

Morgan Lewis

review



2010 Year in Review:
Selected Federal Securities Litigation Developments

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Executive Summary

Morgan Lewis is pleased to present our third 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. Our review includes 55 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.¹

This year, the relevant cases address scienter, causation, reliance, class certification, materiality, SLUSA/CAFA, statutes of limitation, and several other miscellaneous topics.

In 2010, the Supreme Court continued its recent active trend of interpreting the securities laws, releasing two key decisions, *Merck & Co. v. Reynolds*, – U.S. –, 130 S. Ct. 1784 (Apr. 27, 2010) and *Morrison v. National Australia Bank Ltd.* – U.S. –, 130 S.Ct. 2869 (June 24, 2010).

Merck addressed the critical question of when the clock begins to tick on the statute of limitations for a 10b-5 action. While affirming the Third Circuit decision below, the Supreme Court rejected the inquiry notice standard applied by the appellate court, holding that the limitations period does not begin to run until a plaintiff discovers, or a reasonably diligent plaintiff would have discovered, the facts constituting the violation. Importantly, the Supreme Court held that the “facts showing scienter are among those that ‘constitut[e] the violation.’” 130 S. Ct. at 1796. The Supreme Court explained that it would “frustrate the very purpose of the discovery rule in this provision – which, after all, specifically applies only in cases ‘involv[ing] a claim of fraud, deceit, manipulation, or contrivance,’ §1658(b), – if the limitations period began to run regardless of whether a

¹ Cases containing significant discussions of more than one of the topics highlighted in this outline have duplicative listings under each relevant topic heading. We have not included decisions where securities law issues are neither central to the case nor analyzed in a substantive manner. Following this substantive review is a summary chart of the unreported appellate decisions under the securities laws. For a review of enforcement actions, please see Morgan Lewis’s 2010 Year in Review: SEC and SRO Selected Enforcement Cases and Developments Regarding Broker-Dealers.

plaintiff had discovered any facts suggesting scienter. So long as a defendant concealed for two years that he made a misstatement with an intent to deceive, the limitations period would expire before the plaintiff had actually 'discover[ed]' the fraud." *Id.* at 1797.

In *Morrison*, the Supreme Court rejected the "effects" and "conducts" tests used by the Second Circuit to determine the extraterritorial reach of the securities laws. Observing that § 10(b) "contains nothing to suggest it applies abroad," the Supreme Court held that § 10(b) only reaches "transactions in securities listed on domestic exchanges, and domestic transactions in other securities." 130 S.Ct. at 2873-74, 2881, 2884.

This Supreme Court will again weigh in this year. On January 10, 2011, the Supreme Court heard oral argument in *Matrixx Initiatives, Inc. v. Siracusano*, No. 09-1156. The question presented was whether a plaintiff can plead a claim for securities fraud based on a pharmaceutical company's nondisclosure of adverse events that are not scientifically significant. The argument addressed issues of materiality and scienter, and depending on the scope of the Court's opinion, it could affect companies outside of the pharmaceutical industry.

In addition, the Supreme Court granted certiorari in *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, 597 F.3d 330 (5th Cir. Feb. 12, 2010) *cert granted sub nom. Erica P. John Fund, Inc. v. Halliburton Co.*, – S.Ct. –, 2011 WL 47984, 78 U.S.L.W. 3702, 79 U.S.L.W. 3016 (Jan. 07, 2011) (No. 1403), presumably to address the extent to which loss causation must be established at the class certification stage.

Turning to the Circuit Courts, we identified four decisions focusing on scienter and, in each instance, the court concluded that allegations of scienter were insufficient. Of note, for the second time in three years, the Eleventh Circuit affirmed dismissal of an options backdating action where the aggregation of allegations was insufficient to raise an inference of scienter. *Edward J. Goodman Life Income Trust v. Jabil Circuit, Inc.*, 594 F.3d 783 (11th Cir. Jan. 19, 2010).

The Circuit Courts continue to examine the meaning of the dual-pronged statutory safe harbor for forward-looking statements. *Jabil* addressed the PSLRA safe harbor and concluded that allegations of actual knowledge are insufficient to overcome the statutory safe harbor if the challenged forward-looking statement is accompanied by meaningful cautionary language. Similarly, in *In re Cutera Sec. Litig.*, 610 F.3d 1103 (9th Cir. June 30, 2010), the Ninth Circuit found that allegations of actual knowledge could not overcome the safe harbor where the forward-looking statement was accompanied by meaningful cautionary language. In *Slayton v. Am. Express Co.*, 604 F.3d 758 (2d Cir. May 18, 2010), the

Second Circuit found that a statement was protected even though there was no meaningful cautionary language because plaintiffs failed to plead actual knowledge.

