

On statutes of limitations, the Supreme Court held argument this year in *Merck & Co. v. Reynolds*, 543 F.3d 150 (3d Cir. 2008), *cert. granted*, 129 S. Ct. 2432 (May 26, 2009). We anticipate that the Court will soon provide clarity as to the type of "storm warnings" necessary to begin the statute of limitations clock. *Id.* at 161.

Also, last year we included in our review a discussion of *Morrison v. Nat'l Australia Bank Ltd.*, 547 F.3d 167 (2d Cir. Oct. 23, 2008), one of several recent "Foreign Cubed" cases analyzing whether U.S. courts have jurisdiction over securities actions involving foreign

plaintiffs suing foreign issuers concerning securities transactions in foreign countries. The Second Circuit applied a "conduct test" and determined that the District Court lacked subject matter jurisdiction. On November 30, 2009, the Supreme Court granted certiorari, and oral argument is scheduled for March 29, 2010.

The biggest winners this year may have been accounting firms. The Circuit Courts rejected attempts to bring actions against accountants/auditors for the following reasons: the complaints failed to adequately plead scienter (*see W. Va. Inv. Mgmt. Bd. v. Doral Fin. Corp.*, No. 08-3867, 2009 WL 2779119 (2d Cir. Sept. 3, 2009); *Public Employees' Retirement Assoc. of Colo. v. Deloitte & Touche LLP*, 551 F.3d 305 (4th Cir. Jan. 5, 2009)); the claims failed under *Stoneridge* (*see In re Peregrine Systems, Inc. Securities Litigation*, 310 Fed. Appx. 149 (9th Cir. Nov. 6, 2009)); the plaintiffs failed adequately to allege loss causation (*see McAdams v. McCord*, 584 F.3d 1111 (8th Cir. Oct. 20, 2009)); and the claim was barred under the "law of the case" doctrine (*see Public Employees' Retirement Association of New Mexico v. PricewaterhouseCoopers LLP*, 305 Fed. Appx. 742 (2d Cir. Jan. 6, 2009)).

Finally, we are beginning to see appellate decisions concerning alleged stock options backdating, and these initial decisions are favorable to defendants. *See Rosenberg v. Gould*, 554 F.3d 962 (11th Cir. Jan. 9, 2009) (affirming dismissal based on a failure to adequately plead scienter); *Roth v. Reyes*, 567 F.3d 1077 (9th Cir. June 5, 2009) (affirming dismissal of § 16(b) claims based on statute of limitations).

In the coming year, cases arising out of the Madoff scandal and the financial crisis will likely begin to percolate through the Circuit Courts. We anticipate vigorous arguments over loss causation and scienter, and we will provide updates to you throughout the year on significant cases and trends. As always, we welcome your feedback, and look forward to working with you this year.[3]

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[3] This review was prepared by Morgan Lewis partners Brian Herman, John Vassos, and Elizabeth Frohlich, and of counsel Karen Pieslak Pohlmann, and associates Gayle Gowen and Ruby Marenco, with substantial assistance from associates Michelle Ferreri, Mark Hitchcock, Sheila Jambekar, Kate McMahon and Robert Scannell and senior paralegal Jan McGovern. This review is current as of December 31, 2009. Copyright 2010, Morgan, Lewis & Bockius LLP.

Morgan Lewis regularly defends private securities actions, including class actions. For additional inquiries, please contact any of the following attorneys:

New York

Bernard J. Garbutt	212.309.6084	bgarbutt@morganlewis.com
Brian A. Herman	212.309.6909	bherman@morganlewis.com
Michael S. Kraut	212.309.6927	mkraut@morganlewis.com
Kevin T. Rover	212.309.6244	krover@morganlewis.com
John M. Vassos	212.309.6158	jvassos@morganlewis.com

Philadelphia

J. Gordon Cooney, Jr.	215.963.4806	jgcooney@morganlewis.com
Timothy D. Katsiff	215.963.4857	tkatsiff@morganlewis.com
Karen Pieslak Pohlmann	215.963.5740	kpohlmann@morganlewis.com
William P. Quinn, Jr.	215.963.5775	wquinn@morganlewis.com
Marc J. Sonnenfeld	215.963.5572	msonnenfeld@morganlewis.com

San Francisco

Joseph E. Floren	415.442.1391	jfloren@morganlewis.com
Elizabeth A. Frohlich	415.442.1352	efrohlich@morganlewis.com

Washington, D.C.

Christian R. Bartholomew	202.739.6400	cbartholomew@morganlewis.com
Patrick D. Conner	202.739.5594	pconner@morganlewis.com
Christian J. Mixter	202.739.5575	cmixter@morganlewis.com

Miami

Ivan P. Harris	305.415.3398	iharris@morganlewis.com

Citations

For the purposes of the following 2009 securities case law summary, references to the Exchange Act refer to the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a et seq., and references to §§ 10(b), 14(a), 16(b), 20(a), and 20(A) refer to the associated sections of the Exchange Act, 15 U.S.C. §§ 78j(b), 78n(a), 78p(b), 78t(a), and 78t-1. References to Rule 10b-5 refer to SEC Rule 10b-5, promulgated in 1942 pursuant to § 10(b) of the Exchange Act, 17 C.F.R. § 240.10b-5 (2007). References to the Securities Act refer to the Securities Act of 1933, 15 U.S.C. §§ 77a et seq., and references to §§ 11, 12, and 15 refer to the associated sections of the Securities Act, 15 U.S.C. §§ 77k, 77l, and 77o. References to the PSLRA refer to the Private Securities Litigation Reform Act of 1995. *See*, *e.g.*, 15 U.S.C. §§ 78u-4, 78u-5. References to SLUSA refer to the Securities Litigation Uniform Standards Act of 1998, 15 U.S.C. §§ 77p, 78bb(f). References to CAFA refer to the Class Action Fairness Act of 2005, 28 U.S.C. §§ 1711-1715. References to *Tellabs* refer to the Supreme Court decision *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 127 S. Ct. 2499, 168 L. Ed. 2d 179 (June 21, 2007). References to *Stoneridge* refer to the Supreme Court decision *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 128 S. Ct. 761, 169 L. Ed. 2d 627 (Jan. 15, 2008). References to *Dabit* refer to the Supreme Court decision *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 126 S. Ct. 1503, 164 L. Ed. 2d 179 (Mar. 21, 2006). References to *Dura* refer to the Supreme Court decision in *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005). References to GAAP are to generally accepted accounting principles. Opinions published in the Federal Appendix were not chosen for publication in West's Federal Reporter, *see* Fed. R. App. P. 32.1. In certain instances, where a Circuit Court opinion has quoted from or cited to an underlying authority, we have omitted citation to the underlying authority.

Second Circuit

A. *ECA and Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co.*, 553 F.3d 187 (2d Cir. Jan. 21, 2009)

1. Appeal of an order by the District Court (S.D.N.Y.) granting Defendants' motion to dismiss Plaintiffs' second amended complaint with prejudice. Plaintiffs alleged that JP Morgan Chase & Co. ("JPMC") defrauded them through its complicity in Enron's financial scandals. Plaintiffs alleged violations of §§ 10(b), 14(a) and 20(a) of the Exchange Act and Rule 10b-5 promulgated thereunder, and § 11 of the Securities Act. The Second Circuit affirmed.

2. Plaintiffs alleged that JPMC created disguised loans for Enron and concealed the nature of the transactions by making false statements or omissions in its accounting and SEC filings. JPMC allegedly created special purpose entities which allowed Enron to conceal its debt from investors and, in return, earned "exorbitant fees." *Id.* at 194. Plaintiffs further alleged that, following the collapse of Enron, the Senate concluded that JPMC knowingly engaged in and assisted Enron in sham transactions, the resulting disclosure of which caused losses to JPMC's investors. *Id.*

3. In the Second Circuit, a plaintiff can plead scienter by alleging facts to show either that defendants had the motive and opportunity to commit fraud, or strong circumstantial evidence of conscious misbehavior or recklessness. "Motive" is generally shown "when corporate insiders allegedly make misrepresentations in order to sell their own shares at a profit." *Id*. at 199. The desire for a corporation to appear profitable or to keep stock prices high to increase officer compensation is insufficient. Where a plaintiff alleges no motive, the circumstantial evidence must be stronger to state a valid claim.

4. "Allegations of GAAP violations or accounting irregularities, standing alone, are insufficient to state a securities fraud claim." Such allegations are only sufficient where "coupled with evidence of corresponding fraudulent intent." *Id.* at 200. Here, there were no such allegations.

5. With respect to motive and opportunity, the Second Circuit concluded that allegations that JPMC charged excessive fees do not support scienter because the fees would benefit JPMC's shareholders; allegations that Chase was attempting to inflate its share price to reduce the cost of acquiring JP Morgan were attenuated and dubious in light of the absence of temporal proximity; and allegations that individuals had the requisite motive because their bonuses were based on corporate earnings were not sufficiently particular. "[I]ncentive compensation can hardly be the basis on which an allegation of fraud is predicated." *Id*. at 201.

6. The Second Circuit next analyzed whether Plaintiffs adequately pled facts that gave rise to a strong circumstantial evidence of conscious misbehavior or recklessness. To support such an inference based on a violation of the accounting standard at issue, SFAS 57, Plaintiffs needed to establish the materiality of the transactions at issue because SFAS 57 only requires companies to report material related party transactions. Plaintiffs did not do so.

B. *Malin v. XL Capital, Ltd.*, 312 Fed. Appx. 400 (2d Cir. Feb. 26, 2009)[4]

1. Appeal from a judgment of the District Court (D. Conn.) granting Defendants' motion to dismiss. Plaintiffs, purchasers of XL Capital Ltd. ("XL") securities, filed a putative class action against Defendants, a reinsurance company and certain of its executive officers, alleging violations of §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The District Court granted Defendants' motion to dismiss based on Plaintiffs' failure to plead scienter. On appeal, Plaintiffs' argued that their second amended complaint adequately alleged scienter, or, in the alternative, that they should have been granted leave to amend a third time. The Second Circuit affirmed dismissal.

2. In their second amended complaint, Plaintiffs alleged that Defendants knowingly issued false and misleading statements regarding XL's financial condition. Additionally, by failing to adequately reserve for losses in its reinsurance operations, Plaintiffs alleged that Defendants' actions artificially inflated the price of XL's stock to maintain its apparent financial strength and debt ratings. The District Court found that Plaintiffs' second amended complaint failed to adequately explain why Defendants'

[4] Facts taken from underlying District Court opinion, *Malin v. XL Capital Ltd.*, 499 F. Supp. 2d 117 (D. Conn. 2007).

statements were fraudulent. Plaintiffs' allegations failed because they relied largely on insufficient confidential witness statements. Only one of Plaintiffs' witnesses worked at XL's reinsurance subsidiary during the Class Period, while one other left before the start of the Class Period and the remaining two never worked in XL's reinsurance operations at all. Furthermore, the wrongdoing alleged by the confidential witnesses occurred prior to the start of the Class Period.

3. Contrary to Plaintiffs' argument that the District Court improperly failed to consider their allegations collectively, as required by *Tellabs*, the Second Circuit found that the District Court properly considered the allegations. "Moreover, having concluded that none of plaintiffs' allegations showed even a weak inference of scienter, there is no logical way that the District Court could then have determined that the combined effect of the allegations would form a *strong* inference of scienter." *Id.* at *402.

4. The Second Circuit also held that the District Court properly denied Plaintiffs' leave to replead for a third time, noting that Plaintiffs did not make a motion for leave to amend and did not proffer an amended pleading.

C. *Caiafa v. Sea Containers, Ltd.*, 331 Fed. Appx. 14 (2d Cir. May 19, 2009)

1. Appeal of an order by the District Court (S.D.N.Y.) dismissing Plaintiffs' claims with prejudice. Plaintiffs filed claims under §§ 11, 12(a)(2) and 15 of the Securities Act and §§ 10(b) and 20(a) of the Exchange Act against certain officers of Defendant Sea Containers, Ltd. on behalf of a class of individuals who purchased securities of Sea Containers. Plaintiffs alleged that Defendants materially misstated Sea Container's financial statements by overvaluing certain assets on the company's balance sheets, improperly recognizing revenue, and departing from GAAP. The Second Circuit affirmed.

2. The Second Circuit held that Plaintiffs' "cursory allegations" that Defendants failed to record accurately the value of certain assets and departed from GAAP provisions were insufficient to establish either the requisite motive and opportunity or conscious misbehavior or recklessness required to state a claim under § 10(b). *Id.* at *1.

D. *South Cherry Street*, *LLC v. Hennessee Group LLC*, 573 F.3d 98 (2d Cir. July 14, 2009)

1. Appeal of an order by the District Court (S.D.N.Y.) dismissing Plaintiff's breach of contract claim and claims under § 10(b) of the Exchange Act and Rule 10b-5 against investment advisors Hennessee Group LLC for allegedly misrepresenting the financial status and performance of a hedge fund in which Plaintiff invested. The District Court dismissed the contract claim on the basis that the oral contract violated the statute of frauds and dismissed the securities fraud claims for failure to property allege scienter. The Second Circuit affirmed.

2. Plaintiff South Cherry Street, LLC ("South Cherry") alleged that Defendants breached its contract with Plaintiff and violated § 10(b) and Rule 10b-5 by allegedly failing to learn and disclose that Bayou Accredited ("Bayou"), a hedge fund which Defendants recommended as an investment to South Cherry, was part of a Ponzi scheme. South Cherry alleged that, in reliance on Hennessee Group's representations and recommendations, "'and in specific reliance on South Cherry's understanding that Bayou Accredited had passed all stages of Hennessee Group's due diligence process,'" South Cherry invested in Bayou in 2003. *Id.* at *101-02. In September 2005, an SEC action against the Bayou funds' principals revealed that Bayou was part of a Ponzi scheme. South Cherry lost its entire investment. Plaintiff's complaint alleged that Hennessee Group could not have performed any real due diligence in 2003, and thus "had no reasonable basis to credit" the Bayou fund. *Id.* at *103.

3. The District Court dismissed South Cherry's securities fraud claim "that [Hennessee Group] acted recklessly when it failed to uncover the Bayou fraud after it promised to conduct due diligence on Bayou Accredited" because it failed to adequately allege scienter. The Second Circuit found that Plaintiff's complaint failed to give rise to a strong inference of either fraudulent intent or conscious recklessness because Plaintiff never alleged that Defendants had knowledge that any representation they were making was untrue. Plaintiff merely alleged that Defendants "would" have learned of the truth as to the Bayou fund if they had performed the promised "'due diligence.'" *Id.* at *112.

4. Furthermore, Plaintiff never alleged that Hennessee Group did not believe that the various Bayou funds' representations, including their records and financial statements, were accurate. Thus, Plaintiff's allegations did not give rise to a strong inference that the alleged failure to conduct due diligence was indicative of an intent to defraud.

E. *Avon Pension Fund v. GlaxoSmithKline PLC*, No. 08-4363, 2009 WL 2591173 (2d Cir. Aug. 24, 2009)

1. Appeal of an order by the District Court (S.D.N.Y.) dismissing Plaintiffs' putative class action complaint alleging securities fraud by GlaxoSmithKline ("GSK") under §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5 for nondisclosure of alleged cardiovascular risks associated with the drug Avandia. The Second Circuit affirmed the dismissal, concluding that Plaintiffs failed to adequately plead (1) Defendants' duty to disclose the risks of the drug, because the research reporting the risks was not sufficiently conclusive; and (2) scienter.

2. The Second Circuit held that drug "test results must yield reliable evidence of a drug's adverse effect" to give rise to a duty to disclose. *Id.* at *1. Here, the complaint alleged that the drug "showed an estimate" of an "'increased risk of heart attack.'" *Id.* Yet Plaintiffs failed to plead any facts indicating that the test results were statistically significant and, in fact, Plaintiffs acknowledged evidence that the relevant research "presented inconsistent data with regard to the potential cardiovascular risk of Avandia." *Id.* at *1. Such inconclusive research results, even if not disclosed by Defendants, cannot be deemed misleading or material, and thus the Defendants could not have a duty to disclose any such information. *Id.*

3. The Second Circuit also found that the District Court properly concluded that Plaintiffs failed to adequately plead scienter. Importantly, Plaintiffs conceded that "no single allegation prove[d] that during the Class Period defendants knew that their statements (and omissions) concerning Avandia were false or misleading." *Id.* at *2. Nevertheless, Plaintiffs argued that when viewed in combination, their allegations amounted to a strong inference of scienter. The Second Circuit emphasized that the District Court used the proper standard of analysis, as originally put forth in *Tellabs*: "whether all of the facts alleged, taken collectively, give rise to a strong inference of scienter . . . [and that] the inference of

scienter . . . must be cogent and compelling." *Id.* Plaintiffs attempted to utilize a variety of allegations to establish scienter, including alleged insider trading by Defendants and the general high-profile and importance of Avandia to GSK. The Second Circuit found that these allegations were insufficient. With respect to the insider trading allegations, the Second Circuit noted that Defendants' increased stock purchases during the relevant period signaled confidence in GSK and Avandia, not motive to defraud.

4. Finally, the Second Circuit found that the District Court did not err in denying Plaintiffs leave to amend their complaint.

F. *W. Va. Inv. Mgmt. Bd. v. Doral Fin. Corp.*, No. 08-3867, 2009 WL 2779119 (2d Cir. Sept. 3, 2009)

1. Appeal of an order by the District Court (S.D.N.Y.) dismissing Plaintiffs' class action claims under § 10(b) of the Exchange Act and Rule 10b-5 against PricewaterhouseCoopers LLP ("PwC"). The Second Circuit affirmed.

2. PwC issued four audits and one report for Doral Financial Corporation ("Doral") between 2000 and 2005. Plaintiffs alleged that PwC violated § 10(b) and Rule 10b-5 by issuing reports and audits that were materially false, allowing Doral to overstate its pre-tax income by $920 million and understate its debt by approximately $3.3 billion. Investors allegedly sustained substantial losses after the earnings restatement was published.

3. The Second Circuit found that Plaintiffs did not allege sufficient facts to raise a strong inference of scienter by PwC. Plaintiffs alleged that PwC was reckless by failing to (1) uncover secret side-agreements that altered the terms of a sale of securities; (2) discover that Doral had allegedly manipulated valuation of certain of its assets; and (3) identify problems with Doral's internal controls and accounting practices. The Second Circuit found that the opposing inference—that Doral concealed its fraud from PwC just as it concealed it from investors—was objectively more compelling than Plaintiffs' allegations of recklessness. The evidence showed that Doral tightly held secret side-agreements, and that U.S. auditing standards entitled PwC to rely on third-party valuations. In the accounting context, failure to identify problems with Defendant's internal controls and failure to comply with GAAP do not constitute reckless conduct sufficient for § 10(b) liability.

G. *Furher v. Ericsson LM Telephone Co.*, No. 09-0134, 2009 WL 3228895 (2d Cir. Oct. 8, 2009)

1. Appeal from a judgment of the District Court (S.D.N.Y.) granting Defendants' motion to dismiss. Plaintiffs sued Defendants Ericsson LM Telephone Company ("Ericsson"), Carl-Henric Svanberg ("Svanberg"), and Karl-Henrik Sundstrom alleging violations of §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The District Court dismissed the class action complaint finding that Plaintiff failed to plead facts sufficient to demonstrate that Defendants had made any false or misleading statements or that such allegedly false statements had been made with a reckless disregard for the truth, sufficient to establish scienter. The Second Circuit affirmed the dismissal.

2. The Second Circuit agreed with the District Court's conclusion that Plaintiffs failed to adequately plead scienter. Plaintiffs argued that Defendants' statements were made with a reckless disregard for the truth. The Second Circuit found that, "[w]here the allegation of recklessness is supported by nothing other than the fact of inaccuracy, and the statements are, at worst, only slightly inaccurate, the inference of reckless disregard for the truth is not likely to be compelling." *Id.* at *1.

H. *Feiner Family Trust v. VBI Corp.*, No. 09-0018, 2009 WL 3651816 (2d Cir. Nov. 5, 2009)

1. Appeal of an order by the District Court (S.D.N.Y.) denying Plaintiffs' motion for leave to file a third amended complaint alleging violations of §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The Second Circuit affirmed.

2. Plaintiffs, derivatively on behalf of Xcelera.com, Inc., a Cayman Islands corporation, alleged that Xcelera, its directors and its controlling shareholder failed to comply with their securities disclosure obligations. Plaintiffs allege that the intentional consequences of Defendants' actions were that Xcelera was delisted from the American Stock Exchange and trading of its shares was suspended. Plaintiffs further alleged that Defendants engaged in this conduct in order to disentangle themselves from their obligations to minority shareholders under the Investment Company Act and the Exchange Act, and so that they could depress the price and then buy back the shares from Xcelera's minority shareholders.

3. The Second Circuit held that Plaintiffs had failed to properly allege scienter. Defendants' alleged failure to comply with statutory reporting obligations did not raise a strong inference of fraud or deception sufficient for liability under § 10(b). The Second Circuit found that Plaintiffs pled no facts from which it could infer that Defendants actively encouraged minority shareholders to sell their stock back as part of a larger deceptive plan to buy back the Company's shares at a discount. The Second Circuit found equally plausible that Defendants concluded that the cost of regulatory compliance was too high given the Company's languishing share price and volume. Because Plaintiffs did not state a claim under § 10(b), Plaintiffs were unable to establish liability under the Investment Act and the Exchange Act.

I. *Condra v. Pxre Grp. Ltd.*, No. 09-1370, 2009 WL 4893719 (2d Cir. Dec. 21, 2009)

1. Appeal of an order by the District Court (S.D.N.Y.) dismissing putative class action complaint for securities fraud under §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The Second Circuit affirmed.

2. Defendant PXRE Group Ltd. ("PXRE"), a reinsurance company, made certain statements about the losses that PXRE would be exposed to in the wake of Hurricane Katrina as well as PXRE's procedures for calculating loss, which Plaintiffs alleged violated the securities laws. The District Court dismissed the complaint for failing to raise a strong inference of scienter, specifically holding that the Chief Actuary's opinion was insufficient to infer scienter, that the scope of PXRE's understatement of losses did not give rise to an inference of scienter, and that Plaintiffs did not sufficiently allege that Defendants had motive and opportunity in making the alleged misstatements.

3. The Second Circuit affirmed on the basis that Plaintiffs had failed to sufficiently plead facts establishing a "strong inference" of scienter by alleging either that Defendants had "motive and opportunity to commit fraud" or that there was "strong circumstantial evidence of conscious misbehavior or recklessness." *Id.* at *1.

Third Circuit

A. *Inst'l Investors Group v. Avaya, Inc.*, 564 F.3d 242 (3d Cir. Apr. 30, 2009)

1. Appeal of an order by the District Court (D.N.J.) dismissing putative class action claims under §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Shareholders alleged that Defendants made misleading statements about growth potential and pricing pressure by denying unusual price competition and resulting discounts Avaya was giving and by issuing allegedly baseless, impossible financial projections given the price competition. The District Court granted Defendants' motion to dismiss, holding that the statements at issue were either forward looking, and thus protected by the safe harbor, or not actionably false; with regard to the remaining claims, Plaintiffs failed to sufficiently allege scienter. The Third Circuit affirmed in part and reversed in part and remanded for further proceedings. The Third Circuit held that Plaintiffs sufficiently pled that Defendants' pricing-pressure statements were actionably false and that, as to these statements, there was a strong inference of the CFO's scienter. The Third Circuit also held that statements that the company was "'on track'" and that results "'position us'" to meet goals were forward looking and qualified for the protection of the safe harbor. *Id.* at 254-56.

2. Plaintiffs' allegations of scienter need not be irrefutable. The court must make a practical judgment about whether, given the whole factual picture, it is at least as likely as not that Defendants acted with scienter. Inference is not arithmetic, and an array of circumstantial evidence could be sufficient. Here, the Third Circuit found it relevant that the CFO, in response to focused questions about discounting, specifically denied such discounting. "Even if McGuire [the CFO] were not aware of the full extent of the unusual discounting, or the entirety of the other circumstances alleged by Shareholders, he might be culpable as long as what he knew made obvious the risk that his confident, unhedged denials of unusual discounting would mislead investors." *Id.* at 270. In finding scienter as to the discounting allegations, the Third Circuit considered Defendant's position, as well as the content and context of his statements.

3. The Third Circuit also held that after *Tellabs*, "'motive and opportunity' may no longer serve as an independent route to scienter." *Id.* at 277. Allegations of motive and opportunity will no longer be given a special status. Instead, they are to be considered along with the other allegations in the Complaint.

4. In the case of certain erroneous financial projections that were made, Plaintiffs failed to allege actual knowledge of their falsity. As such, these forward-looking statements were protected by the safe harbor. In the Third Circuit, the scienter standard for forward-looking statements is more stringent than the scienter standard for other statements of current or past fact.

Fourth Circuit

A. *Public Employees' Retirement Assoc. of Colo. v. Deloitte & Touche LLP*, 551 F.3d 305 (4th Cir. Jan. 5, 2009)

1. Appeal of an order by the District Court (D. Md.) dismissing claims under § 10(b) of the Exchange Act and Rule 10b-5. The lawsuit arose out of the allegedly improper overstating of income by Royal Ahold, N.V. ("Ahold") and its subsidiary. Plaintiffs alleged that Ahold improperly treated all revenue from certain joint ventures as revenue to Ahold despite its lack of a controlling stake in the ventures. Ahold also allegedly inflated its income from promotional allowances or vendor rebates. The alleged misconduct of Ahold was not at issue. Rather, the action focused on potential liability of the outside accounting firm. The District Court dismissed Plaintiffs' claims and denied leave to file a second amended complaint, holding that investor Plaintiffs failed to adequately allege scienter. The Fourth Circuit affirmed the dismissal, also agreeing that there was no version of the facts that would allow Plaintiffs to meet their burden.

2. Citing *Stoneridge*, the Fourth Circuit explained that, to prevail, Plaintiffs must show "that defendants actually made a misrepresentation or omission in their audit opinions on which investors relied; parties who merely assist another in violating § 10(b) are not liable under § 10(b)." *Id.* at 313. The District Court and the Fourth Circuit applied the *Tellabs* strong inference standard. "With perfect hindsight, one might posit that defendants should have required stronger evidence of control [of the joint ventures] from Ahold. . . . Nonetheless, the evidence as a whole leads to the strong inference that defendants were deceived by their clients into approving the consolidation." *Id.* at 314. Likewise, the Fourth Circuit explained, the strongest inference from the evidence is that Defendants did not detect the improper accounting of the promotional allowances due to its client's collusion with the vendors.

3. "In order to establish a strong inference of scienter, plaintiffs must do more than merely demonstrate that defendants should or could have done more. They must demonstrate that the [accountants] were either knowingly complicit in the fraud, or so reckless in their duties as to be oblivious to malfeasance that was readily apparent." *Id.* The Fourth Circuit concluded that the most compelling inference in this case is that the accountants were deceived by their client's lies. "It is not an accountant's fault if its client actively conspires with others in order to deprive the accountant of accurate information about the client's finances." *Id.* at 316.

B. *Matrix Capital Mgmt. Fund, LP v. BearingPoint, Inc.*, 576 F.3d 172 (4th Cir. July 31, 2009)

1. Plaintiffs appeal from the District Court (E.D. Va.) decision dismissing their class action claims under §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Plaintiffs, shareholders of BearingPoint, alleged that BearingPoint made material misstatements in its financial statements. The District Court dismissed the claims in the First Amended Complaint with prejudice, holding that Plaintiffs failed to adequately plead scienter, and denied Plaintiffs' Rule 59(e) motion to alter or amend the judgment. The District Court gave special consideration to the new *Tellabs* decision. The Fourth Circuit affirmed the dismissal on the basis of scienter, but reversed, vacated and remanded the decision as to the Rule 59(e) motion.

2. The allegations at issue revolve around major alleged internal control problems and large-scale misstatements of income at BearingPoint. At the time of the alleged misstatements, however, BearingPoint was working to incorporate 30 worldwide acquisitions and a new financial reporting system. Thus, the Fourth Circuit concluded that "plausible non-culpable inferences are at least as likely as an inference that any defendant acted knowingly or recklessly with respect to the misstatements." *Id.* at 190.

Fifth Circuit

A. *Brunig v. Clark*, 560 F.3d 292 (5th Cir. Feb. 17, 2009)

1. Appeal of an order by the District Court (S.D. Tex.) dismissing Plaintiff's RICO and securities fraud claims under § 12(2) of the Securities Act and § 10(b) of the Exchange Act. Plaintiff, an attorney, brought claims to recover legal fees owed, part of which took the form of a percentage interest in one of Defendants' oil and gas leases. Plaintiff alleged that Defendants deceived him as to the nature of the interest. Indeed, Plaintiff was surprised to learn that his interest required him to pay certain operating expenses for the leases. The Fifth Circuit affirmed the dismissal of the § 12(2) claim, holding that it only applies to initial public offerings or sales made to the public, which this was not. The Fifth Circuit reversed and remanded as to the dismissal of the § 10(b) claim, holding that Plaintiff pled the claim with sufficient particularity.

2. The Fifth Circuit agreed with the District Court that the Complaint was "unartful and prolix," *id.* at 296, but held that the Complaint did explicitly allege misstatements and omissions attributable to Defendants. The Fifth Circuit also held that, based on the nature of the interest assigned to Plaintiff, Defendants "were either aware of the possibility that [Plaintiff] would have to make cash payments or severely recklesness [sic] in not realizing this possibility." *Id.* As such, there was a strong inference that Defendants acted with the requisite state of mind.

B. *Flaherty & Crumrine Preferred Income Fund, Inc. v. TXU Corp.*, 565 F.3d 200 (5th Cir. Apr. 8, 2009)

1. Appeal of an order by the District Court (N.D. Tex.) dismissing claims under §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5, as well as common law fraud claims. Plaintiffs, holders of

convertible securities who responded to the issuing corporation's self-tender offer, alleged that Defendants were aware of an imminent dividend increase at the time of the repurchase, yet failed to disclose the timing or size of the increase in order to induce Plaintiffs' sale. The District Court dismissed the claims for failure to sufficiently allege scienter, and Plaintiffs appealed. During the time of the appeal, the Supreme Court issued the *Tellabs* decision, which clarified the pleading standard for scienter. The Fifth Circuit remanded to the District Court for further consideration in light of *Tellabs*. The District Court again dismissed the claims. The Fifth Circuit affirmed.

2. The tender offer at issue was announced on September 15, 2004. On October 19, 2004, six days after the expiration of the tender offer period, management proposed a dividend increase to the Board, and on October 22, 2004, the Board approved a 350% increase of the annual dividend on common stock. Immediately following the announcement, the stock price increased 20%. A press release made in May 2004 stated that management did not anticipate a dividend increase until 2006, when certain financial benchmarks were reached. A September 15, 2004 release stated that the dividend policy is "under review." *Id.* at 204. On September 28, 2004, the company's CEO made a presentation where a slide represented that a dividend payout would not occur until debt reduction goals were met. A January 2005 letter explained that management began contemplating the dividend change in August 2004.

3. While the Fifth Circuit recognized that the timing of the dividend change was suspect, Plaintiffs "have not provided facts sufficient to support a 'cogent and compelling' inference that Appellees made any statements intentionally or recklessly to mislead TXU's investors. . . . The close proximity of the dividend increase to the end of the tender offer, though it provides some support for an inference of scienter, is not sufficient, without more, to establish a strong inference of the requisite intent." *Id.* at 210. Indeed, with regard to the "under review" statement, "[t]his court's precedent advises that a 'middle course' is proper when making disclosures concerning future plans which have not been fully determined in the context of a tender offer." *Id.* at 211.

4. With regard to the CEO's presentation, even assuming that he knew of the contemplated increase, this alone would not suffice to establish that he intended to deceive investors or was reckless in revealing only that the policy was under review. Any inference of fraud is merely permissible and does not rise to the cogent and compelling level required by *Tellabs*.

Sixth Circuit

A. *Konkol v. Diebold, Inc.*, No. 08-4572, 2009 WL 4909110 (6th Cir. Dec. 22, 2009)

1. Investors brought a securities fraud class action against the corporation and nine of its senior managers, asserting claims under §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5, alleging that the corporation engaged in a series of schemes to prematurely recognize revenue in order to inflate the price of its stock. The District Court (N.D. Ohio) dismissed the claims with prejudice, explaining that Plaintiffs failed to sufficiently allege scienter and that any amendment would be futile. The Sixth Circuit affirmed.

2. Plaintiffs' allegations of scienter fall into two categories: allegations regarding Defendants' access to certain financial reports and allegations regarding the suspicious timing of Defendants' stock sales. Both are insufficient. The information regarding certain financial reports is insufficient, as Plaintiffs fail to provide any information connecting the reports to Defendants or explaining how the reports were used. "Generalized facts alleging that the Defendants had access to Diebold's financial information, in short, do not support a strong inference that the Defendants knew of or recklessly disregarded the falsity of Diebold's earnings statements and SEC certifications." *Id.* at *4. Similarly, allegations regarding attendance at meetings where financial information was discussed, without allegations that the improper revenue recognition scheme was discussed, are insufficient.

3. While the "fact that five management-level employees sold a significant amount of stock on the same day could be probative of the fact that they knew or at least suspected that Diebold's earnings reports were misleading," *id.* at *6, insider trading "'is suspicious only when it is dramatically out of line with prior trading practices at times calculated to maximize the personal benefit from undisclosed inside information,'" *id.* Thus, "'[f]or individual

defendants' stock sales to raise an inference of scienter, plaintiffs must provide a meaningful trading history for purposes of comparison to the stock sales within the class period.'" *Id.* Plaintiffs failed to provide any such history in this case.

4. Based on the Complaint, the magnitude of the alleged accounting violations are not the type of extreme facts that "cry out" scienter. *Id.* The Complaint does not specify the total amount of revenue allegedly overstated. "Diebold is a multi-billion-dollar company and, as such, the amount of improperly recognized revenue would have to be significant in order to support a finding of scienter. No such significant figures are alleged." *Id.*

5. The fact that confidential witnesses described the alleged scheme in detail is not persuasive given the lack of any detail regarding the identity of the witnesses or their connection to or contact with Defendants. Because the investors do not allege any specific facts establishing that the Defendants knew or recklessly disregarded the falsity of their statements, the proximity of the inconsistent statements (three days between the statements and the corrections) is not sufficient to support a strong inference of scienter. The existence of post-class period SEC or DOJ investigations, without more, are also irrelevant to the scienter analysis. Investors have not given any contemporaneous facts showing that Defendants knew or should have known that their Sarbanes-Oxley certifications were false. Finally, Defendants are not required to proffer a nonfraudulent explanation for their misleading statements. The burden of proof is on Plaintiffs.

6. The District Court did not abuse its discretion in denying a second amendment of the Complaint when the proposed amendment related to mostly post-class period events, which would not shed any light on whether Defendants acted with scienter.

Eighth Circuit

A. *Horizon Asset Mgmt. Inc. v. H&R Block, Inc.*, 580 F.3d 755 (8th Cir. Sept. 9, 2009)

1. Appointed Lead Plaintiff, Horizon, appeals from the District Court's (W.D. Mo.) dismissal of its putative consolidated class action complaint against publicly traded H&R Block ("Block") and two of its

officers and directors. Other shareholders appeal the appointment of Plaintiff as sole Lead Plaintiff. Horizon's consolidated class action complaint asserted claims under §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5, but did not include other Plaintiffs' derivative claims against the individual Defendants. The Complaint alleged that Block and individual Defendants made false and misleading statements to investors regarding Block's financial condition, including (1) failing to disclose the unlawful nature of certain of its programs, which artificially inflated Block's reported earnings, (2) failing to disclose its inadequate internal safeguards and procedural controls to ensure accurate financial statements, and (3) misstating financial results due to erroneous calculation of its effective state income tax rate. The District Court dismissed the claims for failure to allege a false statement with regard to (1) and (2) and failure to sufficiently allege scienter with regard to (3). The Eighth Circuit affirmed in part, dismissing Horizon's claims, but reversed the District Court's order appointing Horizon as Plaintiff for the derivative claims. On remand, the derivative claims of the other Plaintiffs will be reinstated.

2. The allegedly false statements made by the two individual defendants relate to Block's financial results. As to the first Defendant, the Court disregarded several of the statements at issue, pointing out that they were made before the Defendant was hired. As to the second Defendant, the allegations are conclusory, do not include information about the source of the allegation's basis of knowledge, and do not include information about why Defendant would know that certain information attributed to him was false. The Court also explained that "[a]ny inference of scienter is further weakened by the fact that, elsewhere in Horizon's complaint, this same confidential witness inaccurately alleged that [Defendant] had knowledge of accounting errors at a time when he was not even employed by Block." *Id.* at 764.

3. Defendants' signing of Sarbanes-Oxley Act certifications does not create an inference of scienter. *Id.* at 765. There is also no inference of scienter because of Defendants' desire to receive merit bonuses dependant upon Block's performance. The bonuses at issue, approximately $258,000, were not sufficiently large, unusual or suspicious to invoke this inference. Finally, none of the allegations at issue amount to highly unreasonable conduct or an extreme departure from the standards of ordinary care to equate to recklessness.

4. Without deciding whether an individual's state of mind can be imputed to Block to show scienter, the Court also held that the allegations at issue were insufficient to show scienter, because even if there was knowledge of certain accounting problems, Plaintiff did not allege that any individual had reason to believe that these problems would cause materially false financial results.

Ninth Circuit

A. *Zucco Partners, LLC v. Digimarc Corp.*, 552 F.3d 981 (9th Cir. Feb. 10, 2009)

1. Appeal of an order by the District Court (D. Or.) dismissing Plaintiffs' class action claims with prejudice for failing to allege a strong inference of scienter as required by the PSLRA. Plaintiffs, purchasers of publicly traded securities of Digimarc Corporation ("Digimarc"), filed claims against Digimarc and certain of its officers under §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5. In September 2004, Digimarc publicly announced that it had made accounting errors causing it to overestimate earnings for the previous six quarters, and ultimately issued a formal restatement revealing $2.7 million in overstated earnings. Plaintiffs alleged that Defendants manipulated Digimarc's financial prospects by improperly capitalizing internal software development costs, inventory, and fixed assets that they knew should have been expensed under GAAP. The Ninth Circuit affirmed the dismissal.

2. Following *Tellabs*, the Ninth Circuit analyzes scienter under a "dual inquiry." First, the court must examine whether any of the allegations, standing alone, are sufficient to create a strong inference of scienter, and second, if no individual allegation is sufficient, the court must conduct a "holistic" review of the same allegations to determine whether the insufficient individual allegations combine to create a strong inference of intentional conduct or deliberate recklessness. *Id.* at 992.

3. The Ninth Circuit first found that none of Plaintiffs' allegations was "individually cogent or compelling enough to survive under the PSLRA." *Id.* at 1006.

4. With respect to allegations attributed to confidential witnesses, the Ninth Circuit reiterated that a complaint relying on such statements

must pass two hurdles: first, the confidential witnesses "must be described with sufficient particularity to establish their reliability and personal knowledge," and second, those statements which are reported "must themselves be indicative of scienter." *Id.* at 995. The Ninth Circuit found that Plaintiffs failed to establish with requisite particularity that certain statements were based on personal knowledge. The Ninth Circuit found that "the few allegations that had the requisite level of particularity to withstand the first prong of the confidential witness test fail to demonstrate the deliberate recklessness required to survive the second prong." *Id.* at 998.