We continue to observe that claims against outside auditors are meeting with intense scrutiny. In *Louisiana Sch. Employees' Ret. Sys. v. Ernst & Young, LLP*, 622 F.3d 471 (6th Cir. Sept. 22, 2010), the Sixth Circuit found that allegations of scienter against the accounting firm were insufficient: "The standard of recklessness is more stringent when the defendant is an outside auditor. In that instance, recklessness requires a mental state 'so culpable that it approximate[s] an actual intent to aid in the fraud being perpetrated by the audited company'. . . . 'To allege that an independent accountant or auditor acted with scienter, the complaint must identify specific, highly suspicious facts and circumstances available to the auditor at the time of the audit and allege that these facts were ignored, either deliberately or recklessly.'" *Id.* at 479 (citations omitted).

In *Malack v. BDO Seidman, LLP*, 617 F.3d 743 (3d Cir. Aug. 16, 2010), the Third Circuit affirmed the denial of class certification based on a failure to establish predominance of reliance. In *Malack*, the defendant issued audit opinions for a subprime mortgage originator, whose notes were later deemed by the Plaintiffs to be "worthless." In doing so, the Third Circuit rejected Plaintiffs' argument that reliance should be presumed on a "fraud-created-the-market theory." *Id.* at 745.

Claims against outside counsel were similarly rejected on reliance grounds. In *Pacific Inv. Mgmt. Co. LLC v. Mayer Brown LLP*, 603 F.3d 144 (2d Cir. April 27, 2010), the Second Circuit affirmed the dismissal of a fraud claim against outside counsel that allegedly drafted false statements in connection with securities offerings. The "mere identification of a secondary actor as being involved in a transaction, or the public's understanding that a secondary actor 'is at work behind the scenes' are alone, insufficient. To be cognizable, a plaintiff's claim against a secondary actor must be based on that actor's own 'articulated statement,' or on statements made by another that have been *explicitly* adopted by the secondary actor." *Id.* at 155.

Similarly, in *Affco Inv. 2001, LLC v. Proskauer Rose, LLP*, 625 F.3d 185 (5th Cir. Oct. 27, 2010), plaintiffs were unable to demonstrate reliance on the outside law firm: "In short, Plaintiffs do not allege that they knew of Proskauer's role in the tax scheme during the relevant time period when they were making their investment decisions. In the absence of any such attribution to Proskauer, we find that Plaintiffs have failed to show reliance on Proskauer." *Id.* at 195.

Loss causation also continues to be a hot topic. In *In re Omnicom Group, Inc. Sec. Litig.*, 597 F.3d 501, 512 (2d Cir. Mar. 9, 2010), the Second Circuit held that

a “negative characterization of already-public information” does not constitute a corrective disclosure. Similarly, in *New York City Employees’ Ret. Sys. v. Jobs*, 593 F.3d 1018 (9th Cir. Jan. 28, 2010), analyzing loss causation under § 14(a), the Ninth Circuit rejected as “unsupported in caselaw” Plaintiff’s claim that dilution of their shares necessarily constitutes loss causation. *Id.* at 1024.

At the class certification stage, there is growing split amongst the Circuits as to how much must be proven by the Plaintiffs. In *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, 597 F.3d 330 (5th Cir. Feb. 12, 2010) (the subject of the cert petition described above), the Fifth Circuit, reaffirming its decision three years ago in *Oscar Private Equity Investments v. Allegiance Telecom, Inc.*, 487 F.3d 261 (5th Cir. 2007), concluded that loss causation must be established at the class certification stage. This is a “‘rigorous process’ and requires both expert testimony and analytical research or an event study that demonstrates a linkage between the *culpable* disclosure and the stock-price movement.” *Id.* at 341. In contrast, in *Schleicher v. Wendt*, 618 F.3d 679 (7th Cir. Aug. 20, 2010), the Seventh Circuit affirmed the certification of a class without proof of loss causation, holding that the Fifth Circuit’s reasoning in *Oscar*, goes too far, “reinterpreting Rule 23 to make likely success on the merits essential to class certification in securities-fraud suits.” *Id.* at 686.

With respect to materiality, the Ninth Circuit again recognized that corporate puffing should not be confused with a material misstatement. In *In re Cutera Sec. Litig.*, 610 F.3d 1103, 1111 (9th Cir. June 30, 2010) (mentioned above relating to the safe harbor), the Ninth Circuit held that “[w]hen evaluating corporations . . . investors do not rely on vague statements of optimism like ‘good,’ ‘well regarded,’ or other feel good monikers. This mildly optimistic, subjective assessment hardly amounts to a securities violation. Indeed, ‘professional investors, and most amateur investors as well, know how to devalue the optimism of corporate executives.’”

These cases, and many more, are discussed in detail below. As always, we welcome your feedback, and look forward to working with you this year.²

² This review was prepared by Morgan Lewis partners Brian Herman and John Vassos, of counsel Karen Pieslak Pohlmann, and associate Gayle Gowen with substantial assistance from senior paralegal Jan McGovern. This review is current as of December 31, 2010. Copyright 2011, Morgan, Lewis & Bockius LLP.