5. The Ninth Circuit also reiterated its rule that the mere publication of a restatement is not enough to create a strong inference of scienter, unless combined with particular allegations suggesting that management had actual access to the falsely reported information, or unless the falsely reported information is of such prominence that it would be "absurd" to suggest that management was without knowledge of the matter. *Id.* at 1000. Merely alleging that senior management closely reviewed and discussed the accounting and inventory numbers does not support the inference that management was in a position to know such data was being manipulated. Further, the alleged misrepresentations – the erroneous capitalization of costs, inventory, and assets – were not so apparent that Defendants "must have known" about the falsity of the information. *Id.* at 1001.

6. The resignation of KPMG as Digimarc's independent accounting firm a month after the restatement did not support a strong inference of scienter. The Ninth Circuit also held that the mere fact of certain issuers' retirement just prior to the disclosure of the accounting and lack of financial controls does not support a strong inference of scienter.

7. Joining several other circuits, the Ninth Circuit noted that allowing Sarbanes-Oxley certifications to create an inference of scienter in every case where there is an accounting error would "eviscerat[e] the pleading requirements for scienter set forth in the PSLRA" and affirmed that Sarbanes-Oxley certifications are not enough to create a strong inference of scienter. *Id.* at 1004.

8. The Ninth Circuit stated that a strong correlation between financial results and executive stock options or cash bonuses for individual defendants may occasionally be compelling enough to support an

inference of scienter, for example, where the individual defendant compensation was based "principally" on the company's financial performance. *Id.* However, Plaintiffs' generalized allegation that executive bonuses were "based in part" on Defendant's financial performance is inadequate to establish scienter.

9. The Ninth Circuit also noted that there is no indication that *Tellabs* altered the pleadings standard based upon suspicious stock sales, which requires an allegation that individual stock sales are inconsistent with their usual trading patterns. The Ninth Circuit held that no inference of scienter could be gleaned here, as Plaintiffs failed to provide any meaningful history for purposes of comparison to the stock sales within the class period. Similarly, the Ninth Circuit noted that, for a private placement of stock to create a strong inference of scienter, the corporate stock sales must be significant and uncharacteristic enough to cast doubt on the Defendant company's motives.

10. Finally, the Ninth Circuit restated the *Tellabs* standard that a series of less precise allegations may be read together to meet the PSLRA scienter requirement, so long as that inference is at least as compelling as an alternative innocent explanation. Applying the "holistic" analysis here, the Ninth Circuit found that, even together, all of the allegations are "not as cogent or compelling as a plausible alternative inference – namely, that although [Digimarc] was experiencing problems controlling and updating its accounting and inventory tracking practices, there was no specific intent to fabricate the accounting misstatements at issue here." *Id.* at 1007.

B. *Huberman v. Tag-It Pacific Inc.*, 314 Fed. Appx. 59 (9th Cir. Feb. 11, 2009)

1. Appeal of an order by the District Court (C.D. Cal.) denying Plaintiff's motion for class certification and granting Defendant's motion for summary judgment. Plaintiff, Seth Huberman, brought an action against Defendant for violations of §§ 10(b) and 20(a) of the Exchange Act. The Ninth Circuit reversed and remanded.

2. The District Court held that Plaintiff had not produced sufficient evidence of scienter and loss causation, which are both required elements of a private securities fraud action. The Ninth Circuit found that Plaintiff presented evidence suggesting that Defendant was aware of the financial deterioration of the company but failed to disclose it to the public. The Ninth Circuit further found that

Defendant's failure to monitor its inventory adequately, maintain adequate reserves, and accurately report accounts receivable and payable may have amounted to such "egregious deficiencies" as to overcome the fact that negligent accounting or misapplication of accounting principles is not enough to establish scienter. *Id.* at *61.

C. *Siracusano v. Matrixx Initiatives, Inc.*, 585 F.3d 1167 (9th Cir. Oct. 28, 2009)

1. Appeal of an order by the District Court (D.C. Ariz.) granting Defendant Matrixx Initiatives Inc.'s ("Matrixx's") motion to dismiss Plaintiffs' claims under § 10(b) of the Exchange Act and Rule 10b-5. The Ninth Circuit reversed and remanded.

2. Plaintiffs commenced a class action against Matrixx and three of its executives alleging that Matrixx violated the Exchange Act by failing to disclose that Zicam Cold Remedy, a main product of Matrixx's subsidiary Zicam LLC, causes anosmia, a loss of smell. Plaintiffs alleged that the Matrixx securities traded at artificially inflated prices during the class period as a result of the materially false and misleading statements and failure to disclose adverse information about Zicam. Matrixx did not reveal the possibility of Zicam-related product liability suits in several press releases and financial statements during this period, and Matrixx debunked the possibility of a relationship between Zicam and anosmia in a press release after a Dow Jones report was published alleging that the FDA was investigating the issue. Matrixx stock prices plummeted after a February 2004 *Good Morning America* segment aired mentioning several pending lawsuits related to Zicam.

3. The Ninth Circuit rejected the District Court's use of the "statistical significance" standard to conclude that Plaintiffs failed to allege "material misrepresentation" based on the number of complaints. *Id.* at 1178. "The Supreme Court has rejected the adoption of a bright-line rule to determine materiality because '[t]he determination [of materiality] requires delicate assessments of the inferences a "reasonable shareholder" would draw from a given set of facts and the significance of those inferences to him.'" *Id.* The Ninth Circuit explained that, in relying on the statistical significance standard, the District Court decided an issue that should be left to the trier of fact. The Ninth Circuit examined the alleged facts and concluded that the allegations were sufficient to meet the pleading requirements of the PSLRA.

4. The Ninth Circuit also disagreed with the District Court's finding that Plaintiffs had not properly alleged scienter. The Ninth Circuit pointed to Matrixx's withholding of reports of the adverse effects of Zicam and the related lawsuits and held that the inference that Matrixx "withheld the information intentionally or with deliberate recklessness is as least as compelling as the inference that [Matrixx] withheld the information innocently." *Id.* at 1183.

Eleventh Circuit

A. *Rosenberg v. Gould*, 554 F.3d 962 (11th Cir. Jan. 9, 2009)

1. Appeal of an order by the District Court (N.D. Ga.) dismissing putative class action claims brought pursuant to §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Plaintiffs alleged that the corporation's stock was artificially inflated between 2004 and 2006 due to the corporation's failure to report compensation expenses flowing from allegedly backdated stock options granted by the corporation's CEO in 2000 and 2001. CEO Gould was the sole person responsible for granting stock options to nonofficers below the rank of senior vice president during this time. Gould signed filings for the SEC that represented that options were granted at fair market value and did not need to be recorded as a compensation expense, which violates GAAP. The District Court held that Plaintiffs failed to adequately allege scienter. The Eleventh Circuit affirmed the dismissal.

2. The District Court held that Plaintiffs' allegations of scienter against CEO Gould were insufficient to establish an inference of fraudulent intent that is "at least as compelling as any opposing inference of nonfraudulent intent" as required by *Tellabs*. *Id.* at 966. The Eleventh Circuit explained that "[t]he impact on the financial statements during the class period consisted of an increase in non-cash expenses that was only .5 percent of revenue in 2004 and .17 percent of revenue in 2005." *Id.* Thus, it continued, the "de minimis change in the financial statements does not amount to a glaring 'red flag' that would have put Gould on notice that he was overstating earnings when he announced the quarterly results of [the corporation]." *Id.* Plaintiffs' allegations against the corporation failed for the same reason.

3. The Eleventh Circuit also affirmed the District Court's denial for leave to amend. It explained that the District Court had discretion

to deny the request where Plaintiffs' request was improperly made in a footnote to their brief in opposition to Defendants' motion to dismiss.

Fourth Circuit

A. *In re Mut. Funds Inv. Litig.*, 566 F.3d 111 (4th Cir. May 7, 2009)

1. Appeal of an order by the District Court (D. Md.) dismissing putative class action claims under §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Plaintiff, First Derivative Traders, on behalf of shareholders of Janus Capital Group ("JCG"), filed a complaint against JCG and its wholly owned subsidiary Janus Capital Management LLC ("JCM") alleging that JCG and JCM were responsible for misleading statements about market timing appearing in the prospectuses of Janus funds. The statements represented that the funds' managers took steps to prevent market timing, which were found to be false in a prior lawsuit. The District Court dismissed the claims for failure to allege that JCM or JCG actually made the false statements in the prospectuses, and there can be no aiding or abetting liability in securities fraud actions. As to JCM, the District Court also held that there was no nexus between plaintiffs, as JCG shareholders, and JCM. The Fourth Circuit reversed and remanded for further proceedings.

2. Defendants argued that Plaintiffs failed to establish reliance. To gain the benefit of the fraud-on-the-market presumption, one must prove "(1) that the defendant made the public misrepresentations; (2) that the misrepresentations were material; (3) that the shares were traded on an efficient market; and (4) that the plaintiff purchased the shares after the misrepresentations but before the truth was revealed." *Id.* at 120. To satisfy the public misrepresentation element, a party must sufficiently allege that the statement at issue is attributable to Defendant. The Fourth Circuit held that, to satisfy this element of the reliance inquiry in the fraud-on-the-market context, a plaintiff "must ultimately prove that interested investors (and therefore the market at large) would attribute the allegedly misleading statement to the defendant. At the complaint stage a plaintiff can plead fraud-on-the-market reliance by alleging facts from which a court could plausibly infer that interested investors would have known that the defendant was responsible for the statement at the time it was made, even if the statement on its face is not directly attributed to the defendant." *Id.* at 124. The Fourth Circuit concluded that "the attribution determination is properly made on a case-by-case basis by considering whether interested investors would attribute to the defendant a substantial role in preparing or approving the allegedly

misleading statement." *Id.* The Fourth Circuit held that Plaintiffs met this requirement as to JCM, an investment advisor to the Janus funds, but that they did not meet it as to JCM's parent, JCG.

Seventh Circuit

A. *Stark Trading v. Falconbridge Ltd.*, 552 F.3d 568 (7th Cir. Jan. 5, 2009)

1. Appeal of an order by the District Court (E.D. Wis.) dismissing claims brought pursuant to § 10(b) of the Exchange Act and Rule 10b-5 and § 11 of the Securities Act. Plaintiffs, hedge fund investors, purchased shares of Falconbridge believing that the shares were undervalued. When an undervalued tender offer forced Plaintiffs to redeem their stock for cash, they claimed damage and pointed to alleged inaccuracies in the offering documents. Plaintiffs never tried to stop the tender offer by convincing other minority shareholders that the stock was undervalued. The District Court dismissed the § 10(b) and Rule 10b-5 claim for failure to properly allege scienter. The Seventh Circuit affirmed the dismissal, holding that there was no reliance to support the § 10(b) and Rule 10b-5 claim and no alleged damages to support the § 11 claim.

2. Plaintiffs cannot recover on a Rule 10b-5 claim when their very theory of the case belies any inference of reliance on the alleged misstatements. In this case, Plaintiffs purchased the stock believing that the publicly disseminated value estimates were inaccurate. It seems that Plaintiffs believed "the combination of the tender-offer price and a later suit (this suit) against the defendants a better deal than holding on to their shares and by doing so, and disseminating their doubts, trying to defeat the tender offer. That is not a strategy that the courts should reward in the name of rectifying securities fraud." *Id.* at 573.

3. Plaintiffs' § 11 claim fails because they have failed to allege that they sold their stock at a loss, as required to state a claim.

Eleventh Circuit

A. *Ledford v. Peeples*, 568 F.3d 1258 (11th Cir. May 22, 2009)

1. Appeal of an order by the District Court (N.D. Ga.) granting summary judgment in favor of Defendants and denying Defendants' motion for sanctions under the PSLRA. Plaintiffs, members and owners of a limited liability company ("LLC"), brought this action against a party that financed the buy-out of its interest in the LLC, claiming violation of §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5, as well as other common law and state statutory claims. The Eleventh Circuit affirmed in part, reversed in part and remanded.

2. Plaintiffs, referred to herein as DynaVision, owned a 50% interest in Signature Hospitality Carpets, LLC ("Signature"). The other 50% owner, referred to herein as Walker et al., consisted of three individuals with great expertise in the carpet industry. DynaVision financed the LLC, while Walker et al. ran the company. The parties had a buy-sell agreement that enabled either party to buy out the other's interest in the company at a set price. After receiving an offer, the offeree had 30 days to accept the offer or elect to purchase the offeror's interest at the same set price.

3. In December 2001, Shelby Peeples expressed an interest in buying Signature. Peeples met with Walker et al. on several occasions to discuss this interest. DynaVision was not included in these meetings. Peeples came to an agreement with Walker et al. that Peeples would loan Walker et al. $3.5 million to purchase DynaVision's interest in Signature. At the time of the buy-out, DynaVision asked Walker et al. if Peeples was providing the purchase price, and Walker et al. falsely said that he was not. DynaVision tried to get another buyer for the company, but ultimately gave in to Walker et al.'s offer, as it had no ability to run Signature without Walker et al.

4. Plaintiffs alleged that Defendant violated §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5 by denying any involvement in the buy-out deal and by controlling Walker et al. and causing them to agree to the buy-out. The Eleventh Circuit affirmed the dismissal of these claims, finding that the direct and circumstantial evidence showed that Plaintiffs did not rely on the misrepresentation at issue, that Peeples was not involved in the buy-out, in making its decision to sell its half of Signature in connection with the buy-out offer. To the contrary, Plaintiffs admitted that they lacked the experience to run Signature without Walker et al., that they could not find another management team to take Walker et al.'s place, and that it was in their financial self-interest to sell.

5. Given the lack of evidentiary support for a claim under the PSLRA, the District Court erred in not awarding sanctions against Plaintiffs' attorney. The Eleventh Circuit explained that the frivolity of the claims would have been clear if the District Court had, as it was supposed to, isolated each individual Plaintiff's claim under § 10(b).

Causation

Fourth Circuit

A. *In re Mut. Funds Inv. Litig.*, 566 F.3d 111 (4th Cir. May 7, 2009)

1. Appeal of an order by the District Court (D. Md.) dismissing putative class action claims under §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Plaintiff First Derivative Traders, on behalf of shareholders of Janus Capital Group ("JCG"), filed a complaint against JCG and its wholly owned subsidiary Janus Capital Management LLC ("JCM") alleging that JCG and JCM were responsible for misleading statements about market timing appearing in the prospectuses of certain Janus funds. The statements represented that the funds' managers took steps to prevent market timing, which were found to be false. The District Court dismissed the claims for failure to allege that JCM or JCG actually made the false statements in the prospectuses, and there can be no aiding or abetting liability in securities fraud actions. As to JCM, the District Court also held that there was no nexus between plaintiffs, as JCG shareholders, and JCM. The Fourth Circuit reversed and remanded for further proceedings.

2. On the issue of loss causation, Plaintiffs must show that Defendants' "conduct was a substantial cause of [their] injury." *Id.* at 128. "The facts alleged in the complaint therefore need not conclusively show that the securities' decline in value is attributable solely to the alleged fraud rather than to other intervening factors." *Id.* The Fourth Circuit found that Plaintiffs met this requirement.

Fifth Circuit

A. *Lormand v. US Unwired, Inc.*, 565 F.3d 228 (5th Cir. Apr. 9, 2009)

1. Appeal of an order by the District Court (E.D. La.) dismissing putative class action claims under §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Plaintiffs alleged that they bought the common stock of Defendant US Unwired at artificially inflated prices due to Defendants' material misrepresentations. The District Court dismissed the claims, holding that some of the statements at issue were protected by the PSLRA's safe harbor for forward-looking statements, and Plaintiffs failed to sufficiently allege loss causation. The Fifth Circuit reversed in part and remanded for further proceedings. It held that the safe harbor did not apply because Plaintiffs alleged that Defendants had actual knowledge of

the statements' falsity. It also held that there was a duty to disclose certain developments in their business which Defendants knew to be detrimental to future cash flow. Finally, it held that Plaintiffs sufficiently alleged loss causation with regard to one misrepresentation, but not with regard to the other.

2. US Unwired is an affiliate of Sprint. Sprint offered three types of affiliations, with the differences between the affiliations revolving around the amount of control the affiliate maintained over their customer base, customer billing and general operations. During the time frame at issue, Sprint allegedly began exerting pressure on US Unwired to change its affiliation level so that Sprint could have more control over US Unwired's operations. Sprint allegedly threatened US Unwired with excessive fines and reduced access to technology if US Unwired did not agree. Maintaining control over its customer base and billing was essential to US Unwired's business plan. Nevertheless, ultimately, Sprint allegedly forced US Unwired to change its affiliation level. At the same time, Sprint began an initiative to increase its customer base by targeting subprime credit class customers. US Unwired had previous experience with this customer group and knew that it would be detrimental to its business. Despite alleged internal memos and emails regarding the well-known feeling within the company about these new programs, US Unwired did not reveal its opinion of how the change in affiliation level or the subprime credit customers' initiative would affect its business. Instead, it supported these programs before the public. Plaintiffs alleged that US Unwired misled the public by concealing material facts of which they were aware, i.e., that Sprint was forcing US Unwired to change its affiliation level and to enlist credit-risky subscribers.

3. Rule 8(a)(2) requires a plaintiff to allege "a facially 'plausible' causal relationship between the fraudulent statements or omissions and plaintiff's economic loss, including allegations of a material misrepresentation or omission, followed by the leaking out of relevant or related truth about the fraud that caused a significant part of the depreciation of the stock and plaintiff's economic loss." *Id.* at 258. The alleged disclosures of relevant truth in this case, however, related only to subscriber growth and the sub-prime market. There were no alleged disclosures on the issue of the conversion to a Type II affiliation. The disclosures of the alleged truth, for example, related to increased customer churn and customer terminations after the reinstallation of a deposit fee. Thus, the Fifth Circuit held that the complaint sufficiently pleads loss causation on the issue of subscriber growth and the subprime

market, but not on the issue of the conversion to a Type II affiliation.

4. A party may plead loss causation based on alleged facts constituting circumstantial rather than direct evidence. *Id.* at 264. Further, a plaintiff may plead loss causation based on truth about the alleged fraud that was disclosed by persons other than defendants. *Id.*

B. *Alaska Elec. Pension Fund v. Flowserve Corp.*, 572 F.3d 221 (5th Cir. June 19, 2009)

1. Appeal of an order by the District Court (N.D. Tex.) denying Plaintiffs' motion for class certification and granting Defendants' motion for summary judgment. Plaintiffs, Alaska Electrical Pension Fund and Massachusetts State Carpenters Pension Fund (collectively, "Alaska"), brought a putative class action against Defendants for violations of §§ 10(b) and 20(a) of the Exchange Act and §§ 11 and 15 of the Securities Act. The action revolved around the alleged misstated earnings and fraudulent forecasts of Defendant Flowserve Corp. The Fifth Circuit reversed in part, vacated in part and remanded.

2. The District Court refused to certify Plaintiffs' class for failure to show that questions of law or fact common to the class predominate as to the reliance element of Alaska's claims. The District Court properly found that Plaintiffs had to prove loss causation by a "preponderance of the evidence" to obtain certification of its class. *Id.* at 228.

3. However, the District Court applied an improper standard for assessing loss causation. A "corrective disclosure . . . need not precisely mirror [an] earlier misrepresentation." *Id.* at 230. It must, however, reflect at least part of the relevant truth obscured by the fraudulent statements. Thus, "it was enough that the market learned that the October 2001 guidance was wrong and that other negative information unrelated to the reduced FY2002 guidance did not cause the decline in Flowserve's share price." *Id.* at 231. On the other hand, Alaska did not have to go so far as to show that the October 2001 guidance was actually fraudulent. *Id.*

4. Once a plaintiff lays out a prima facie case under the Securities Act, loss causation is presumed. Pursuant to § 11(e), the defendant

has the heavy burden of rebutting that presumption. The District Court erred by improperly placing this burden on Plaintiffs. Thus, in order to win summary judgment, Defendants were "required to prove that no reasonable juror could believe that any portion of Alaska's July and September 2002 losses was caused by the defendants' alleged misrepresentations in the registration statements." *Id.* at 234. The Fifth Circuit vacated the District Court's grant of summary judgment dismissing Alaska's Securities Act claims and remanded for further proceedings.