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For the purposes of the following 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. 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.

Sixth Circuit

- A. *Louisiana Sch. Employees' Ret. Sys. v. Ernst & Young, LLP*, 622 F.3d 471 (6th Cir. Sept. 22, 2010)
1. Appeal of an order of dismissal by the District Court (W.D. Tenn.). Shareholders of pharmaceutical distribution company Accredo Health, Inc. brought securities fraud class action against the company's auditor, Ernst & Young, LLP alleging violations of § 10(b) of the Exchange Act and Rule 10b-5. Shareholders alleged that the auditor issued a falsely positive audit of company Gentiva Health Services Inc., subsequently purchased by Accredo, causing Gentiva, and thus, Accredo, to overstate income by approximately \$58.5 million. The District Court dismissed the claims for failure to adequately allege scienter according to the standard set forth in *Tellabs* and denied leave to amend. The Sixth Circuit affirmed.
 2. The Sixth Circuit reiterated the heightened pleading required to establish scienter for an outside auditor. "The standard of recklessness is more stringent when the defendant is an outside auditor. In that instance, recklessness requires a mental state 'so culpable that it approximate[s] an actual intent to aid in the fraud being perpetrated by the audited company'. . . . To allege that an independent accountant or auditor acted with scienter, the complaint must identify specific, highly suspicious facts and circumstances available to the auditor at the time of the audit and allege that these facts were ignored, either deliberately or recklessly." *Id.* at 479 (citations omitted).
 3. Plaintiffs alleged that the auditor failed to follow professional standards regarding allowance for doubtful accounts because it used old or stale data in generating its opinion. Plaintiffs cited a worksheet that showed the auditor had access to more current data than that used in the audit. The Sixth Circuit found this allegation of an accounting error to be insufficient to create an inference of scienter.
 4. Plaintiffs also alleged that the auditor disregarded numerous red flags. The Sixth Circuit explained that, to create the necessary strong inference of scienter against an outside auditor, such red flags "must consist of an 'egregious refusal to see the obvious, or to investigate the doubtful.' Mere allegations that an accountant negligently failed to closely review files or follow [GAAP] cannot raise a strong inference of scienter." *Id.* at 482.
 5. The Sixth Circuit also rejected Plaintiffs' claim that the magnitude of the fraud supported an inference of scienter. "Allowing such an inference would eviscerate the principle that accounting errors alone cannot support a finding of scienter." *Id.* at 484.

6. Finally, Plaintiffs' allegation that the auditor was motivated to commit fraud based upon the promise of future fees in connection with a transaction also fails. The Complaint failed to allege that the fees in connection with this client were more significant than its fees from other clients.
7. The District Court properly denied leave to amend where Plaintiffs never formally sought leave to amend, except to ask the District Court to allow them the opportunity to move for amendment should it grant any portion of the motion to dismiss. Because Plaintiffs failed to follow the proper procedure under Rule 15(a), the District Court did not abuse its discretion by denying Plaintiffs an opportunity to amend its Complaint.

Eighth Circuit

B. *Detroit Gen. Ret. Sys. v. Medtronic, Inc.*, 621 F.3d 800 (8th Cir. Sept. 16, 2010)

1. Appeal of a District Court (D. Minn.) order dismissing class action claims under § 10(b) of the Exchange Act and Rule 10b-5 and denying Plaintiffs' right to amend the Complaint for futility. Shareholders alleged that Medtronic, Inc., a medical device manufacturer, and three of its officers made material misstatements and omissions regarding the efficacy of its defibrillator lead. The Eighth Circuit affirmed the dismissal, holding that Plaintiffs failed to sufficiently plead material falsity or omissions or to raise a strong inference of scienter, and that the proposed amendments would not cure the defects in the Complaint.
2. Medtronic designs, manufactures and markets the Fidelis lead, an FDA-approved medical device wire that connects a defibrillator to a patient's heart. On February 15, 2007, one doctor informed a vice-president at Medtronic that he was concerned about the failure rate of the Fidelis lead at his clinic and that he would no longer use the device. On February 27, 2007, the same doctor gave Medtronic a study he conducted and planned to publish regarding Fidelis lead's failure rate. On March 21, 2007, Medtronic issued a letter to doctors telling them that some clinics had reported higher than normal failure rates and that Medtronic was investigating the reports. The letter also explained that the failure rate may be related to doctor error and that the Fidelis lead performance and failure rate was in line with its other devices. In May 2007, Medtronic applied to the FDA to modify the design of the lead, and in July 2007, it announced that it had identified a problem with the device. Medtronic subsequently suspended sales and issued a recall, after which its stock price dropped more than 11%.
3. Plaintiffs claimed that Medtronic misled investors when it issued its March 2007 letter to doctors concerning the device as well as promotional statements and earning reports and projections.

4. The Eighth Circuit concluded that Plaintiffs failed to plead facts showing that any individual Defendant knew that statements issued by the company concerning the device were false when made. Likewise, Plaintiffs failed to sufficiently allege the collective scienter of Medtronic. The Eighth Circuit explained that “mere possession of uncollected data does not indicate Medtronic was aware of the implications of that data. The complaint itself alleges Medtronic was reviewing the tracking data and does not allege the reports were conclusive any earlier than the date on which Medtronic took action with respect to the Fidelis leads.” *Id.* at 809.
5. Plaintiffs sought to amend the complaint to add, among other things, allegations regarding four, as opposed to two, fracture sites on the Fidelis lead. Absent allegations that Medtronic knew that these fracture sites caused the failure rate of the device to exceed acceptable failure rates, however, such allegations are irrelevant. For this reason, leave to amend the complaint was appropriately denied.

Eleventh Circuit

C. *Edward J. Goodman Life Income Trust v. Jabil Circuit, Inc.*, 594 F.3d 783 (11th Cir. Jan. 19, 2010)

1. Appeal of an order by the District Court (M.D. Fla.) dismissing Plaintiffs’ class action claims under §§ 10(b), 14(a) and 20A of the Exchange Act and Rule 10b-5 against Jabil Circuit, Inc. and its officers and directors. Plaintiffs alleged that Jabil violated its stated policy requiring the exercise price of options to be “at least equal to fair market value” by issuing backdated stock options. The District Court dismissed the claims for failure to plead falsity, failure to raise a sufficient inference of scienter and failure to plead loss causation. The Eleventh Circuit affirmed the dismissal on the basis of lack of scienter.
2. The Eleventh Circuit concluded that Plaintiffs’ contention that the financial reports and policy statements were false is plausible, but that there is no plausible case of an intentional backdating scheme that can be constructed from the Complaint.
3. Turning to scienter, Plaintiffs alleged a number of facts raised a substantial inference of scienter including insider trades by Jabil officers during the class period, the insider status of each individual Defendants, financial benefits and motivation to artificially inflate the stock price, admitted GAAP violation, membership of several individual Defendants in the corporate committee that directed stock option grants, and the accounting expertise of several of the Defendants.
4. The Eleventh Circuit evaluated the aggregation of Plaintiffs’ allegations,

and concluded that the allegations were strikingly similar to those in *Rosenberg v. Gould*, 554 F.3d 962 (11th Cir. 2009), a similar options backdating case that was dismissed on scienter grounds. Plaintiffs alleged that Defendants, who had significant accounting expertise, were responsible for the stock option grants, which were later explained by the company as an accounting mistake. While the net income at issue on an annual basis was close to 50% of the company's net income, it was a small percentage of total revenue, and thus not helpful to Plaintiffs in the scienter analysis. While Plaintiffs did allege that Defendants violated GAAP provision APB 25, and that doing this is *per se* severe recklessness, Plaintiffs failed to allege that any Defendant had knowledge of the violation. Plaintiffs also cited an article in *The Wall Street Journal* as an ignored red flag, but the article at issue does not address Plaintiffs' specific allegations. Evidence of stock trades is also not meaningful, as Plaintiffs failed to set forth Defendants' trading history before the class period.

5. The Eleventh Circuit also rejected the insider trading claims because Plaintiffs failed to state which Defendant knew what information and why the information was material.

D. *Thompson v. Relationserve Media, Inc.*, 610 F.3d 628 (11th Cir. June 30, 2010)

1. Appeal and cross-appeal of an order by the District Court (S.D. Fla.) dismissing with prejudice a Second Amended Class Action Complaint and denying one Defendant's request for Rule 11 sanctions and attorney's fees. Plaintiff investors sued RelationServe Media, Inc. and eleven of its directors and employees, alleging violations of §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5 for failing to disclose that \$2,000,000 in stock had been privately offered for sale by unregistered brokers before the company went public. The District Court had also dismissed Plaintiff's state law claims without prejudice, explaining that it no longer had supplemental jurisdiction over the claims. The Eleventh Circuit affirmed the dismissal of Plaintiff's claims and vacated and remanded Defendant's motion for sanctions.
2. On May 24, 2005, Defendant RelationServe entered into an agreement with Summit Financial Partners, LLC whereby Summit sold shares of RelationServe through a private offering in exchange for its own shares of RelationServe stock and a seller's fee. On June 14, 2005, RelationServe filed a Form 10-QSB, indicating that Chubasco Resources Corp. had completed a reverse acquisition of RelationServe. On June 16, 2005, RelationServe disclosed its agreement with Summit. On June 30, 2005, RelationServe became a publicly traded company. The Second Amended Class Action Complaint alleged that RelationServe did not disclose that a broker was involved in the initial securities sale to hide the fact that RelationServe sold securities through unregistered brokers. Assuming all

facts as true, the shotgun-style claims were deemed by the District Court and the Eleventh Circuit as nonsensical and untrue under any rendition of the facts.