C. *Fener v. Operating Engineers Const. Ind. and Misc. Pension Fund (Local 66)*, 579 F.3d 401 (5th Cir. Aug. 12, 2009)

1. Plaintiffs appeal from the District Court (N.D. Tex.) decision denying their motion for class certification. Plaintiffs, shareholders of media company Belo Corp., brought claims under § 10(b) of the Exchange Act and Rule 10b-5, alleging that Belo's misrepresentations regarding the circulation of its largest newspaper caused them to buy shares of Belo at artificially inflated prices. The District Court denied the motion for class certification, holding that Plaintiffs failed to show loss causation. The Court of Appeals affirmed.

2. "A court can examine loss causation at the pleadings stage, the class certification stage, on summary judgment, or at trial." *Id.* at 407. To prove loss causation, a plaintiff must show that "the false statement causing the increase [in stock price] was related to the statement causing the decrease [in stock price]." *Id.* When the ultimately truthful disclosure is coupled with other negative information that is unrelated to the fraud, plaintiffs must show that "it is more probable than not that it was this negative statement, and not other unrelated negative statements, that caused a significant amount of the decline." *Id.* Expert testimony is required to show loss causation at the class certification stage of the proceedings. SEC reports, stock price charts and analyst reports, without supporting expert testimony, are insufficient.

3. In this case, the disclosing press release contained information about Belo's alleged improper overstatement of its circulation, but also information about a market downturn and future circulation reductions. Thus, the Court held that the expert testimony was fatally flawed, as it relied on the idea that the press release was only one piece of news. The Court "reject[s] any event study that shows only how a 'stock reacted to the entire bundle of negative

information,' rather than examining the 'evidence linking the culpable disclosure to the stock-price movement." *Id.* at 410.

Sixth Circuit

A. *Ind. State Dist. Council of Laborers and Hod Carriers Pension and Welfare Fund v. Omnicare, Inc.*, 583 F.3d 935 (6th Cir. Oct. 21, 2009)

1. Appeal of the District Court's (E.D. Ky.) dismissal of Plaintiffs' class action claims under §§ 10(b) and 20(a) of the Exchange Act, Rule 10b-5, and § 11 of the Securities Act against Defendant Omnicare, a pharmaceutical care provider, and its officers and board members. Plaintiffs alleged four general categories of fraud claims: (1) misrepresentations about Omnicare's readiness for the new Medicare Part D program; (2) the nondisclosure of an ongoing contract dispute with United Health Group; (3) GAAP violations that inflated Omnicare's revenue; and (4) false assurances of legal compliance with certain drug repackaging and recycling programs. The Sixth Circuit affirmed the dismissal of the Exchange Act claims and reversed and remanded the dismissal of the Securities Act claim.

2. The District Court properly dismissed the claims relating to Omnicare's readiness for the new Medicare Part D program for failure to plead loss causation. While it may be true that Omnicare misrepresented their preparedness for the upcoming program, no statements in the Complaint explain how the statements regarding its preparedness were revealed to be false and thereby caused a drop in the stock price. Indeed, there were many other factors that could have caused the stock-price decline at issue. The same is true for the alleged GAAP violations.

3. The District Court dismissed the § 11 claim for failure to plead loss causation. Loss causation, however, is not an element of a § 11 claim, but an affirmative defense to it. For this reason, the Sixth Circuit reversed the dismissal of this claim and remanded to the District Court for further proceedings.

Eighth Circuit

A. *McAdams v. McCord*, 584 F.3d 1111 (8th Cir. Oct. 20, 2009)

1. Shareholders brought claims under §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5 against UCAP, Inc., a multistate provider of mortgage services, and several of its executives, and claims under § 10(b) of the Exchange Act against UCAP's auditor, MSF. Plaintiffs alleged that UCAP and MSF defrauded them by inducing them to invest in UCAP through misrepresentations about UCAP's financial condition. The District Court (W.D. Ark.) dismissed the claims, holding that Plaintiffs did not meet the heightened pleading standards of the PSLRA. On this appeal, the only remaining issue related to Plaintiffs' claims against MSF. The Eighth Circuit affirmed the dismissal on different grounds, holding that Plaintiffs failed to plead loss causation as to MSF.

2. The only statements allegedly made by MSF relate to MSF's "clean" audit opinions, which were incorporated by reference in UCAP's Forms 10-K. *Id.* at 1114. The Complaint alleges that Plaintiffs invested in UCAP "as a direct and proximate result of Defendants' fraudulent misrepresentations and omission of material facts." *Id.* "This threadbare, conclusory statement does not sufficiently allege loss causation. It does not specify how two statements by MSF, as compared to the complaint's long list of alleged misrepresentations and omissions by the executives, proximately caused the investors' losses." *Id.* at 1114-15. Furthermore, while the Complaint alleges that the truth about UCAP's financial position came out when UCAP announced the need for a financial restatement, the Complaint does not state the value of UCAP's stock when the investors made their investment, or its value right before, or right after, the need for the restatement was announced. *Id.* at 1115. Without these facts, Plaintiffs cannot show loss causation.

Ninth Circuit

A. *Huberman v. Tag-It Pacific Inc.*, 314 Fed. Appx. 59 (9th Cir. Feb. 11, 2009)

1. Appeal of an order by the District Court (C.D. Cal.) denying Plaintiff's motion for class certification and granting Defendant's motion for summary judgment. Plaintiff, Seth Huberman, brought an action against Defendant for violations of §§ 10(b) and 20(a) of the Exchange Act. The Ninth Circuit reversed and remanded.

2. With respect to the loss causation, the Ninth Circuit held as follows: "Loss causation requires that a plaintiff present facts that demonstrate a connection between the defendant's material misrepresentation and the plaintiff's loss." *Id.* at *61. As evidence of loss causation, Plaintiff presented Defendant's negative press releases and a chart that tracked the significant drop in the stock price of the company directly following these announcements. Based upon the extent to which the drop in stock price tracked the press release, the Ninth Circuit determined that a reasonable factfinder could conclude that Defendant's allegedly fraudulent press release was a substantial cause of Plaintiff's loss.

B. *In re Redback Networks, Inc. Sec. Litig.*, 329 Fed. Appx. 715 (9th Cir. Apr. 14, 2009)

1. Appeal of an order of the District Court (N.D. Cal.) dismissing with prejudice Plaintiffs' class action complaint pursuant to Rule 12(b)(6) for failure to state a claim upon which relief can be granted. Plaintiffs alleged claims under §§ 10(b), 18, 20(a), and 20(A) of the Exchange Act. With little analysis of the specific facts alleged in the Complaint, the Ninth Circuit affirmed on the grounds that Plaintiffs did not adequately plead loss causation in connection with their claims based on allegations that Defendant generated its business with a third party through improper means.

2. The Ninth Circuit held that it reviewed dismissals pursuant to Rule 12(b)(6) de novo, and held that regardless of whether Plaintiffs adequately pled falsity, they did not adequately plead loss causation. The Ninth Circuit rejected Plaintiffs' allegations that their loss was caused when investors learned the alleged truth on the grounds that the allegations were conclusory and involved

unreasonable inferences. Accordingly, the Ninth Circuit held that both Plaintiffs' § 10(b) claim alleging fraudulent statements and their § 10(b) claim alleging a fraudulent scheme could not survive dismissal. For the same reason, Plaintiffs' claim under § 18 was properly dismissed. The Ninth Circuit further held that Plaintiffs' claims under §§ 20(A) (insider trading) and 20(a) (control person liability) were also properly dismissed because both require a showing of primary liability, which Plaintiffs failed to provide. Finally, the Ninth Circuit held that the dismissal with prejudice was not an abuse of discretion because the District Court had given Plaintiffs sufficient opportunity to amend their complaint to correct the deficiencies.

Tenth Circuit

A. *In re Williams Sec. Litig.-WCG Subclass*, 558 F.3d 1130 (10th Cir. Feb. 18, 2009)

1. Appeal of an order by the District Court (N.D. Okla.) granting summary judgment for Defendants. Plaintiffs were investors in Williams Communications Group ("WCG"), a subsidiary of The Williams Companies ("WMB") that went bankrupt less than two years after its spin-off. When the spin-off occurred, Defendants announced WCG's adequate capitalization and great prospects as a stand-alone company. Plaintiffs brought class action claims under §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5, alleging that Defendants misrepresented WCG's prospects for success and the reason for its spin-off. The Tenth Circuit affirmed, holding that Plaintiffs failed to raise a genuine issue of fact as to loss causation.

2. While the District Court agreed that triable issues of fact existed with regard to whether Defendants made material misrepresentations with scienter, it held that Plaintiffs failed to show that the decline in WCG stock was attributable to the fraud disclosure, as opposed to the myriad of other causes that can affect a stock. While Plaintiffs presented an expert on the issue of loss causation, the District Court found the expert's two causation theories unreliable under *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579, 113 S. Ct. 2786, 125 L. Ed. 2d 469 (June 28, 1993).

3. Plaintiffs' expert presented two loss causation theories. His first theory was labeled the fraud leakage theory. This theory pointed to the fact that WCG's stock declined over the class period and posited that, while the fraud was not revealed to the market by any significant corrective disclosure, WCG's true financial condition leaked out over the class period. The District Court held that this theory failed because it did not specifically identify how the market learned of the fraud, thereby causing the price decline over the period. *Id.* at 1138-39.

4. Plaintiffs' second loss causation theory focused on the stock price declines following four specific disclosures. These disclosures – an announcement of an assessment of contingent obligations, a lender's announcement that WCG might be in default, a public consideration of Chapter 11, and WCG's filing for bankruptcy – were loosely related to the undisclosed risks that were eventually revealed. The District Court rejected this theory because it failed to "tie these four particular disclosures to any of the alleged misrepresentations or describe why they should be considered 'corrective.'" *Id.* at 1140. For example, the expert could not say for sure that the first disclosure actually revealed any new information to the market. Furthermore, "the causal connection between false statements about a company's prospects and that same company's eventual bankruptcy years later is too remote to constitute a corrective disclosure." *Id.* at 1142.

5. The court must ask "whether the risk that caused the loss was within the zone of risk concealed by the misrepresentations and omissions alleged by a disappointed investor." *Id.* at 1140. This theory, like the leakage theory, "fails to identify the mechanism by which fraud was revealed to the market." *Id.* at 1143. Furthermore, the theory did not account for the nonfraud-related disclosures that could have affected WCG's value.

Class Certification, and Issues Concerning the Appointment of Class Plaintiff and Class Counsel

Third Circuit

A. *In re Flag Telecom Holdings, Ltd. Sec. Litig.*, 574 F.3d 29 (2d Cir. July 22, 2009)

1. Appeal of an order by the District Court (S.D.N.Y.) certifying class of Plaintiffs for securities fraud class action against Flag Telecom Holdings ("Flag"), its lead underwriter and individual officers. Plaintiffs' class action was brought on behalf of those who purchased or acquired Flag common stock between February 11, 2000 and February 13, 2002 for violations of §§ 11, 12(a)(2) and 15 of the Securities Act ("the Securities Act Plaintiffs"), and §§ 10(b) and 20(a) of the Exchange Act ("the Exchange Act Plaintiffs"). Plaintiffs alleged that, as a result of Defendants' materially false and misleading statements, the value of Flag stock was artificially inflated. The Second Circuit affirmed the certification of the class, but held that investors who sold their stock before the alleged corrective disclosures did not satisfy the required typicality or adequacy requirements, and thus vacated the order to the extent the class included such individuals. The Second Circuit remanded for further proceedings.

2. In February 2000, Flag offered its shares to the public in an IPO. In the prospectus, Flag stated that it had obtained hundreds of millions of dollars in (1) bank financing, and (2) presales, to construct its fiber optic cable system. Defendants allegedly made misstatements and omissions in the prospectus and during the two years following the IPO. On February 13, 2002, Flag disclosed that approximately 14% of its revenues for the year were associated with so-called "reciprocal transactions." Shortly thereafter, Flag filed a Chapter 11 bankruptcy petition and Flag's stock became virtually worthless.

3. In appealing class certification, Defendants argued first that the class suffered from a fundamental internal conflict rendering it uncertifiable because "'success for the [Exchange] Act plaintiffs necessarily precludes recovery by the [Securities] Act plaintiffs and vice-versa'" on the issue of loss causation. *Id.* at *35. The Second Circuit held that the District Court did not abuse its discretion in concluding that the typicality requirement for class certification was met despite the fact that the Complaint alleged that the artificial inflation of the stock was based on both a false registration statement and post-IPO actions, even though the Securities Act

Plaintiffs could only recover if the decline in stock price was due to misrepresentations in the IPO, while the Securities Exchange Plaintiffs could only recover if the decline in stock price was due to post-IPO actions. It was possible that the decline was caused by both alleged post-IPO fraud relating to reciprocal transactions and alleged misstatements relating to pre-sales found in the registration statement.

4. Defendants also argued that the District Court abused its discretion by including in the class investors who sold their stock before the February 13, 2002 alleged corrective disclosures were made ("the In-and-Out Traders"), because including these individuals in the class violated the typicality and adequacy requirements of Fed. R. Civ. P. 23(a). Defendants relied on *Dura* to argue that the In-and-Out Traders could not prove loss causation.

5. The Second Circuit found that the District Court abused its discretion in finding that the In-and-Out Traders could show loss causation, explaining that the "'conceivable'" standard of proof applied by the District Court did not satisfy the requisite preponderance of the evidence standard. *Id.* at *38. Under *Dura* and *Lentell v. Merrill Lynch & Co.*, 369 F.3d 161 (2d Cir. Jan. 20, 2005), Plaintiffs who sold their stock before the February 13, 2002 disclosures would have to prove that the loss they suffered was both foreseeable and caused by the "materialization of the concealed risk." *Id.* at *40. To do so, Plaintiffs would have to demonstrate that any of the information that "'leaked'" into the market prior to February 13, 2002, revealed the truth with respect to the specific misrepresentations alleged. *Id.* at *41. Because Plaintiffs have not put forth sufficient evidence linking any pre-February 13 disclosure to the alleged misrepresentations, the Second Circuit vacated that portion of the District Court's opinion certifying the In-and-Out Traders as part of the class, and remanded for further proceedings.

B. *In re Constar International Inc. Sec. Litig.*, 585 F.3d 774 (3d Cir. Oct. 29, 2009)

1. Defendants moved for an interlocutory appeal of the District Court's (E.D. Pa.) order granting Plaintiffs' motion for class certification. Plaintiffs sought relief under §§ 11 and 15 of the Securities Act, alleging that Defendants' registration statement contained materially false and misleading statements regarding Constar's financial viability and future. Plaintiffs also brought a claim against

Defendants' underwriters under § 11 of the Securities Act. The Third Circuit affirmed.

2. Reviewing the District Court's decision for abuse of discretion, the Third Circuit held that, following a "rigorous analysis," the District Court applied the correct standard, and not an improperly "liberal" standard, in evaluating Plaintiffs' motion for class certification. *Id.* at 781. The District Court's use of the word "liberal" in its analysis was merely a preface. Indeed, "[n]owhere in the analysis does the Special Master or the District Court identify a presumption in favor of class certification or suggest that class certification is appropriate in close cases." *Id.* at 781.

3. The District Court did not need to decide whether the market for Constar securities was efficient to decide the issue of predominance for the class certification motion. A claim under § 11 requires only a showing of a material misrepresentation and does not require proof of loss causation or reliance. Injury and loss are presumed under § 11. While loss causation can be an affirmative defense, it would not defeat predominance here, as any defense on this ground would present a common issue, not an individual one. If, for example, something other than the alleged misrepresentation caused a loss, such as the weather or the market, it would affect class members uniformly. Thus, with a § 11 claim, the issue of market efficiency is not relevant.

Eighth Circuit

A. *Horizon Asset Mgmt. Inc. v. H&R Block, Inc.*, 580 F.3d 755 (8th Cir. Sept. 9, 2009)

1. Appointed Lead Plaintiff, Horizon, appeals from the District Court's (W.D. Mo.) dismissal of its putative consolidated class action complaint against publicly traded H&R Block ("Block") and two of its officers and directors. Other shareholders appeal the appointment of Plaintiff as sole Lead Plaintiff. Horizon's consolidated class action complaint asserted claims under §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5, but did not include other Plaintiffs' derivative claims against the individual Defendants. The Complaint alleged that Block and individual Defendants made false and misleading statements to investors regarding Block's financial condition, including (1) failing to disclose the unlawful nature of certain of its programs, which artificially inflated Block's reported

earnings, (2) failing to disclose its inadequate internal safeguards and procedural controls to ensure accurate financial statements, and (3) misstating financial results due to erroneous calculation of its effective state income tax rate. The District Court dismissed the claims for failure to allege a false statement with regard to (1) and (2) and failure to sufficiently allege scienter with regard to (3). The Eighth Circuit affirmed in part, dismissing Horizon's claims, but reversed the District Court's order appointing Horizon as Plaintiff for the derivative claims. On remand, the derivative claims of the other Plaintiffs will be reinstated.

2. The District Court erred when it concluded that certain of Plaintiffs' claims "are not really derivative claims" and appointed Horizon as sole Lead Plaintiff, knowing that Horizon would not assert the derivative claims. *Id.* at 769. The Eighth Circuit remanded and reinstated the derivative claims.

Ninth Circuit

A. *Huberman v. Tag-It Pacific Inc.*, 314 Fed. Appx. 59 (9th Cir. Feb. 11, 2009)

1. Appeal of an order by the District Court (C.D. Cal.) denying Plaintiff's motion for class certification and granting Defendant's motion for summary judgment. Plaintiff, Seth Huberman, brought an action against Defendant for violations of §§ 10(b) and 20(a) of the Exchange Act. The Ninth Circuit reversed and remanded.

2. The District Court refused to certify Plaintiff's class for failure to meet the requirement of typicality and for failure to show that questions of law or fact common to the class predominated because Plaintiff may have had access to insider information. The Ninth Circuit disagreed, arguing that this was "unsupported speculation." *Id.* at 62. Further, Plaintiff presented sufficient evidence to establish the application of the fraud-on-the-market presumption and, therefore, common questions of fact and law predominated.

B. *Desai v. Deutsche Bank Securities Ltd.*, 573 F.3d 931 (9th Cir. May 7, 2009)

1. Appeal of an order by the District Court (C.D. Cal.) denying Plaintiffs' motion for class certification in their putative securities class action against banking entities that allegedly violated §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5 by participating in an extensive stock manipulation scheme. Plaintiffs, former investors in GenesisIntermedia, Inc. ("GENI"), alleged that Defendant Deutsche Bank Securities Ltd. ("DBSL"), and certain of its affiliates and officers, artificially inflated the price of GENI stock through manipulation, allowing Defendants to profit without having to sell any shares. As the price of GENI stock eventually collapsed in September of 2001, Plaintiff investors brought their putative class action, and sought class certification under Fed. R. Civ. P. 23(b)(3). The Ninth Circuit affirmed the District Court's denial of class certification.

2. Plaintiffs alleged that DBSL violated securities laws by both engaging in manipulative conduct and making certain omissions. The District Court properly found that Plaintiffs failed to adequately allege reliance or create an adequate presumption for reliance on behalf of the class. Plaintiffs had two theories under which to create a presumption of reliance: the *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 92 S. Ct. 1456, 31 L. Ed. 2d 741 (Apr. 24, 1972), standard for omissions cases, and the fraud-on-the-market presumption. The District Court properly found that the *Affiliated Ute* standard did not apply because this was not primarily an omissions case. The fact that a prior version of Plaintiffs' Complaint made more extensive allegations of omissions was not relevant. The most recent version of a complaint is deemed operative.