3. The Eleventh Circuit affirmed the dismissal, holding that the conclusory allegations were insufficient to establish a strong inference of the required scienter.

Second Circuit

- A. *Pacific Inv. Mgmt. Co. LLC v. Mayer Brown LLP*, 603 F.3d 144 (2d Cir. April 27, 2010)
1. Appeal of an order dismissing investors' securities fraud claims under §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5 against law firm and an individual lawyer that served as primary counsel for a failed brokerage firm. Investors alleged that the law firm and lawyer knowingly drafted false statements in certain security offerings that helped hide the brokerage firm's allegedly fraudulent loan transactions designed to hide the firm's uncollectible debt. While the documents at issue stated that Mayer Brown represented the brokerage firm, none of them specifically attributed any information to Mayer Brown or its lawyers. The District Court (S.D.N.Y.) dismissed the claims. The Second Circuit affirmed.
 2. The Second Circuit rejected the proposed "creator standard," which would hold a defendant liable for statements investors rely on regardless of attribution if he created the statement at issue. "[S]econdary actors can be liable in a private action under 10b-5 for only those statements that are explicitly attributed to them. The mere identification of a secondary actor as being involved in a transaction, or the public's understanding that a secondary actor 'is at work behind the scenes' are alone, insufficient. To be cognizable, a plaintiff's claim against a secondary actor must be based on that actor's own 'articulated statement,' or on statements made by another that have been explicitly adopted by the secondary actor." *Id.* at 155.
 3. The Second Circuit explained that its ruling was consistent with *Stoneridge* and its desire for a "bright-line" approach. *Id.* at 156. In this case, it is clear that there was no attribution of any of the statements at issue to the law firm or the individual lawyer, and thus dismissal was appropriate.
 4. The Second Circuit also rejected Plaintiffs' argument of scheme liability based on *Stoneridge*. Plaintiffs admit that they were unaware of Defendants' conduct or alleged scheme when they purchased the stock. Further, "the mere fact that the ultimate result of a secondary actor's deceptive course of conduct is communicated to the public through a company's financial statements is insufficient to show reliance on the secondary actor's own deceptive conduct." *Id.* at 159.

Third Circuit

B. *Malack v. BDO Seidman, LLP*, 617 F.3d 743 (3d Cir. Aug. 16, 2010)

1. Appeal of an order denying class certification of a putative class action for failure to show predominance on an issue of reliance. Plaintiff investors sued accounting firm BDO Seidman, which was responsible for issuing audit opinions for a subprime mortgage originator, whose notes were later deemed “worthless” during the subprime mortgage meltdown. Plaintiffs brought claims under § 10(b) of the Exchange Act and Rule 10b-5. The Third Circuit affirmed the order denying class certification.
2. On an issue of first impression for the Third Circuit, Plaintiffs argued that reliance should be presumed based upon the newly proffered “fraud-created-the-market” theory. *Id.* at 745. The theory posits that “the securities laws allow an investor to rely on the integrity of the market to the extent that the securities it offers to him for purchase are entitled to be in the market place. A presumption of reliance is established where a plaintiff proves that the defendants conspired to bring to market securities that were not entitled to be marketed.” *Id.* at 747-48. Thus, under this theory, a plaintiff must prove that the mere existence of the security resulted from a successful fraud on the investment community and that he/she purchased the security in reliance on the market.
3. “Critical to the fraud-created-the-market theory’s coherency is the assumption that it is reasonable for an investor to rely on a security’s availability on the market as an indication of its apparent genuineness.” *Id.* at 748. The Third Circuit held that this was not a reasonable assumption. It explained that all of the parties involved in bringing a security to market are self-interested to do so. Further, the SEC does not conduct merit regulation in its review of new securities. The SEC does not independently examine the truth of the disclosures in registration statements, but reviews the statements for their adequacy and clarity. Thus, the Third Circuit rejected the newly proffered theory, explaining that the “fraud-created-the-market theory lacks a basis in common sense, probability, or any of the other reasons commonly provided for the creation of a presumption.” *Id.* at 756.
4. The Third Circuit further held that the fraud-created-the-market theory runs contrary to Congress’ stated goal in the PSLRA of limiting frivolous securities litigation and to the policy expressed in *Stoneridge* of limiting the expansion of the private cause of action under § 10(b).

Fifth Circuit

- C. *Affco Inv. 2001, LLC v. Proskauer Rose, LLP*, 625 F.3d 185 (5th Cir. Oct. 27, 2010)
1. Appeal of an order dismissing claims against law firm alleging violations of RICO, §§ 10(b) and 20(a) of the Exchange Act, Rule 10b-5 and Texas state law. Investors sued over advice as to the validity of an alleged tax shelter scheme after the IRS investigated the scheme and found it illegal. The District Court (S.D. Tex.) dismissed the RICO and securities fraud claims and declined to exercise supplemental jurisdiction over the remaining claims. The Fifth Circuit affirmed the dismissal.
 2. The RICO claims are barred by the PSLRA, which bars civil RICO claims based upon predicate acts of securities fraud.
 3. The District Court held that the claim under § 10(b) fails because Plaintiffs did not adequately plead reliance as to law firm Proskauer Rose LLP. Plaintiffs had been sold the alleged tax scheme by an accounting firm that was to deliver legal opinions from “major national law firms” as to the scheme’s legitimacy. *Id.* at 188. Using a scheme liability theory, Plaintiffs alleged that Proskauer worked with the accounting firm to prepare opinions supporting the legitimacy of the alleged scheme. However, Plaintiffs did not allege that they knew of Proskauer’s alleged role before their actual investment, or that the accounting firm specifically identified Proskauer as being one of the firms that was to provide a legal opinion. The Fifth Circuit held that “explicit attribution is required to show reliance under section 10(b).” *Id.* at 194. “In short, Plaintiffs do not allege that they knew of Proskauer’s role in the tax scheme during the relevant time period when they were making their investment decisions. In the absence of any such attribution to Proskauer, we find that Plaintiffs have failed to show reliance on Proskauer.” *Id.* at 195.

Eleventh Circuit

- D. *Ledford v. Peeples*, 605 F.3d 871 (11th Cir. May 6, 2010)
1. 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. Plaintiffs petitioned for rehearing following an Eleventh Circuit decision affirming Defendant’s motion for summary judgment dismissing Plaintiffs’ claims and reversing the District Court’s (N.D. Ga.) refusal to grant sanctions against Plaintiffs’ attorneys under the PSLRA. *See Ledford v. Peeples*, 568 F.3d 1258 (11th Cir. May 22, 2009). Plaintiffs argued that

the Eleventh Circuit applied the wrong standard in reviewing the District Court's sanctions decision. The Eleventh Circuit granted the Petition in part and denied it in part.

2. Plaintiff DynaVision, owned a 50% interest in Signature Hospitality Carpets, LLC. DynaVision also had four co-Plaintiffs ("co-Plaintiffs"), who were shareholders of DynaVision. The other 50% owner, 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 thirty days to accept the offer or elect to purchase the offeror's interest at the same set price. 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 funds for 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.
3. 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. On the initial appeal, 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 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. The Eleventh Circuit also held that, given the frivolity of the claims under the PSLRA, the District Court erred in not awarding sanctions against Plaintiffs' attorney.
4. On rehearing, the Eleventh Circuit held that the District Court lacked jurisdiction to address the Count 1 claims (§§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5) of all Plaintiffs except for DynaVision, as DynaVision was the only Plaintiff that actually sold a security, as required to bring a cause of action under Rule 10b-5.
5. On rehearing, the Eleventh Circuit affirmed the prior decision that Plaintiffs failed to allege any reliance to sustain their claim.

Second Circuit

A. *In re Omnicom Group, Inc. Sec. Litig.*, 597 F.3d 501 (2d Cir. Mar. 9, 2010)

1. Investors brought a class action against Omnicom Group, Inc. and its managers, alleging that Defendants improperly accounted for a transaction in which Omnicom transferred certain failed Internet investments to a newly-formed entity owned by Omnicom, Seneca, thereby violating § 10(b) of the Exchange Act and Rule 10b-5. The District Court (S.D.N.Y) granted summary judgment in favor of Omnicom, holding that Plaintiffs failed to allege loss causation. The Second Circuit affirmed.
2. The transaction at issue, whereby certain soured investments were allegedly transferred to newly-formed Seneca, occurred in the first quarter of 2001. Several news articles reported on the transaction around that time, speculating that it was an attempt to shed certain depreciating assets. Despite this, Omnicom's stock never experienced a significant drop. On June 5, 2002, Omnicom disclosed that an individual had resigned from its Board without disclosing a reason why. On June 6, 2002, Omnicom's stock dropped as rumors circulated that *The Wall Street Journal* would be publishing a negative article about accounting at Omnicom. On June 12, 2002, *The Wall Street Journal* published an article that raised questions about the reason for the Board member's resignation, raised questions about Omnicom's general accounting practices, and referenced the 2001 Seneca transaction. Soon after this second article, Omnicom's stock dropped significantly.
3. The Second Circuit observed that information about the alleged use of the Seneca transaction as an accounting method to remove losses from Omnicom's books was known to the market one year before the stock price declined. "What [Plaintiffs have] shown is a negative characterization of already-public information." *Id.* at 512. This does not constitute a corrective disclosure, as required to show loss causation.
4. Plaintiffs also argued that, even if no new financial facts were revealed in June 2002, the Board Member's resignation and ensuing negative media attention were foreseeable risks of the fraudulent Seneca transaction and caused the temporary share price decline in June 2002. "The losses suffered by the class are, the argument goes, due to the materialization of that risk." The Second Circuit rejected this argument, explaining that it is always true that fraud can lead to resignations. Despite this, the "generalized investor reaction of concern [following the resignation] causing a temporary share price decline in June 2002, is far too tenuously connected-indeed, by a metaphoric thread-to the Seneca transaction to support liability." *Id.* at 514.