3. The Ninth Circuit also found that the fraud-on-the-market theory of reliance did not apply. A key element of this presumption is the efficiency of the market in which the securities trade. Because Plaintiffs acknowledged that the market for GENI's shares was not efficient, the presumption was inapplicable. Despite this deficiency, Plaintiffs argued a new presumption for manipulative conduct cases. Plaintiffs argued that investors typically rely on market integrity, meaning a lack of undue influence on market efficiency. Thus, according to Plaintiffs, a presumption of reliance is appropriate, even where market efficiency lacks, if the market's inefficiency is due to outside manipulation. The Ninth Circuit found

that the District Court, although not forbidden to do so, was not required to recognize such a presumption, and therefore acted appropriately in proceeding to examine whether Plaintiffs could prove reliance directly. Because reliance would need to be proved on an individual basis, the District Court correctly denied Plaintiffs' motion for class certification.

C. *Cohen v. U.S. District Court for N.D. Cal.*, 586 F.3d 703 (9th Cir. Nov. 5, 2009)

1. Lead Plaintiff in a putative securities fraud class action petitioned for writ of mandamus seeking to vacate District Court (N.D. Cal.) order appointing lead counsel and to compel the District Court to appoint his chosen firm. The District Court had denied lead Plaintiff's request for leave to file a motion for reconsideration of order appointing lead counsel. The Ninth Circuit granted the writ in part.

2. Plaintiffs brought a putative class action against Defendant NVIDIA Corporation ("NVIDIA") alleging that NVIDIA fraudulently concealed from investors the use of flawed materials and processes in producing certain products and that when this information was disclosed, stock prices declined substantially. After applying two separate measures to determine the plaintiff with the largest financial stake in the litigation, the District Court appointed Roberto Cohen and New Jersey Carpenters as co-lead plaintiffs. The District Court appointed two law firms as co-lead counsel, including New Jersey Carpenters' choice of law firm but not Cohen's. Cohen requested leave to file a motion for reconsideration of the lead counsel order or, in the alternative, application for an order certifying interlocutory appeal, arguing that the PSLRA and *In re Cavanaugh*, 306 F.3d 726 (9th Cir. 2002), afford him the right, as lead plaintiff, to select counsel for the class. The Depies Group (the group of class members that had submitted the name of the chosen lead counsel) also moved for reconsideration and/or clarification of the District Court's order in which they argued that the District Court should deny Cohen's motion and/or that it should allow the Depies Group to challenge the appointment of lead plaintiff. The District Court denied the motions.

3. The Ninth Circuit held that, while the District Court had the authority to reject lead Plaintiff's choice of counsel, it did not have the authority to select counsel of its own choosing. The PSLRA mandates that selecting and retaining class counsel is a power

belonging to the most adequate plaintiff. "The clause subjecting the lead Plaintiff's selection of counsel 'to the approval of the district court' in no way suggests that a district court shares in the lead plaintiff's authority to select lead counsel or that disapproval of a lead plaintiff's choice divests the lead plaintiff of this authority." *Id.* at 709. The Ninth Circuit declined to compel appointment of Cohen's choice of counsel, instead remanding to the District Court to approve or disapprove of Cohen's choice subject to appropriate criteria. The Ninth Circuit also declined to consider the merits of the Depies Group's motion that, in the face of clear error, the proper remedy is to remand to reassess the appointment of lead plaintiff.

Tenth Circuit

A. *In re Bard Assocs., Inc.*, No. 09-6243, 2009 WL 4350780 (10th Cir. Dec. 2, 2009)

1. Bard Associates ("Bard"), an investment advisory firm, requested a writ of mandamus vacating the District Court's (D. Okla.) order denying its motion to serve as Lead Plaintiff in a putative class action lawsuit under the PSLRA against Quest Resource.[5] The Tenth Circuit affirmed.

2. A writ of mandamus may only be invoked in extraordinary circumstances. In this case, Plaintiff must show that the District Court's appointment of Lead Plaintiff ignored the mandates of the PSLRA or otherwise constituted a gross abuse of discretion. *Id.* at *2. Bard was denied Lead Plaintiff status because, at the time it moved for such status, it lacked valid claim assignments from its clients. According to *W.R. Huff Asset Management Co. v. Deloitte & Touche LLP*, 549 F.3d 100 (2d Cir. Dec. 3, 2008), *cert. denied*, 129 S. Ct. 2011 (Apr. 20, 2009), an investment advisor lacks Article III standing to assert securities claims based on client losses absent assignments conferring title to the claims. Bard did eventually secure assignments, but only after the PSLRA's 60-day deadline to apply as Lead Plaintiff. On this basis, the Court denied Bard's request, explaining that its demonstration of its financial interest was too late.

[5] The precise statutory basis for the claims was unspecified in the appellate court opinion. The District Court opinion is not reported.

Fourth Circuit

A. *Public Employees' Retirement Assoc. of Colo. v. Deloitte & Touche LLP*, 551 F.3d 305 (4th Cir. Jan. 5, 2009)

1. Appeal of an order by the District Court (D. Md.) dismissing claims under § 10(b) of the Exchange Act and Rule 10b-5. The lawsuit arose out of the allegedly improper overstating of income by Royal Ahold, N.V. and its subsidiary. Plaintiffs alleged that Ahold improperly treated all revenue from certain joint ventures as revenue to Ahold despite its lack of a controlling stake in the ventures. Ahold also allegedly inflated its income from promotional allowances or vendor rebates. The alleged misconduct of Ahold was not at issue. Rather, the action focused on potential liability of the outside accounting firm. The District Court dismissed Plaintiffs' claims and denied leave to file a second amended complaint, holding that investor Plaintiffs failed to adequately allege scienter. The Fourth Circuit affirmed the dismissal, also agreeing that there was no version of the facts that would allow Plaintiffs to meet their burden.

2. Citing *Stoneridge*, the Fourth Circuit explained that to prevail, Plaintiffs must show "that defendants actually made a misrepresentation or omission in their audit opinions on which investors relied; parties who merely assist another in violating § 10(b) are not liable under § 10(b)." *Id.* at 313. The District Court and the Fourth Circuit applied the *Tellabs* strong inference standard. "With perfect hindsight, one might posit that defendants should have required stronger evidence of control [of the joint ventures] from Ahold. . . . Nonetheless, the evidence as a whole leads to the strong inference that defendants were deceived by their clients into approving the consolidation." *Id.* at 314. Likewise, the Fourth Circuit explained, the strongest inference from the evidence is that Defendants did not detect the improper accounting of the promotional allowances due to its client's collusion with the vendors.

B. *In re Mut. Funds Inv. Litig.*, 566 F.3d. 111 (4th Cir. May 7, 2009)

1. Appeal of an order by the District Court (D. Md.) dismissing putative class action claims under §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Plaintiff First Derivative Traders, on behalf of shareholders of Janus Capital Group ("JCG"), filed a complaint

against JCG and its wholly owned subsidiary Janus Capital Management LLC ("JCM"), alleging that JCG and JCM were responsible for misleading statements about market timing appearing in the prospectuses of certain Janus funds. The statements represented that the funds' managers took steps to prevent market timing, which were found to be false. The District Court dismissed the claims for failure to allege that JCM or JCG actually made the false statements in the prospectuses, and there can be no aiding or abetting liability in securities fraud actions. As to JCM, the District Court also held that there was no nexus between Plaintiffs, as JCG shareholders, and JCM. The Fourth Circuit reversed and remanded for further proceedings.

2. On the issue of scheme liability, following *Stoneridge*, the Fourth Circuit explained that the existence of a fraudulent scheme does not permit a party to avoid proving any of the traditional elements of primary liability.

Ninth Circuit

A. *In re Peregrine Systems, Inc. Securities Litigation*, 310 Fed. Appx. 149 (9th Cir. Nov. 6, 2009)

1. Appeal of an order by the District Court (S.D. Cal.) dismissing claims against 11 of 21 Defendants named in Plaintiff Loran Group's complaint alleging securities fraud by Peregrine Systems, Inc. ("Peregrine") and others under §§ 10(b) and 20(a) of the Exchange Act. Plaintiff alleged that Defendants KPMG LLP, BearingPoint, Inc., and Larry Rodda ("KPMG Defendants") enabled Peregrine to improperly recognize revenue by "parking" transactions whereby they agreed to purchase software at the end of fiscal quarters, allowing Peregrine to meet its quarterly projections.

2. Citing *Stoneridge*, the Ninth Circuit confirmed that "these transactions cannot form the basis of § 10(b) liability unless a member of the investing public had knowledge . . . of [the business partner's] deceptive acts sufficient to demonstrate reliance upon any of [the business partner's] actions." *Id.* at *151 (internal quotations omitted).

3. The District Court dismissed, with prejudice, the claims against KPMG Defendants. The Ninth Circuit affirmed. The Ninth Circuit held that references to a business partnership between Peregrine and KPMG Defendants in press releases given to investors did not trigger the “fraud on the market” presumption of reliance because the press releases did not communicate any specific information about the “alleged parking” transactions and thus did not communicate KPMG Defendants’ allegedly deceptive acts.

SLUSA[6]

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[6] SLUSA amended § 16 of the Securities Act and § 28 of the Exchange Act by providing for both removal and dismissal of (i) a "covered class action," as that term is defined in SLUSA; (ii) based on state law; (iii) alleging either "a misrepresentation or omission of material fact" or "that the defendant used or employed any manipulative or deceptive device or contrivance"; (iv) "in connection with the purchase or sale of a covered security." 15 U.S.C. §§ 77p, 78bb(f). SLUSA is frequently referred to as a law of "preemption." However, the Supreme Court has noted that it is actually a law of "preclusion." This is because SLUSA does not displace state law but rather makes some state law claims "nonactionable through the class action device in federal as well as state court." *Kircher v. Putnam Funds Trust*, 547 U.S. 633, 636 n.1, 126 S. Ct. 2145, 165 L. Ed. 2d 92 (June 15, 2006). In accordance with the Supreme Court's view, we refer to SLUSA throughout as a law of "preclusion," notwithstanding the fact that certain of the Circuit Courts continue to refer to it as a law of "preemption."

Third Circuit

A. *In re Lord Abbett Mut. Funds Fee Litig.*, 553 F.3d 248 (3d Cir. Jan. 20, 2009)

1. Appeal of an order by the District Court (D.N.J.) dismissing Plaintiffs' class action claims under the Investment Company Act (ICA) and state law. Plaintiffs, shareholders of mutual funds managed by Lord Abbett & Co., alleged that Lord Abbett charged its existing investors excessive fees that were improperly used to pay brokers to market Lord Abbett funds to other investors. The District Court dismissed the entire action, holding that the state law claims were preempted by SLUSA. The Third Circuit vacated the District Court opinion and remanded for further proceedings.

2. The District Court held that preclusion of one claim under SLUSA requires dismissal of the entire action, including claims that did not specifically fall within SLUSA's ambit. The District Court noted that the very language of SLUSA refers to "covered class action[s]," not claims. *Id.* at 252 (emphasis added).

3. The Third Circuit reversed, holding that inclusion of a state-law claim that was precluded by SLUSA does not require dismissal of the entire action. "Allowing those claims that do not fall within SLUSA's preemptive scope to proceed, while dismissing those that do, is consistent with the goals of preventing abusive securities litigation while promoting national legal standards for nationally traded securities." *Id.* at 257.

Fourth Circuit

A. *In re Mut. Funds Inv. Litig.*, 309 Fed. Appx. 722 (4th Cir. Jan. 30, 2009)

1. Appeal of an order by the District Court (D. Md.) dismissing Plaintiffs' consolidated putative class actions based upon SLUSA. Plaintiffs were owners of variable annuities, and the proceeds of their investments were invested in "sub-accounts" corresponding to mutual funds containing foreign securities. Plaintiffs did not engage in market timing. Plaintiffs brought claims under state law, alleging that Defendants negligently exposed their investments to the dilution effect of market timing by other investors. The Fourth Circuit affirmed the dismissal.

2. The District Court held that the claims at issue occurred "in connection with" the purchase or sale of securities. *Id.* at 725. This was despite the fact that Plaintiffs were nontrading "holders" of the securities at issue. Under *Dabit*, "SLUSA applies broadly and preempts claims brought by holders of securities, as well as by purchasers and sellers." *Id.* The Fourth Circuit affirmed for the reasons set forth in the District Court opinion. See *In re Mut. Funds Inv. Litig.*, 437 F. Supp. 2d 439 (D. Md. 2006).

Sixth Circuit

A. *Segal v. Fifth Third Bank, N.A.*, 581 F.3d 305 (6th Cir. Sept. 17, 2009)

1. Appeal of an order by the District Court (S.D. Ohio) dismissing Plaintiff's class action suit, which asserted state-law claims of breach of fiduciary duty, breach of contract and unjust enrichment against bank Fifth Third. Plaintiff was the beneficiary of trust accounts administered by the bank, and alleged that the bank breached its fiduciary and contractual duties in its investment and management of the trust assets. Plaintiff alleged that Defendant invested in lower-yielding funds to cover near-term liabilities and falsely claimed that it would individually manage the fiduciary accounts. The District Court dismissed the claims, holding that they were barred by SLUSA. The Sixth Circuit affirmed.

2. SLUSA bars the Complaint, which was brought on behalf of a class of over 50 individuals, alleges untrue statements or material omissions, and is in connection with the purchase of securities, namely, Fifth Third's mutual funds. Plaintiff's disclaimer that the Complaint does not relate to misrepresentations is not controlling. "Courts may look to-they must look to-the substance of a complaint's allegations in applying SLUSA. Otherwise SLUSA enforcement would reduce to a formalistic search through the pages of the complaint for magic words-'untrue statement,' 'material omission,' 'manipulative or deceptive device'-and nothing more." *Id.* at 310. A claimant cannot avoid SLUSA through artful pleading.

3. A plaintiff cannot avoid SLUSA by disclaiming the importance of an allegation of misrepresentation. SLUSA preclusion does not turn on whether the claims depend upon alleged misrepresentations, but on whether the complaint contains allegations of misrepresentations: "The Act does not ask whether the complaint

makes ‘material’ or ‘dependent’ allegations of misrepresentation in connection with buying or selling securities. It asks whether the complaint includes these types of allegations, pure and simple.” *Id.* at 311. The complaint at issue does.

Seventh Circuit

A. *Kurz v. Fidelity Mgmt. & Research Co.*, 556 F.3d 639 (7th Cir. Feb. 23, 2009)

1. Appeal of an order by the District Court (S.D. Ill.) holding that Plaintiffs’ breach of contract claims against their investment advisor were barred by SLUSA. Plaintiff investors owned portfolios managed by Fidelity Management & Research Co. and FMR Co., Inc. (collectively, “FMR”). Plaintiffs brought a breach of contract claim in state court alleging that Fidelity violated the NASD “best execution” rule when its employees allegedly accepted improper gifts and entertainment to place trades through Jefferies & Co. After removal from state court, the District Court dismissed the claims. The Seventh Circuit affirmed the dismissal, holding that the claims were barred by SLUSA.

2. While a genuine contract action could fall outside the scope of SLUSA, Plaintiffs did not allege that FMR breached a contract with Plaintiffs. At bottom, Plaintiffs’ claims are based upon the securities laws, and the statute of limitations for these securities claims has run.

Ninth Circuit

A. *Beckett v. Mellon Investor Services LLC*, 329 Fed. Appx. 721 (9th Cir. Apr. 8, 2009)

1. Appeal of an order of the District Court (W.D. Wash.) dismissing with prejudice Plaintiff’s class action complaint alleging violations of Washington state law as precluded by SLUSA. The Ninth Circuit affirmed in part and reversed in part, and remanded to the District Court for further proceedings consistent with its opinion.

2. Plaintiff alleged that, contrary to his instructions to Defendant, and in violation of Washington state law, Defendant delayed selling

certain stock and did not pay the highest available share price. Plaintiff also alleged that Defendant charged undisclosed trading and service fees for selling the securities.

3. In affirming the District Court's dismissal, the Ninth Circuit recognized that SLUSA must be read broadly. The Ninth Circuit held that the alleged undisclosed fees effectively reduced Plaintiff's take from the sale, and it was implied from the allegations that Plaintiff and other class members would have taken a different course of action with regard to the sale had they known about the fees. Because all of Plaintiff's state law class claims relied on allegations regarding undisclosed fees, the Ninth Circuit held that they were prohibited by SLUSA and dismissal was proper.

4. The Ninth Circuit remanded on the grounds that Plaintiff might be able to make out a nonprecluded claim, such as breach of contract or fiduciary duty, with respect to the alleged failure to properly execute his order.

B. *Madden v. Cowen & Co.*, 576 F.3d 957 (9th Cir. Aug. 7, 2009)

1. Appeal of an order by the District Court (N.D. Cal.) denying Plaintiffs' motion to remand to state court and granting Defendant Cowen & Company's ("Cowen's") motion to dismiss pursuant to SLUSA. The Ninth Circuit vacated and remanded.

2. Plaintiffs were shareholders of two related closely held corporations ("the corporations") in California and Delaware. Cowen had been retained by the corporations to look for prospective buyers, to give advice regarding potential sales, and to provide fairness opinions. Cowen recommended FPA Medical Management ("FPA") as a buyer and the corporations entered into a merger agreement with FPA. Cowen concluded that the transaction was financially fair, and issued a "fairness opinion." The transaction was subsequently approved, with Plaintiffs voting in favor of the transaction. A few months later, FPA issued a first-quarter report showing earnings well below expected levels. Two months later, FPA declared bankruptcy with a share price at 0.5% of its value at the time of the merger.

3. A group of shareholders brought suit in California state court, alleging that Cowen committed negligent misrepresentation and professional negligence under state law. Cowen removed the suit

to the District Court under SLUSA and moved to dismiss. Plaintiffs moved to remand. The District Court held that the suit was properly removed and that the suit was precluded under SLUSA.

4. The Ninth Circuit held that Plaintiffs had alleged misrepresentations or omissions "in connection with" the purchase or sale of a security. Further, although the securities were not registered during the entire course of Cowen's work, alleged misstatements were made subsequent to registration, including inclusion of the "fairness opinion" in SEC filings. Therefore, the "covered security" element of SLUSA was satisfied.

5. Plaintiffs also argued that the case was not precluded because it falls under SLUSA's "Delaware carve-out," which allows for the prosecution of state court class actions involving "a communication with respect to the sale" of the issuer's securities "based on the law of the" state where the issuer is incorporated, where the communication was "made by or on behalf of" the issuer to shareholders of the issuer "concern[ing]" certain specified shareholder decisions, such as a "response to a tender or exchange offer."

6. The Ninth Circuit rejected Cowen's argument that the Delaware carve-out was inapplicable because Cowen's statements were on behalf of the corporations, not FPA, the "issuer" of the "covered securities." "[T]he plain language of §77p(d) allows a shareholder to bring a covered class action under state law against any 'issuer' that has made certain communications regarding the sale of its 'securities', and that these securities need not be 'covered securit[ies]' referred to in §77p(b)."

7. The Ninth Circuit remanded to the District Court to determine whether the statements at issue were made on behalf of the California corporation Defendant and would therefore fall within the carve-out. On remand, Cowen would bear the burden of proving that the Delaware carve-out was not applicable and thus that the District Court had jurisdiction.

C. *Proctor v. Vishay Intertechnology Inc.*, 584 F.3d 1208 (9th Cir. Oct. 9, 2009)

1. Appeal of an order from the District Court (N.D. Cal.) denying minority shareholders' motion to remand; dismissing the action as

to the corporation's auditor, Ernst & Young; and granting summary judgment as to the corporation's majority shareholder, Vishay Intertechnology Inc. ("Vishay"). Minority shareholders brought the action against corporation Siliconix, Inc. ("Siliconix"), Vishay, and Ernst & Young, asserting a derivative shareholder claim for breach of fiduciary duty and waste of corporate assets and a class action claim for breach of fiduciary duty. Plaintiffs also participated in a separate class action in the Delaware Court of Chancery against Vishay for breach of fiduciary duty, which resulted in a settlement and release of liability. Defendants removed the California action to federal court pursuant to SLUSA. The Ninth Circuit affirmed in part, reversed in part, and remanded.

2. The District Court found that removal was proper under SLUSA but that, as a matter of "federal-state comity," *id.* at 1218, the suit was barred by an injunction filed against Plaintiffs in the Delaware Court of Chancery. Accordingly, the District Court dismissed the action against Ernst & Young, and granted summary judgment to Vishay.