B. *Operating Local 649 Annuity Trust Fund v. Smith Barney Fund Mgmt. LLC*, 595 F.3d 86 (2d Cir. Feb. 16, 2010)

1. Appeal of an order of the District Court (S.D.N.Y.) dismissing class action claims under § 10(b) of the Exchange Act and Rule 10b-5 and breaches of fiduciary duty in violation of the Investment Company Act. Investors in mutual funds brought a class action alleging that Defendants failed to properly disclose an in-house fee arrangement with a newly created affiliate that improperly benefited the funds' management over the interests of funds' investors. The District Court dismissed the claims. The Second Circuit affirmed in part, vacated in part and remanded, holding that the investors sufficiently alleged a material representation and loss causation to support a claim under § 10(b). The Second Circuit affirmed the dismissal of the claim under the Investment Company Act.
2. Plaintiffs alleged that Smith Barney negotiated a contract for transfer agent services that "saddled" Smith Barney mutual funds with "excessive, misleadingly disclosed fees, a significant portion of which were, in essence, kicked back to a Smith Barney affiliate." *Id.* at 89.
3. The Second Circuit held that Plaintiffs adequately alleged loss causation. It explained that Plaintiffs alleged that the misrepresentations at issue "caused investors to make and maintain investments in Funds that were subject to excessive fees and expenses, and that the periodic deduction of those fees and expenses reduced the value of the investments over time." *Id.* at 96. These allegations of real losses are sufficient to support Plaintiffs' claim.

Fifth Circuit

C. *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, 597 F.3d 330 (5th Cir. Feb. 12, 2010)), *cert granted sub nom. Erica P. John Fund, Inc. v. Halliburton Co.*, --- S.Ct. ---- , 2011 WL 47984, 78 U.S.L.W. 3702, 79 U.S.L.W. 3016 (Jan 07, 2011) (No. 1403)

1. Appeal of an order by the District Court (N.D. Tex.) denying Plaintiff's motion for class certification in a class action against Halliburton and its CEO alleging claims under §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Plaintiff claimed that Halliburton made false statements about three areas of its business: its potential liability in asbestos litigation, its accounting of revenue in its engineering and construction business, and the benefits of a proposed merger. Plaintiff alleged that it was damaged when subsequent disclosures correcting the false statements caused a market decline. Plaintiff relied on the fraud-on-the-market theory, which assumes an efficient market such that all public information about a company is known to the market and reflected in its stock price. The

District Court denied class certification because it found that Plaintiff failed to prove loss causation, or that the corrected truth of the former falsehoods caused the stock price to fall. The Fifth Circuit affirmed.

2. A plaintiff must prove loss causation by a preponderance of all admissible evidence at the class certification stage. Thus, to have a class certified, a plaintiff must identify a corrective disclosure causing a decrease in stock price that is related to the alleged false positive statement made earlier, and show that it is more probable than not that it was this disclosure, and not an unrelated negative statement or occurrence, that caused the price decline.
3. Causation “requires the Plaintiff to demonstrate the joinder between an earlier false or deceptive statement, for which the defendant was responsible, and a subsequent corrective disclosure that reveals the truth of the matter, and that the subsequent loss could not otherwise be explained by some additional factors revealed then to the market.” *Id.* at 336.
4. The corrective disclosure must reflect part of the truth obscured by the alleged fraud. The District Court properly found that Plaintiff failed to identify disclosures that had a corrective effect (as opposed to just a negative effect, which is insufficient). Thus, a statement explaining the need to increase Halliburton’s asbestos reserve, without more, is not corrective, but merely an example of a company being wrong in a prior estimate. The same is true of statements reducing earnings due, in part, to lower than expected profits from certain business units or mergers.
5. The Fifth Circuit also explained that the “showing of loss causation is a rigorous process and requires both expert testimony and analytical research or an event study that demonstrates a linkage between the culpable disclosure and the stock-price movement.” *Id.* at 341. Thus, even if Plaintiff could say that the prior allegedly false statements were more than just erroneous expectations, Plaintiff failed to provide the required evidence to show that the stock movement was connected to the disclosure, and not some other piece of information. Plaintiff’s proffered expert testimony based on mere news commentary and analysts was rejected as “merely well-informed speculation.” *Id.* at 342.

Ninth Circuit

D. *New York City Employees’ Ret. Sys. v. Jobs*, 593 F.3d 1018 (9th Cir. Jan. 28, 2010)

1. Appeal of an order by the District Court (N.D. Cal.) dismissing Plaintiffs’ claims under §§ 14(a) and 20(a) of the Exchange Act based on allegedly

misleading statements in a proxy statement. The Ninth Circuit affirmed dismissal but remanded with leave to replead under § 10(b).