3. The Ninth Circuit agreed that Plaintiffs' class action claim for breach of fiduciary duty was precluded by SLUSA and thus the District Court had removal jurisdiction over minority shareholders' entire action. The Ninth Circuit also explained that the clock for removal did not begin to run until Plaintiffs filed their Third Amended Complaint, for that was the first time a SLUSA-covered claim appeared. Further, the filing of notice of removal was effective, even without individual consent documents on behalf of each Defendant. "One defendant's timely removal notice containing an averment of the other defendants' consent and signed by an attorney of record is sufficient." *Id.* at 1225.

4. SLUSA does not require dismissal of Plaintiffs' nonprecluded claims. "Dismissal of precluded claims while allowing the remainder of the case to remain pending thus fully comports with the statutory language." *Id.* at 1227. Instead, the court must remand the remaining nonprecluded claims to state court.

5. The Ninth Circuit reversed the District Court's order granting Vishay's motion for summary judgment and Ernst & Young's motion to dismiss based on the Delaware settlement. By its own terms, SLUSA requires remand once a federal court dismisses precluded claims. After dismissing Plaintiffs' second claim, the District Court should have remanded the case to state court for further proceedings, including the effect of the Delaware injunction.

Supreme Court

A. *Merck & Co. v. Reynolds*, 543 F.3d 150 (3d Cir. 2008), *cert. granted*, 129 S. Ct. 2432 (May 26, 2009)

1. Appeal from the September 9, 2009 decision of the Third Circuit (D.N.J.) reversing and remanding the District Court's (D.N.J.) order granting Defendants' motion to dismiss. The Complaint alleged that statements and omissions during the class period materially misrepresented the safety and commercial viability of VIOXX, in violation of §§ 11, 12(a)(2), and 15 of the Securities Act; §§ 10(b), 20(a), and 20(A) of the Exchange Act; and Rule 10b-5. The District Court dismissed the claims as time barred. The Court of Appeals reversed and remanded, holding that the District Court acted prematurely in finding as a matter of law that Plaintiffs were on inquiry notice of the alleged fraud. The Supreme Court granted Defendants' Petition for Certiorari.

2. A complaint alleging "fraud, deceit, manipulation, or contrivance" under the Exchange Act "may be brought not later than the earlier of . . . 2 years after the discovery of the facts constituting the violation; or . . . 5 years after such violation." 28 U.S.C. § 1658(b). An investor is not on inquiry notice until a "'reasonable investor of ordinary intelligence would have discovered the information and recognized it as a storm warning.'" *Merck*, 543 F.3d at 161. "If the existence of storm warnings is adequately established the burden shifts to the plaintiffs to show that they exercised reasonable due diligence and yet were unable to discover their injuries." *Id*. "[W]hether the plaintiffs, in the exercise of reasonable diligence, should have known of the basis for their claims depends on whether they had sufficient information of possible [as opposed to probable] wrongdoing to place them on inquiry notice or to excite storm warnings of culpable activity." *Id.* at 164. In this case, the court held that the alleged storm warnings (a medical journal article that gave an alternative hypothesis for Merck's explanation for VIOXX's cardiovascular data, an FDA warning letter explaining that Merck's promotional campaign must not ignore alternative hypotheses for the cardiovascular data, consumer lawsuits, and Merck's officer's admission of an alternative hypothesis for cardiovascular data) did not put the investors on notice of securities fraud. While these events exposed data showing that there was an increased risk of cardiovascular events with VIOXX, they did not refute Merck's hypothesis that the cardiovascular data was not

caused by VIOXX, but by something that would not impact VIOXX's commercial viability. Thus, the events did not trigger the two-year statute of limitations.

3. Petitioners-Defendants argue that the Third Circuit decision amounts to holding that a party must possess information that the defendant acted with scienter to be on inquiry notice. The discovery rule in § 1658(b) incorporates inquiry notice, which asks when a party has enough information sufficiently suggestive of wrongdoing to trigger a duty of further investigation. Defendants argue that a party can be on inquiry notice without having any information that relates specifically to scienter. They argue that in a case such as this, where Plaintiffs did not conduct any reasonably diligent investigation, the Third Circuit rule essentially eviscerates the principle of inquiry notice. In other words, once a party has information relating to all of the elements of his claim, he could be said to have already "discovered" his claim.

4. Respondents-Plaintiffs argue that a party is not on inquiry notice, and thus does not have a duty to investigate, until it receives sufficient storm warnings of fraud. They argue that the Third Circuit properly applied the storm warning standard in finding that no storm warnings of the alleged fraud existed more than two years before the filing of the complaint. The events relied upon by Defendants as triggering a duty to investigate are all consistent with the nonfraudulent front that was proffered by Defendants. The Third Circuit had no need to consider whether, once Plaintiffs received storm warnings, they conducted a sufficient investigation. They also had no need to consider whether and when the statute of limitations was triggered after Plaintiffs were under a duty to investigate.

5. Oral argument before the Supreme Court was held on November 30, 2009. According to press reports, the Justices challenged Merck's position that, while there is insufficient evidence to prove fraud, investors had sufficient information regarding the alleged fraud and should have sued them earlier. A decision is expected by June 2010.

Second Circuit

A. *In re AIG Advisor Group Sec. Litig.*, 309 Fed. Appx. 495 (2d Cir. Feb. 13, 2009)

1. Appeal of an order by the District Court (E.D.N.Y.) granting Defendants' motion to dismiss with prejudice. Plaintiffs asserted a putative class action with claims under §§ 10(b) and 20(a) of the Exchange Act based on Defendants' alleged failure to disclose payments, financial incentives, and rewards received through the sale of certain mutual funds, known as "Shelf-Space Funds." The Second Circuit affirmed.

2. The District Court dismissed Plaintiffs' amended complaint, finding Plaintiffs' allegations that brokers stood to gain from shelf space arrangements too general. The District Court also found the sums involved here (Plaintiffs alleged that the Defendant brokers stood to gain approximately $25 per $10,000 transaction) were "too small to state a claim upon which relief can be granted." *Id.* at *1.

3. The Second Circuit affirmed the dismissal on an alternative basis. In their Complaint, Plaintiffs incorporated by reference Defendants' website disclosures of the allegedly undisclosed shelf-space arrangements. The website disclosures foreclosed Plaintiffs' claims because they disclosed the conflict of interest underlying Plaintiffs' complaint and triggered the statute of limitations.

Third Circuit

A. *Alaska Elec. Pension Fund v. Pharmacia Corp.*, 554 F.3d 342 (3d Cir. Jan. 30, 2009), *petition for cert. filed*, 77 U.S.L.W. 3611 (U.S. Apr. 22, 2009) (08-1315)

1. Appeal of an order by the District Court (D.N.J.) granting summary judgment to Defendants on statute of limitations grounds. Plaintiffs brought class action claims under §§ 10(b) and 20(a) of the Exchange Act, alleging that the pharmaceutical company Defendants had made materially false statements about the results of a clinical study of a new medication. Plaintiffs alleged that Defendants purposefully manipulated the study data, withholding several months of study results, to positively spin the results. The Third Circuit vacated and remanded for further proceedings.

2. The District Court had held that inquiry notice was triggered by a public dispute between the FDA and Defendants over the study results, at which time it first became known that Defendants truncated the study results. The Third Circuit disagreed, noting that, to the reasonable investor, this apparently legitimate scientific dispute was not necessarily indicative of fraud. "For inquiry notice to occur, there must be some indicia of potential malfeasance." *Id.* at 351. In other words, the court requires "some reason to suspect that defendants did not genuinely believe the accuracy of their statements." *Id.* at 350. This occurred a few months later when a newspaper article raised the red flag of impropriety.

3. Consistent with its holding regarding the statute of limitations, the Third Circuit extended the class period from the date of the dispute with the FDA to the later date of the newspaper article warning the investors of the potential fraud.

Ninth Circuit

A. *Roth v. Reyes*, 567 F.3d 1077 (9th Cir. June 5, 2009)

1. Appeal of an order by the District Court (N.D. Cal.) dismissing Plaintiff's § 16(b) of the Exchange Act claims against four officers of Brocade Communications System ("Brocade"). The Ninth Circuit affirmed.

2. Plaintiff alleged that Defendants were corporate insiders for purposes of §16(b), that they received stock options over four different periods between 1999 and 2001, and that they sold shares of Brocade equity securities within six months of these dates. Plaintiff, in a complaint dated April 24, 2006, sought to recoup Defendants' short-swing profits based on their sales of Brocade stock within six months of acquiring the call options.

3. The Ninth Circuit determined that the statute of limitations on a §16(b) claim is two years and that, contrary to Plaintiff's position, the limitations period was not tolled by the fact that Defendants failed to disclose their acquisitions accurately by allegedly falsely reporting that their options acquisitions were exempt from §16(b) under Rule 16b-3(d). In *Whittaker v. Whittaker Corp.*, 639 F.2d 516, 528 (9th Cir. 1981), the Ninth Circuit held that tolling is required when the pertinent §16(a) reports are not filed. Here, the Ninth

Circuit explained that the reasoning in *Whittaker* does not extend to situations where the insider does file §16(a) reports but also erroneously claims an exemption for the disclosed transactions. Such a reading would undermine the statutory scheme because it would effectively eliminate the two-year limitations period in any case that turned on the applicability of an exemption.

Eleventh Circuit

A. *Puterman v. Lehman Brothers, Inc.*, 332 Fed. Appx. 549 (11th Cir. May 29, 2009)

1. Appeal of an order by the District Court (S.D. Fla.) dismissing a putative class action alleging claims under § 10(b) of the Exchange Act and Rule 10b-5. In June 2005, Plaintiffs, a group of investors, sued SunTrust Bank, Inc. In a second amended complaint, Plaintiffs added Pension Fund of America ("PFA") as a Defendant. The suit involved an alleged fraud related to PFA's alleged diversion of investor funds contrary to promises to investors and alleged inconsistencies between SunTrust's agreements with its clients and SunTrust's master agreement with PFA. The second amended complaint noted that investors had filed a lawsuit against PFA and SunTrust in February 2003 for breach of fiduciary duty. One of the plaintiffs from the state court case was a plaintiff in the current federal court case. The District Court dismissed the claims based on the expiration of the two-year statute of limitations. The Eleventh Circuit affirmed the ruling as to Defendant SunTrust, but vacated the ruling as to Defendant Luis Cornide.

2. Plaintiffs' duty to investigate the claims as to SunTrust, which was not named in the state court case until June 2003, arose when Plaintiffs knew of PFA's alleged fraud and the involvement of financial institutions, including SunTrust. Further, inquiry notice for statute of limitations purposes is gauged by the knowledge of the alleged fraud of the class representative. In this case, the class representative was involved in the prior state court case.

3. With regard to the control person claims against individual Cornide, the Eleventh Circuit reversed and remanded because Cornide had not filed a motion to dismiss. The courts have "prohibited the sua sponte dismissal of a claim as meritless under Rule 12(b)(6) where the district court did not provide plaintiff with notice of its intent to dismiss or an opportunity to respond." *Id.* at 553.

Second Circuit

A. *ECA and Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co.*, 553 F.3d 187 (2d Cir. Jan. 21, 2009)

1. Appeal of an order by the District Court (S.D.N.Y.) granting Defendants' motion to dismiss Plaintiffs' second amended complaint with prejudice. Plaintiffs alleged that JP Morgan Chase & Co. ("JPMC") defrauded them through its complicity in Enron's financial scandals. Plaintiffs alleged violations of §§ 10(b), 20(a) and 14(a) of the Exchange Act, and Rule 10b-5 promulgated thereunder, and § 11 of the Securities Act. The Second Circuit affirmed.

2. Plaintiffs alleged that JPMC created disguised loans for Enron and concealed the nature of the transactions by making false statements or omissions in its accounting and SEC filings. JPMC allegedly created special purpose entities which allowed Enron to conceal its debt from investors and, in return, earned "exorbitant fees." *Id.* at 194. Plaintiffs further alleged that, following the collapse of Enron, the Senate concluded that JPMC knowingly engaged in and assisted Enron in sham transactions, the resulting disclosure of which caused losses to JPMC's investors. *Id.*

3. The District Court found that JPMC mischaracterized certain transactions as "trading activities" in its financial disclosures rather than classifying them as loans. Such a mischaracterization must be material to support a fraud claim. The Second Circuit first evaluated the quantitative impact of the mischaracterization. Although the Second Circuit does not impose a bright-line test for materiality based on the quantitative impact of an alleged misrepresentation, neither does it exclude the analysis from its consideration. The SEC established a five percent numerical threshold in SAB No. 99. The Second Circuit noted that this standard serves as "a good starting place for assessing the materiality of [an] alleged misstatement." *Id.* at 204. However, the Second Circuit found that the mischaracterization in this matter, which "affects less than one third of a percent of total assets," was not sufficiently material. *Id.*

4. The Second Circuit also analyzed the decision to classify the transactions as loans qualitatively. The Second Circuit applies a

qualitative analysis "to allow for a finding of materiality if the quantitative size of the misstatement is small, but the effect of misrepresentation is large." *Id.* at 205. Plaintiffs based their qualitative materiality arguments on three factors contained in SAB No. 99: (1) that the transaction was unlawful, (2) that the misstatements related to a significant aspect of JPMC's operations, and (3) the market reaction to the alleged misstatements.

5. Here, Plaintiffs failed to allege the transactions were illegal. Also, JPMC's Enron transactions only accounted for .1% of its revenues. Further, the Second Circuit commented that SAB No. 99 limits the utility of the market reaction factor to situations in which management anticipates that a misstatement would result in a market reaction. Plaintiffs failed to allege facts that would permit such an inference. In this matter, Plaintiffs did not allege any facts that would "have been viewed by a reasonable investor as having significantly altered the total mix of information made available." *Id.* Under both a qualitative and quantitative analysis, Plaintiffs failed to allege the materiality of the accounting classification.

6. The Second Circuit dismissed Plaintiffs' claims related to alleged misstatements about JPMC's reputation as puffery and too general to cause a reasonable investor to rely on them.

B. *Lowinger v. Pzena Inv. Mgmt., Inc.*, No. 08-49322009, WL 2476641 (2d Cir. Aug. 13, 2009)

1. Appeal of an order by the District Court (S.D.N.Y.) dismissing Plaintiffs' complaint alleging securities fraud by Pzena Investment Management ("Pzena"), Richard Pzena, Goldman Sachs & Co. ("Goldman Sachs") and UBS Securities LLP ("UBS") under §§ 11 and 12(a)(2) of the Securities Act. The Second Circuit affirmed the dismissal, concluding that Plaintiffs failed to state a claim for which relief could be granted.

2. Plaintiffs' claims centered on alleged material misstatements made by Defendants in a Pzena prospectus. Specifically, Plaintiffs claimed that Defendants' prospectus statements, although literally true, misled investors as to the degree to which Pzena remained an attractive investment option. These statements – 1) indicating that Pzena's assets under management ("AUM") fell approximately $2.1 billion as a result of market depreciation, and 2) implying that withdrawals of client funds played merely a secondary role in the reopening of certain Pzena investment strategies – allegedly

created an inaccurately positive image for Pzena in light of news reports that Pzena's operations were and continued to be successful.

3. In upholding the District Court's analysis, the Second Circuit emphasized that the proper standard for determining whether a prospectus statement is materially misleading is that "even if particular statements, 'taken separately, were literally true,' they are actionable if 'taken together and in context,' [they] would have misled a reasonable investor about the nature of the [securities]." *Id.* at *1. In this case, the District Court correctly determined that, taken as a whole, Defendants' disclosure of a significant decline in Pzena's AUM and the accompanying warning would have made a reasonable investor aware that investors were likely to withdraw assets from Pzena's funds. The Second Circuit also noted that Defendants' statement regarding the reopening of investment strategies did not misstate the general investment risk that remained, because Defendants disclosed that the primary reason for reopening was an overall increase in '"investable universes'" and was not predicated on Pzena's general investment success. *Id.* at *2.

4. The Second Circuit also found unpersuasive Plaintiffs' argument that Defendants failed to disclose a materially adverse business trend when they failed to publicize investors' net redemptions. Defendants fulfilled their prospectus disclosure obligations regarding this fact when they disclosed the market-depreciation-driven decline in Pzena's AUM and warned that such a development could result in investor withdrawals.

C. *Avon Pension Fund v. GlaxoSmithKline PLC*, No. 08-4363, 2009 WL 2591173 (2d Cir. Aug. 24, 2009)

1. Appeal of an order by the District Court (S.D.N.Y.) dismissing Plaintiffs' putative class action complaint alleging securities fraud by GlaxoSmithKline ("GSK") under §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5 for nondisclosure of alleged cardiovascular risks associated with the drug Avandia. The Second Circuit affirmed the dismissal, concluding that Plaintiffs failed to adequately plead (1) Defendants' duty to disclose the risks of the drug, because the research reporting the risks was not sufficiently conclusive, and (2) scienter.

2. The Second Circuit held that drug "test results must yield reliable evidence of a drug's adverse effect" to give rise to a duty to disclose. *Id*. at *1. Here, the Complaint alleged that the drug "showed an estimate" of an '"increased risk of heart attack.'" *Id.* Yet Plaintiffs failed to plead any facts indicating that the test results were statistically significant, and, in fact, Plaintiffs acknowledged evidence that the relevant research "presented inconsistent data with regard to the potential cardiovascular risk of Avandia." *Id.* Such inconclusive research results, even if not disclosed by Defendants, cannot be deemed misleading or material, and thus the Defendants could not have a duty to disclose any such information. *Id.*

Third Circuit

A. *Inst'l Investors Group v. Avaya, Inc*., 564 F.3d 242 (3d Cir. Apr. 30, 2009)

1. Appeal of an order by the District Court (D.N.J.) dismissing putative class action claims under §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Shareholders alleged that Defendants made misleading statements about growth potential and pricing pressure by denying unusual price competition and resulting discounts Avaya was giving and by issuing allegedly baseless, impossible financial projections given the price competition. The District Court granted Defendants' motion to dismiss, holding that the statements at issue were either forward looking, and thus protected by the safe harbor, or not actionably false; with regard to the remaining claims, Plaintiffs failed to sufficiently allege scienter. The Third Circuit affirmed in part and reversed in part and remanded for further proceedings. The Third Circuit held that Plaintiffs sufficiently pled that Defendants' pricing-pressure statements were actionably false and that, as to these statements, there was a strong inference of the CFO's scienter. The Third Circuit also held that statements that the company was '"on track'" and that results '"position us'" to meet goals were forward looking and qualified for the protection of the safe harbor. *Id.* at 254-56.

2. The present part of a mixed present/future statement is not entitled to the protection of the safe harbor. However, the language that Defendants were '"on track'" to meet its future goals and that first quarter results '"position us'" to meet projected goals cannot meaningfully be distinguished from the future projection, and thus, are protected by the safe harbor. *Id.* The language "does not advert to a particular current fact such as cash on hand, but

expresses only defendants' continuing comfort with the earlier, October annual projection, which they were then reiterating; that is, it amounts in essence to a reaffirmation of that projection." *Id.* at 256. Further, Plaintiffs have not sufficiently pleaded a strong inference that Defendants acted with actual knowledge in order to defeat the safe harbor.

Fifth Circuit

A. *Lormand v. US Unwired, Inc.*, 565 F.3d 228 (5th Cir. Apr. 9, 2009)

1. Appeal of an order by the District Court (E.D. La.) dismissing putative class action claims under §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Plaintiffs alleged that they bought the common stock of Defendant US Unwired at artificially inflated prices due to Defendants' material misrepresentations. The District Court dismissed the claims, holding that some of the statements at issue were protected by the PSLRA's safe harbor for forward-looking statements and that Plaintiffs failed to sufficiently allege loss causation. The Fifth Circuit reversed in part and remanded for further proceedings. It held that the safe harbor did not apply because Plaintiffs alleged that Defendants had actual knowledge of the statements' falsity. It also held that there was a duty to disclose certain developments in their business which Defendants knew to be detrimental to future cash flow. Finally, it held that Plaintiffs sufficiently alleged loss causation with regard to one misrepresentation, but not with regard to the other.

2. US Unwired is an affiliate of Sprint. Sprint offered three types of affiliations, with the differences between the affiliations revolving around the amount of control the affiliate maintained over its customer base, customer billing and general operations. During the time frame at issue, Sprint allegedly began exerting pressure on US Unwired to change its affiliation level so that Sprint could have more control over US Unwired's operations. Sprint allegedly threatened US Unwired with excessive fines and reduced access to technology if US Unwired did not agree. Maintaining control over its customer base and billing was essential to US Unwired's business plan. Nevertheless, ultimately, Sprint allegedly forced US Unwired to change its affiliation level. At the same time, Sprint began an initiative to increase its customer base by targeting subprime credit class customers. US Unwired had previous experience with this customer group and knew that it would be detrimental to its business. Despite alleged internal memos and

emails regarding the well-known feeling within the company about these new programs, US Unwired did not reveal its opinion of how the change in affiliation level or the subprime credit customers initiative would affect its business. Instead, it supported these programs before the public. Plaintiffs alleged that US Unwired misled the public by concealing material facts of which it was aware, i.e., that Sprint was forcing US Unwired to change its affiliation level and to enlist credit-risky subscribers.

3. Because Plaintiffs adequately allege that Defendants knew that their statements were false when made, the safe harbor does not apply. Furthermore, the statements at issue were not accompanied by "meaningful cautionary language." *Id.* at 244. Boilerplate, generic warnings are not sufficient. Instead, "[e]ach statement that benefits from the safe harbor must be addressed individually." *Id.* at 245. In this case, the disclaimer, "only with slight variations, was used in conjunction with each alleged misrepresentation the district court exempted from analysis under the safe harbor provision." *Id.* "The generic language is merely a 'litany of generally applicable risk factors' applied as boilerplate to every alleged misrepresentation." *Id.*

4. "The omission of a known risk, its probability of materialization, and its anticipated magnitude, are usually material to any disclosure discussing the prospective result from a future course of action." *Id.* at 248. In this case, the total mix of information was misleading, as it was skewed toward the positive affects of a Type II affiliation and the potential customer growth from the new initiative. This was not an accurate depiction of management's true feelings about these programs. Thus, there was a duty to disclose, and the failure to do so is a material omission.

Sixth Circuit

A. *Ind. State Dist. Council of Laborers and Hod Carriers Pension and Welfare Fund v. Omnicare, Inc.*, 583 F.3d 935 (6th Cir. Oct. 21, 2009)

1. Appeal of the District Court's (E.D. Ky.) dismissal of Plaintiffs' class action claims under §§ 10(b) and 20(a) of the Exchange Act, Rule 10b-5, and § 11 of the Securities Act against Defendant Omnicare, a pharmaceutical care provider, and its officers and board members. Plaintiffs alleged four general categories of fraud claims: (1) misrepresentations about Omnicare's readiness for the new

Medicare Part D program; (2) the nondisclosure of an ongoing contract dispute with United Health Group ("UHG"); (3) GAAP violations that inflated Omnicare's revenue; and (4) false assurances of legal compliance with certain drug repackaging and recycling programs. The Sixth Circuit affirmed the dismissal of the Exchange Act claims and reversed and remanded the dismissal of the Securities Act claim.

2. With regard to the UHC dispute, Plaintiffs fail to explain why Omnicare had a duty to disclose the dispute. Plaintiffs' claim that the statement that "Omnicare's revenue and earnings growth outlook remains positive" is misleading given the dispute is wrong. The statement at issue is forward looking and thus entitled to safe harbor protection. Furthermore, this type of rosy affirmation commonly heard from management is too vague to be considered material.

3. Omnicare's claims of legal compliance are not actionable. A company's opinion about the legality of its own actions is considered "soft" information. *Id.* at 945. Furthermore, the complaint does not sufficiently allege that Omnicare knew that its legal compliance claim was false. Finally, Omnicare did not have a duty to disclose its illegal operations based upon its compliance claim. "[T]he materiality of the alleged omission derives solely from predictions regarding the actions of third parties, particularly whether fines or other sanctions would be brought based on findings of regulatory violations. This information is 'soft,' and no disclosure is required despite the generalized claim of 'legal compliance.'" *Id.* at 947.

Ninth Circuit

A. *Sherman v. Network Commerce Inc.*, No. 06-35575, 2009 WL 3017297 (9th Cir. Sept. 22, 2009)

1. Appeal of an order of the District Court (W.D. Wash.) dismissing Plaintiffs' Complaint alleging violations of § 11 of the Securities Act. The Ninth Circuit affirmed in part and reversed in part, and remanded to the District Court for further proceedings consistent with its opinion.

2. Plaintiffs alleged that Defendant, Network Commerce Inc. ("NCI"), failed to disclose a $52,912.50 loan made to its CEO in registration statements accompanying NCI's IPO and follow-up offering. The District Court held that Defendant had filed a Form 4, which placed Plaintiffs on inquiry notice, thereby starting the one-year statute of limitations and time-barring Plaintiffs' Complaint. The Ninth Circuit, noting that it could affirm "on any ground supported by the record," affirmed on the ground that the loan was of such small value as to be not material. *Id.* at *1.

3. Plaintiffs also alleged that Defendant did not disclose a compensation plan for senior executives. Citing Rule 8(a), the Ninth Circuit held that Plaintiffs failed to plead any facts detailing the "plan" beyond its "unadorned allegation." *Id.* Further, even if Plaintiffs' allegations had been more specific, they would still fail to state a claim because Defendant's statements to investors that it retained broad discretion in the use of its proceeds were sufficiently specific and cautionary to be protected by the bespeaks caution doctrine and the statutory safe harbor.

4. Plaintiffs also alleged that Defendant failed to disclose two loans in excess of $1 million each. Because the District Court did not address this particular claim, the Ninth Circuit remanded, instructing the District Court to consider this last claim.

B. *Siracusano v. Matrixx Initiatives, Inc.*, 585 F.3d 1167 (9th Cir. Oct. 28, 2009)

1. Appeal of an order by the District Court (D. Ariz.) granting Defendant Matrixx Initiatives Inc.'s ("Matrixx's") motion to dismiss Plaintiffs' claims under §10(b) of the Exchange Act and Rule 10b-5. The Ninth Circuit reversed and remanded.

2. Plaintiffs commenced a class action against Matrixx and three of its executives, alleging that Matrixx violated the Exchange Act by failing to disclose that Zicam Cold Remedy, a main product of Matrixx's subsidiary Zicam LLC, causes anosmia, a loss of smell. Plaintiffs alleged that the Matrixx securities traded at artificially inflated prices during the class period as a result of the materially false and misleading statements and failure to disclose adverse information about Zicam. Matrixx did not reveal the possibility of Zicam-related product liability suits in several press releases and financial statements during this period, and Matrixx debunked the possibility of a relationship between Zicam and anosmia in a press

release after a Dow Jones report was published alleging that the FDA was investigating the issue. Matrixx stock prices plummeted after a February 2004 *Good Morning America* segment aired mentioning several pending lawsuits related to Zicam.

3. The Ninth Circuit rejected the District Court's use of the "statistical significance" standard to conclude that Plaintiffs failed to allege "material misrepresentation" based on the number of complaints. *Id.* at 1178. "The Supreme Court has rejected the adoption of a bright-line rule to determine materiality because '[t]he determination [of materiality] requires delicate assessments of the inferences a "reasonable shareholder" would draw from a given set of facts and the significance of those inferences to him.'" *Id.* The Ninth Circuit explained that in relying on the statistical significance standard, the District Court decided an issue that should be left to the trier of fact. The Ninth Circuit examined the alleged facts and concluded that the allegations were sufficient to meet the pleading requirements of the PSLRA.

Falsity and Particularity

Second Circuit

A. *Panther Partners Inc. v. Ikanos Commc'ns, Inc.*, No. 08-3398, 2009 WL 2959883 (2d Cir. Sept. 17, 2009)

1. Appeal of an order by the District Court (S.D.N.Y.) dismissing Plaintiff's amended complaint with prejudice, denying leave to amend the complaint, and denying a motion for reconsideration. The Second Circuit affirmed in part, vacated in part, and remanded.

2. Plaintiff alleged that Ikanos Communications ("Ikanos"), along with various directors and underwriters, negligently made false statements in connection with its IPO and a secondary offering in violation of §§ 11, 12, and 15 of the Securities Act. The District Court granted Defendant's motion to dismiss.

3. The Second Circuit held that the District Court may have erred in requiring Plaintiff to allege facts with more particularity than required by *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007). Whereas the District Court suggested that Plaintiff needed to allege exactly when Ikanos knew the exact failure rate of certain chips produced by it, the Second Circuit held that it would be sufficient for Plaintiff to allege that that Ikanos knew of abnormally high failure rates before it published a registration statement with its secondary offering. Although the District Court may have applied the wrong standard, the District Court's dismissal of the amended complaint was ultimately proper because Plaintiff's allegations failed to meet the plausibility standard. The Second Circuit remanded on the grounds that leave to amend anew might not be futile.

B. *Furher v. Ericsson LM Telephone Co.*, No. 09-0134, 2009 WL 3228895 (2d Cir. Oct. 8, 2009)

1. Appeal from a judgment of the District Court (S.D.N.Y.) granting Defendants' motion to dismiss. Plaintiffs sued Defendants Ericsson LM Telephone Company ("Ericsson"), Carl-Henric Svanberg ("Svanberg"), and Karl-Henrik Sundstrom alleging violations of §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The District Court dismissed the Complaint, finding that Plaintiffs failed to plead facts sufficient to demonstrate that Defendants had made any false or misleading statements or that such allegedly false statements had been made with a reckless disregard for the truth sufficient to establish scienter. The Second Circuit affirmed the dismissal.

2. Plaintiffs alleged that Ericsson's CEO, Svanberg, made false and misleading statements during an analysts and investors conference, focusing on statements which, Plaintiffs contended, "conveyed the impression that third-quarter results would only be down slightly from second-quarter results." *Id.* at *1. The Second Circuit agreed with the District Court's findings that Plaintiffs had taken the statements out of context and that the statements were not misleading when considered in light of the analysts' questions and the full context of the discussion.

Third Circuit

A. *Inst'l Investors Group v. Avaya, Inc.*, 564 F.3d 242 (3d Cir. Apr. 30, 2009)

1. Appeal of an order by the District Court (D.N.J.) dismissing putative class action claims under §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Shareholders alleged that Defendants made misleading statements about growth potential and pricing pressure by denying unusual price competition and resulting discounts Avaya was giving and by issuing allegedly baseless, impossible financial projections given the price competition. The District Court granted Defendants' motion to dismiss, holding that the statements at issue were either forward looking, and thus protected by the safe harbor, or not actionably false; with regard to the remaining claims, Plaintiffs failed to sufficiently allege scienter. The Third Circuit affirmed in part and reversed in part and remanded for further proceedings. The Third Circuit held that Plaintiffs sufficiently pled that Defendants' pricing-pressure statements were actionably false and that, as to these statements, there was a strong inference of the CFO's scienter. The Third Circuit also held that statements that the company was '"on track'" and that results '"position us'" to meet goals were forward looking and qualified for the protection of the safe harbor. *Id.* at 254-56.

2. The Third Circuit examined the state of the law with regard to confidential witnesses in light of the *Tellabs* case. "The PSLRA imposes a particularity requirement on all allegations, whether they are offered in support of a statement's falsity or of a defendant's scienter. In the case of confidential witness allegations, we apply that requirement by evaluating the 'detail provided by the confidential sources, the sources' basis of knowledge, the reliability of the sources, the corroborative nature of other facts alleged, including from other sources, the coherence and plausibility of the allegations, and similar indicia.' If anonymous source allegations

are found wanting with respect to these criteria, then we must discount them steeply. This is consistent with *Tellabs's* teaching that 'omissions and ambiguities count against inferring scienter' under the PSLRA's particularity requirements. If on the other hand, a complaint's confidential witness allegations are adequately particularized, we will not dismiss them simply on account of their anonymity." *Id.* at 263.

3. In this case, the confidential witnesses' anecdotal accounts of the deep discounting and the falsity of the March projections are sufficiently particularized to meet the PSLRA standard. On the other hand, the facts alleged relating to the other, earlier forecasts are insufficient.

Fifth Circuit

B. *Brunig v. Clark*, 560 F.3d 292 (5th Cir. Feb. 17, 2009)

1. Appeal of an order by the District Court (S.D. Tex.) dismissing Plaintiff's RICO and securities fraud claims under § 12(2) of the Securities Act and § 10(b) of the Exchange Act. Plaintiff, an attorney, brought claims to recover legal fees owed, part of which took the form of a percentage interest in one of Defendants' oil and gas leases. Plaintiff alleged that Defendants deceived him as to the nature of the interest. Indeed, Plaintiff was surprised to learn that his interest required him to pay certain operating expenses for the leases. The Fifth Circuit affirmed the dismissal of the § 12(2) claim, holding that it only applies to initial public offerings or sales made to the public, which this was not. The Fifth Circuit reversed and remanded as to the dismissal of the § 10(b) claim, holding that Plaintiff pled the claim with sufficient particularity.

2. The Fifth Circuit agreed with the District Court that the Complaint was "unartful and prolix," *id.* at 296, but held that the Complaint did explicitly allege misstatements and omissions attributable to Defendants. The Fifth Circuit also held that, based on the nature of the interest assigned to Plaintiff, Defendants "were either aware of the possibility that [Plaintiff] would have to make cash payments or severely recklesness [sic] in not realizing this possibility." *Id.* As such, there was a strong inference that Defendants acted with the requisite state of mind.

Seventh Circuit

A. *Beck v. Dobrowski*, 559 F.3d 680 (7th Cir. Mar. 20, 2009)

1. Appeal of an order by the District Court (N.D. Ill.) dismissing Plaintiff's derivative claims under § 14(a) of the Exchange Act and SEC Rule 14a-9, 17 C.F.R. § 240.14a-9, which forbid material misrepresentations or omissions in soliciting a shareholder's proxy vote. Plaintiff also brought a state law claim. Plaintiff, a shareholder of a real estate investment trust ("REIT"), alleged that the trust's directors made false statements in solicitation of a shareholder proxy vote on the proposed sale of the REIT. The District Court dismissed the federal claims as not meeting the requirements of the PSLRA and the state claim on the basis of abstention. The Seventh Circuit did not adopt the reasoning of the District Court but affirmed.

2. Plaintiff's allegations revolve around shareholder proxy solicitations that were circulated in connection with a private equity bidding war over the sale of Equity Office Property, of which Plaintiff was a shareholder. The ultimately winning bid included a steep termination fee, which greatly increased the premium that the competing bidder would have had to pay to produce an attractive counter-bid. Plaintiff alleged that there was impropriety with respect to the termination fee. Indeed, the losing bid was for a greater total value (although less cash, as the Court pointed out) than the winning bid.

3. The Seventh Circuit rejected the claim, explaining that the mere fact that there was a high termination fee cannot support a claim under § 14(a). The fee was disclosed. Thus, there was no misrepresentation, as required to maintain a claim under § 14(a).

4. The fact that the losing bid was for a greater value than the winning bid does not prove that the shareholders, who approved the deal, were misled. The winning bid contained more cash and thus less risk than the losing bid. "A suit of this kind if it succeeded would place corporate management on a razor's edge." *Id.* at 684. Indeed, "there is nothing in the complaint to suggest that any shareholder was misled or was likely to be misled" by any lack of information. *Id.* at 685.

5. Plaintiff also argued that there was insufficient time (six days) between the mailing of the last proxy solicitation and the shareholder meeting. "[T]hat is not a rule for a court to impose. It is a matter for the SEC to consider if it wants, because it involves a delicate tradeoff best confided to specialists in the securities markets." *Id.*

6. While the Seventh Circuit agreed that the PSLRA applies to claims brought under § 14(a), it explained that "Section 14(a) requires proof only that the proxy solicitation was misleading, implying at worst negligence by the issuer." *Id.* at 682.

Eighth Circuit

A. *In re 2007 Novastar Fin. Inc., Sec. Litig.*, 579 F.3d 878 (8th Cir. Sept. 1, 2009)

1. Plaintiff investor appealed the dismissal of its consolidated securities fraud class action against corporation Novastar and its officers and directors. Novastar originates, purchases, invests in and services residential mortgages. Plaintiff brought this class action after Novastar's announcement that it expected to earn far less income than it had originally expected. The 104-page Complaint alleged that Novastar made misleading statements about the financial health of the company, violating §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The Eighth Circuit affirmed.

2. The Complaint described the alleged deterioration of Novastar and included extensive excerpts from Novastar's SEC filings. The Complaint did not, however, identify what specific statements are alleged to be false or misleading. Plaintiff tries to remedy this shortcoming on appeal, identifying specific statements as false in the briefing. "Identifying specifically the false or misleading statements for the first time on appeal, however, does not excuse a litigant's failure to comply with the pleading requirements under the PSLRA." *Id.* at 883. For this reason, the Complaint fails to meet the requirements of the PSLRA.

3. The District Court denied Plaintiff's motion to amend the Complaint. Although leave to amend shall be freely given, there is no absolute right to amend. In order to preserve the right to amend, the plaintiff

must submit the proposed amendment along with the plaintiff's motion. *Id.* at 884. Plaintiff failed to submit a proposed amendment in this case. Thus, the Eighth Circuit affirmed the District Court's denial of leave to amend.

Ninth Circuit

A. *Rubke v. Capitol Bancorp, Ltd.*, 551 F.3d 1156 (9th Cir. Jan. 13, 2009)

1. Appeal of an order by the District Court (N.D. Cal.) dismissing with prejudice the Complaint of minority shareholders of Napa Community Bank ("NCB") against controlling stockholder Capitol Bancorp, Ltd. and its president and CEO for alleged violations of § 11 of the Securities Act and §§ 10(b) and 14(e) of the Exchange Act in connection with a tender offer. The Ninth Circuit affirmed the dismissal based on Plaintiffs' failure to plead with the level of particularity required by Fed. R. Civ. P. 9(b) and the PSLRA.

2. Plaintiffs' claims were based on allegedly misleading statements in fairness opinions, in the registration statement, and in telephone conversations between a board member of NCB and the minority shareholders allegedly pressuring the minority shareholders to accept the tender offer.

3. With respect to the fairness opinions, the Ninth Circuit held that such opinions can only give rise to a claim under § 11 where the complaint alleges with particularity that the statements were both objectively false and misleading. Thus, the Complaint must allege that the Defendants believed that the proposed transaction was unfair. Plaintiffs' allegations, based on information and belief, that the Defendants should have known the transaction was unfair were insufficient.

4. The Ninth Circuit also rejected Plaintiffs' § 11 claim based on alleged misstatements and omissions in the registration statement. For example, Defendants were not required to include information about a similar transaction a year earlier because there was no indication that the alleged omission made any statement in the registration statement false or misleading. "Section 11 does not require the disclosure of all information a potential investor might take into account when making his decision." *Id.* at 1162-63. The Ninth Circuit also rejected Plaintiffs' "squabbles" with language in

the registration statement. For example, the registration statement stated that the controlling shareholder "believes that profitability will increase." The Ninth Circuit rejected Plaintiffs' claim that the statement violated § 11 because it failed to indicate the "extraordinary nature of NCB's growth." *Id.* at 1163.

5. With respect to the telephone conversations, each occurred after the registration statement became effective, and therefore could not form a basis for relief under § 11. *Id.* at 1164.

6. Plaintiffs' § 10(b) claims were based on the same statements as their § 11 claims were. "Because the inquiry into whether plaintiffs have pled falsity with the requisite particularity under the PSLRA is nearly identical" to that under Fed. R. Civ. P. 9(b), each of the claims, with the exception of the claims based on the postregistration telephone conversations, also failed under § 10(b). *Id.* at 1165.

7. With respect to statements during the telephone conversations, they were made by a board member of NCB, not by the controlling shareholder, and the Complaint failed to allege with particularity that the calls were made at the behest of the controlling shareholder. The only allegations concerning the controlling shareholder's involvement in these calls were based on information and belief without revealing the source of that information. In addition, the Ninth Circuit concluded, with brief analysis, that the Complaint did not adequately allege scienter under *Tellabs* as it merely stated that the controlling shareholder would benefit from the transaction.

8. Finally, the Ninth Circuit held that the falsity pleading requirements under § 14(e) are identical to those under § 10(b), and therefore affirmed the dismissal of those claims. *Id.* at 1167.

B. *In re FoxHollow Tech., Inc., Sec. Litig.*, No. 08-16469, 2009 WL 4913215 (9th Cir. Dec. 4, 2009)

1. Appeal of an order by the District Court (N.D. Cal.) dismissing Plaintiff's putative class action alleging that Defendant FoxHollow Technologies, Inc. ("FoxHollow") made various misrepresentations

in violation of §§ 10(b) and 20(a) of the Exchange Act[7] and Rule 10b-5. The Ninth Circuit affirmed.

2. Plaintiff claimed that Defendant had a duty to update certain statements it had made concerning the importance of certain senior executives, e.g., "[t]he loss of any of our senior management team could harm our business," in light of subsequent efforts to remove senior managers. *Id.* at *1. The Ninth Circuit determined that the statements at issue were not clear, factual, forward-looking statements that all senior management would be left in place, and therefore the statements could not support a fraud claim. The Ninth Circuit also held that although statements that the CEO was leaving for "personal reasons" were false, such statements are "ubiquitous and transparent" and reasonable people would not make investment decisions in reliance on them. *Id.* at *2. Finally, statements made by the interim CEO announcing things such as "I look forward to leading our outstanding group of senior management until we have named a replacement" were not in conflict with the fact that two out of seven senior managers were let go a month later. *Id.* As such, Plaintiff failed to adequately allege falsity.

Eleventh Circuit

A. *Ferrell v. Durbin*, 311 Fed. Appx. 253 (11th Cir. Feb. 9, 2009)

1. Appeal of an order by the District Court (S.D. Fla.) dismissing Plaintiffs' claims under the securities laws[8] and state and federal RICO statutes. The case arose out of a dispute between former owners of a hotel and resort. Among other things, Plaintiffs alleged that a joint owner improperly used a power of attorney to secretly sell one of the Plaintiff's interests in a property, and then violated a settlement agreement based upon this transgression. The Eleventh Circuit affirmed the dismissal.

2. The District Court held that Plaintiffs failed to state a claim upon which relief could be granted. On appeal, Plaintiffs merely recited the law and then, in one sentence, made a conclusory assertion

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[7] Some facts taken from underlying District Court opinion. *In re FoxHollow Tech., Inc., Sec. Litig.*, 2008 WL 2220600 (N.D. Cal. May 27, 2008).

[8] The precise statutory basis for the claims was unspecified in the appellate court opinion. The District Court opinion is not reported.

that the elements of their securities claim had been met. The Eleventh Circuit held that Plaintiffs had abandoned their claim for failure to present any argument in support thereof. Alternatively, it held that Plaintiffs failed to satisfy the particularity requirements of the PSLRA. The Eleventh Circuit chastised Plaintiffs for their "shotgun style pleading," noting that the Court is not "required to parse the complaint searching for allegations of misrepresentations that could conceivably form the basis of each of Appellants' claims." *Id.* at 259. Even after parsing Plaintiffs' complaint and construing the allegations in the light most favorable to Plaintiffs, the Eleventh Circuit found that the Complaint fails to state a claim.

Law-of-the-Case

Second Circuit

A. *Public Employees Retirement Assoc. of New Mexico v. PricewaterhouseCoopers LLP*, 305 Fed. Appx. 742 (2d Cir. Jan. 6, 2009)

1. Appeal of an order by the District Court (S.D.N.Y) denying Plaintiffs' motion to amend to include claims against Defendant auditor PricewaterhouseCoopers ("PWC"). Plaintiffs, investors of BISYS Group, Inc. ("BISYS"), brought a securities class action against BISYS and its independent auditor PWC, alleging violations of § 10(b) of the Exchange Act and Rule 10b-5. The District Court granted Defendant PWC's motion to dismiss for failing to plead scienter. Plaintiffs subsequently informed the District Court that they would not seek to amend their Complaint to include PWC and stipulated to the dismissal of claims against PWC with prejudice. Eleven months after the dismissal, Plaintiffs moved to amend their Complaint pursuant to Rule 15(a) to add PWC back in as a defendant based on "newly discovered evidence." *Id*. at 743. The District Court construed the request as a motion under Rule 54(b) to revise the dismissal, and denied the motion. The Second Circuit affirmed.

2. The Second Circuit reviewed the District Court's Rule 54(b) determination under the law-of-the-case doctrine, and found that its decision was "within a permissible range of decisions." *Id.* at 745. Under the law-of-the-case doctrine, a court has discretion to reexamine an issue upon which a ruling has already been made, but the doctrine is "informed principally by the concern that disregard of an earlier ruling not be allowed to prejudice the party seeking the benefit of the doctrine." *Id.* at 744.

3. The Second Circuit also upheld the District Court's denial for leave to amend under Rule 15(a)(2). The Second Circuit found that although a district court should freely give leave to amend, this liberal standard is not "carte blanche for a plaintiff to continually amend its pleadings," and district courts have discretion to deny leave for good reason. *Id.* at 745.

4. Under Rules 15(a) and 54(b), a court has discretion to deny motions upon a finding that undue prejudice would result from a grant thereof. The Second Circuit found no error in the District Court's determination that PWC would be unduly prejudiced if Plaintiffs were permitted to amend their complaint. Thus, the Second Circuit upheld the denial of Plaintiffs' motions.

Settlement

Second Circuit

A. *Gimbel v. UBS Fin. Servs., Inc.*, 309 Fed. Appx. 469 (2d Cir. Feb. 11, 2009)

1. Appeal of an order by the District Court (S.D.N.Y.) enjoining Plaintiffs from pursuing claims relating to a class action settlement. Plaintiffs, investors in WorldCom securities, attempted to bring suit against UBS Financial Services, Inc. ("UBS") (as successor to PaineWebber), which served as Plaintiffs' broker and financial advisor. Finding that Plaintiffs' claims were substantially similar to the claims brought in the WorldCom class action, the District Court enjoined Plaintiffs' suit. The Second Circuit affirmed.

2. The Second Circuit concluded that a broad reading of the release arising out of the WorldCom litigation was preferable in light of a well-known, $3.5 billion settlement. *Id.* at *2. All class members, including Plaintiffs, were on notice that all potential claims against UBS were contemplated by the settlement release.

3. "If the Claimants wished to bring their own separate claims against their broker for losses in their WorldCom trading, they could have opted out of the class action. If the Claimants wish today to bring a claim against their broker for unsuitable investment advice concerning investments other than WorldCom, they may do so. What they may not do is remain in the class action and try to pursue their own separate litigation over investment losses in the same securities." *Id.*

Sixth Circuit

A. *Gordon v. Dadante*, 336 Fed. Appx. 540 (6th Cir. July 14, 2009)

1. A subset of Plaintiffs from the underlying class action appealed the District Court's (N.D. Ohio) approval of a settlement agreement following Plaintiffs' allegations of violations of the Exchange Act, RICO and state securities laws by Defendant Ferris Baker. The Sixth Circuit affirmed the District Court's approval of the settlement.

2. The Sixth Circuit reviewed the decision to approve the settlement agreement for abuse of discretion. Despite Plaintiffs' argument that they should have had the right to conduct discovery on the value of the settlement, the record shows that the District Court was well informed as to the value of the settlement, including potential barred claims. The District Court was not obligated to explicitly consider the nine *Girsh* factors (*Girsh v. Jepson*, 521 F.2d 153 (3d Cir. 1975) (analyzing a class action settlement)) in analyzing the settlement. These factors are merely "relevant" to determining fairness. *Id.* at *8. Plaintiffs failed to show that the District Court undervalued their potential claims. Plaintiffs have no individual securities law claims against Defendants, as they cannot prove reliance. Indeed, Plaintiffs never consulted with Ferris Baker regarding their investments.

Eleventh Circuit

A. *In re Healthsouth Corp. Sec. Litig.*, 572 F.3d 854 (11th Cir. June 17, 2009)

1. Former chairman appealed District Court (N.D. Ala.) decision which issued a bar order contained in a partial final judgment approving a class action settlement agreement. Appeal arose from a partial settlement between Plaintiffs and HealthSouth Corp. in the HealthSouth securities fraud class action. Richard Scrushy, the former chairman and CEO of HealthSouth, is a nonsettling defendant and appeals the scope of the bar order, which extinguishes his contractual claims against HealthSouth for indemnification of settlement payments he might have to make to plaintiffs and his claims for legal defense costs. The Eleventh Circuit affirmed, holding that the bar order was not inconsistent with the PSLRA and provided adequate compensation to the chairman.

2. Scrushy argued that the mandatory contribution bar contained in the PSLRA – the prohibition against anyone who settles a case

under the PSLRA from then being sued for contribution by another party – is exclusive, and thus protects other claims (like a claim for indemnification) brought against those that settle a case under the PSLRA. The Eleventh Circuit held that the mandatory contribution bar in the PSLRA does not preclude a bar order containing a provision that would bar a potential indemnification claim. Nothing in the statute expressly or implicitly limits the bar to contribution. Indeed, the PSLRA was enacted in a climate of established case law which approved bar orders preventing indemnification claims. Further, the instant bar order includes as compensation to Scrushy a judgment credit that credits Scrushy $445 million against any future judgment that Plaintiffs might obtain against him. Thus, Plaintiffs receive nothing from Scrushy except to the extent a judgment against him exceeds this credit. The Eleventh Circuit found this credit to be more than adequate compensation.

3. Despite the fact that the money at issue is not paid directly to Plaintiffs, Scrushy's contractual claim against HealthSouth for advancement of legal fees is not an independent claim. Thus, it, too, can be precluded by the bar order.

B. *In re CP Ships Ltd. Sec. Litig.*, 578 F.3d 1306 (11th Cir. Aug. 13, 2009)

1. Class member and Plaintiff appeals from the District Court's (M.D. Fla.) order approving the settlement of a securities class action, alleging claims under §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The District Court dismissed the underlying claims for failure to plead scienter under the PSLRA. While an appeal from the dismissal was pending, the parties settled. The settlement class includes the claims of some foreigners, but excludes the claims of Canadians who purchased shares of Defendant CP Ships Ltd. on the Toronto Stock Exchange ("TSX"). Plaintiff is a Canadian citizen who purchased his shares of CP on the NYSE. Plaintiff argues that the District Court lacked subject matter jurisdiction over the claims of foreign investors or should have declined jurisdiction as a matter of comity, that the notice of the settlement was inadequate, and that the settlement was not fair or reasonable. The Eleventh Circuit affirmed.

2. Plaintiff raised a "facial" challenge to the Court's jurisdiction. *Id.* at 1311. A facial attack on the Complaint requires the Court merely to see if the Plaintiff has sufficiently alleged a basis of subject matter jurisdiction, taking the allegations of the Complaint as true. As set forth in the Complaint, substantial fraudulent activity occurred in the

United States, as CP's accounting office was located in Tampa, Florida. With respect to transnational securities frauds, the court asks: "(1) whether the wrongful conduct occurred in the United States," known as the "conduct test," and (2) "whether the wrongful conduct had a substantial effect in the United States or upon United States Citizens," known as the "effects test." *Id.* at 1313. "[T]he Complaint alleges ample facts sufficient to establish subject matter jurisdiction under the 'conduct test' over unnamed foreign class members who purchased on the TSX." *Id.* The conduct test is met "whenever (1) the defendant's activities in the United States were more than merely preparatory to a securities fraud conducted elsewhere and (2) the activities or culpable failures to act within the United States directly caused the claimed losses." *Id.*

3. Notice to class members of a proposed settlement must be "reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections." *Id.* at 1317. The Court found that the notice in this case was adequate.

4. Plaintiff argued that the settlement was not fair because the foreign class members have potential for greater recovery in the Canadian actions. "Any class member wishing to pursue the Canadian Actions could opt out of the instant settlement." *Id.* at 1318. The recovery in the Canadian Action is also speculative. Because there is no other allegation that the recovery is otherwise unfair, the District Court did not abuse its discretion in approving the settlement.

Sanctions

First Circuit

A. *Citibank Global Markets, Inc. v. Rodriguez Santana*, 573 F.3d 17 (1st Cir. July 17, 2009)

1. Appeal of an order by the District Court (D.P.R.) granting a motion to dismiss, but denying the motion for sanctions and fees. Account holder Rodriguez brought suit against Defendant over excess commissions charged in connection with his account. The parties settled the suit, and Defendant took steps to finalize an agreement.

This litigation spawned from conflict over the settlement agreement, which Rodriguez claimed was coerced and unfair. Defendant broker-dealer brought an action seeking a declaration that settlement was valid and moved for sanctions and attorneys' fees. The First Circuit affirmed, holding that the settlement was fair and valid and that the District Court did not abuse its discretion in denying sanctions.

2. In connection with its motion for sanctions, appellant broker-dealer argued that the case must be remanded for findings regarding compliance with Rule 11(b), as required by the PSLRA. 15. U.S.C. § 78u-4(c)(1). While there were securities claims in the original suit, all claims had been dismissed on state law grounds. The First Circuit explained that the PSLRA did not contain any exceptions to its requirement that a court make findings pursuant to Rule 11(b) as to any complaint raising a claim under the securities laws. Despite this, the First Circuit held that remand was not necessary. The District Court had already denied the broker-dealer's claim for attorneys' fees under a similar standard, and the First Circuit's review of the record did not suggest that the case was brought for improper purpose. "[A] remand for a Rule 11 determination is not necessary if the record provides no basis for awarding sanctions." *Id.* at 32.

Leave to Amend

Fourth Circuit

A. *Matrix Capital Mgmt. Fund, LP v. BearingPoint, Inc.*, 576 F.3d 172 (4th Cir. July 31, 2009)

1. Plaintiffs appeal from the District Court (E.D. Va.) decision dismissing their class action claims under §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Plaintiffs, shareholders of BearingPoint, alleged that BearingPoint made material misstatements in its financial statements. The District Court dismissed the claims in the First Amended Complaint with prejudice, holding that Plaintiffs failed to adequately plead scienter, and denied Plaintiffs' Rule 59(e) motion to alter or amend the judgment. The District Court gave special consideration to the new *Tellabs* decision. The Fourth Circuit affirmed the dismissal on the

basis of scienter, but reversed, vacated and remanded the decision as to the Rule 59(e) motion.

2. In denying Plaintiffs' leave to amend, the District Court made no determinations about prejudice, bad faith or futility, as required by Rule 15. Instead, the Court merely reiterated its reasons for dismissing the Complaint. This was an abuse of discretion. The Fourth Circuit held that there was no bad faith on Plaintiffs' part. The apparent delay in the case (which had been pending for over two years) was due to circumstances out of Plaintiffs' control. The case was delayed while Plaintiffs waited for Defendants to file certain delinquent financial statements and was stayed by the court during the pendency of the *Tellabs* decision. The added allegations in the proposed amended complaint appear to change the analysis, such that amendment is not futile. Finally, the filing of an amended complaint, which would merely add specificity to the scienter allegations, would not prejudice Defendants.

Eighth Circuit

A. *In re 2007 Novastar Fin. Inc., Sec. Litig.*, 579 F.3d 878 (8th Cir. Sept. 1, 2009)

1. Plaintiff investor appealed the dismissal of its consolidated securities fraud class action against corporation Novastar and its officers and directors. Novastar originates, purchases, invests in and services residential mortgages. Plaintiff brought this class action after Novastar's announcement that it expected to earn far less income than it had originally expected. The 104-page Complaint alleged that Novastar made misleading statements about the financial health of the company, violating §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The Eighth Circuit affirmed.

2. The Complaint described the alleged deterioration of Novastar and included extensive excerpts from Novastar's SEC filings. The Complaint did not, however, identify what specific statements are alleged to be false or misleading. Plaintiff tries to remedy this shortcoming on appeal, identifying specific statements as false in the briefing. "Identifying specifically the false or misleading statements for the first time on appeal, however, does not excuse a litigant's failure to comply with the pleading requirements under the

PSLRA." *Id.* at 883. For this reason, the Complaint fails to meet the requirements of the PSLRA.

3. The District Court denied Plaintiff's motion to amend the Complaint. Although leave to amend shall be freely given, there is no absolute right to amend. In order to preserve the right to amend, a plaintiff must submit the proposed amendment along with the plaintiff's motion. *Id.* at 884. Plaintiff failed to submit a proposed amendment in this case. Thus, the Eighth Circuit affirmed the District Court's denial of leave to amend.

Federal Preemption

Eighth Circuit

A. *Pet Quarters, Inc. v. Depository Trust and Clearing Corp.*, 559 F.3d 772 (8th Cir. Mar. 9, 2009)

1. Appeal of an order by the District Court (E.D. Ark.) dismissing Plaintiffs' state law claims as preempted. Plaintiffs consist of a pet supply business and several of its shareholders. Plaintiffs sued DTC and its subsidiaries under state law in Arkansas state court, alleging that a program created and operated by Defendants, the Stock Borrow Program, drove down the market price for Plaintiffs' shares and eventually put Pet Quarters out of business. The Stock Borrow Program allegedly allows "naked short selling," *id.* at 777, whereby a seller offers to sell a security which he does not own and has not arranged to borrow. The Program handles these naked short sales by borrowing shares from loaning members. Plaintiffs allege that this process creates "phantom shares" that dilute the value of the borrowed stock. The case was removed to federal court, where the District Court held that the removal was proper and that the claims were preempted by federal law. The Eighth Circuit affirmed the dismissal.

2. Removal was proper under § 1441, federal question jurisdiction. Plaintiffs' claims present a substantial federal question because they directly implicate actions taken by the Securities and Exchange Commission in approving the creation of the Stock Borrow Program.

3. Plaintiffs' state law misrepresentation claims regarding the program were also properly dismissed as preempted. The claims ask a state court to find that parts of the Stock Borrow Program conflict with the Commission-approved rules, that a program declared efficient in rules approved under federal law was not, that the operation of a Commission-approved program was illegal, and that the Commission-approved rules were invalid. "A favorable ruling on any [claim] would conflict with the Commission's control of the national securities clearing and settlement system and pose an obstacle to the congressional objectives in Section 17A." *Id.* at 780. Thus, the District Court was correct in dismissing the Complaint on the basis of preemption.

Securities Filings Requirements

Fifth Circuit

A. *Affiliated Computer Serv., Inc. v. Wilmington Trust Co.*, 565 F.3d 924 (5th Cir. Apr. 16, 2009)

1. Appeal of an order by the District Court (N.D. Tex.) granting Plaintiff's motion for summary judgment, issuing judgment in favor of Plaintiff. Plaintiff, an issuer of publicly traded notes, brought a declaratory judgment action seeking determination that it was not in default under its indenture agreement with Defendant for failure to timely file a Form 10-K with the SEC. The Fifth Circuit affirmed.

2. Plaintiff was unable to timely file its 10-K due to an ongoing internal investigation. Plaintiff eventually filed its 10-K with the SEC, and subsequently sent a copy of the report to Defendant. The indenture agreement at issue required Plaintiff to file with Defendant all SEC filings within 15 days after the same is filed with the SEC. Section 314 of the Trust Indenture Act ("TIA") has a similar requirement.

3. The TIA does not impose an independent obligation to file reports with the SEC, but rather requires the issuer to provide copies of reports that are actually filed with the SEC. The TIA does not independently impose any particular timetable for the filing of reports with the SEC. Therefore, Plaintiff did not violate the TIA.

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