2. Individual shareholders of Apple Inc. filed a class action complaint alleging claims under §§ 10(b), 14(a) and 20(a) of the Exchange Act. Lead Plaintiff filed a consolidated amended complaint alleging direct claims under §§ 14(a) and 20(a) based on a proxy solicitation, and claims under state law for various disclosures, all arising out of alleged stock options backdating by Apple.
3. Plaintiff alleged that shareholders were injured through impairment of their right to a fully informed vote and dilution of shares. The District Court dismissed the §§ 14(a) and 20(a) claims with leave to amend solely to plead a derivative claim, and concluded that Plaintiff had waived its right to add a direct claim under § 10(b) because no such claim was included in the consolidated amended complaint.
4. The Ninth Circuit held that a claim by shareholders that they were deprived the right to a fully informed vote is a direct claim, not a derivative one. Nonetheless, Plaintiff must still allege economic loss. Plaintiff's claim of dilution as economic loss is "unsupported in case law" and, as the District Court recognized, "economic loss does not necessarily accompany dilution, so such conclusory assertions of loss are insufficient." *Id.* at 1024.
5. The Ninth Circuit further held that the District Court improperly concluded that Plaintiff waived the right to reassert a direct claim under § 10(b). "We have never held, however, that a plaintiff who omits previously dismissed claims from an amended complaint waives his right to reallege these claims in further amendments at the district court level. The district court's application of a waiver rule to the § 10(b) claim was an erroneous application of the law and, thus, an abuse of discretion." *Id.* at 1025.

E. *Miller v. Thane Int'l, Inc.*, 615 F.3d 1095 (9th Cir. Aug. 9, 2010)

1. Appeal of an order granting Defendants' motion for judgment after bench trial on claim under § 12(a)(2). Ninth Circuit affirmed District Court's (C.D. Cal.) grant of Defendants' motion for judgment on loss causation affirmative defense. This case was on appeal after remand from a prior appeal in which the Ninth Circuit reversed and remanded the entry of judgment for Defendants after a bench trial on materiality grounds. 519 F.3d 879 (2008).
2. When Thane International, Inc. merged with Reliant Interactive Media Corp., the merger agreement provided that Reliant shareholders would receive shares of Thane as payment and stated that Thane stock, which

was not previously publicly traded, had been approved for trading on the NASDAQ National Market System. However, after the merger was consummated, Thane shares traded on the NASDAQ Over-the-Counter Bulletin Board. For the first 19 days (12 trading days) after the merger, it traded at or above the “imputed merger price.”

3. The District Court found no causation since the price did not drop below the merger price for 19 days. Plaintiffs argued that the prior appeal foreclosed this result, but the Ninth Circuit rejected this argument, stating that materiality was different from causation. 615 F.3d at 1101-02.
4. Plaintiffs argued that the price was unreliable because the market was inefficient, *id.* at 1102-03, but the Ninth Circuit held that price may be used to show loss causation even in an inefficient market. The test is whether there was a full response to the information, not whether the factors of *Cammer v. Bloom*, 711 F. Supp. 1264, 1286-87 (D.N.J. 1989), are satisfied. “[A]n immediate response is not required for loss causation. Rather, the loss causation inquiry requires only a full response to the misrepresentation—one that is enough to assess whether the misrepresentation caused the plaintiffs’ loss. Significantly, a full response may occur in a market that is not *Cammer* efficient because ‘[e]ven an ‘inefficient’ market price is objective and contemporaneous with events, ‘chang[ing] in response to news, including statements by the [principals].’” 615 F.3d at 1103.
5. The Ninth Circuit also held that, under the clear error standard of review, the District Court’s conclusion that Plaintiffs failed to show causation was supported by substantial evidence, and the District Court’s determination that Defendants’ expert was credible was not erroneous.

F. *In re Oracle Corp. Sec. Litig.*, 627 F.3d 376 (9th Cir. Nov. 16, 2010).

1. Ninth Circuit affirmed several pre-trial rulings and grant of summary judgment in favor of Defendants by District Court (N.D. Cal.) in case involving claims of violations of §§ 10(b), 20(a) and 20(A) of the Exchange Act. Originally, the District Court had dismissed the complaint for failure sufficiently to allege scienter, but the Ninth Circuit reversed. 380 F.3d 1226 (9th Cir. 2004). “Copious discovery ensued.” 2010 WL 4608794 at *3.
2. Oracle Corporation (“Oracle”) missed its third quarter 2001 earnings per share (“EPS”) forecast. Evidence showed that historically the majority of Oracle’s sales were in the final days of the quarter. Until approximately three weeks before the end of the quarter at issue, every internal forecast by Oracle showed it could meet its forecasts. Thereafter, the internal forecasts began to fluctuate. Earlier in the quarter, two Oracle executives had exercised and sold millions of options, but these sales predated the

first internal forecast showing a potential EPS lower than the guidance. After Oracle announced the earnings miss, litigation followed.

3. The District Court granted summary judgment in favor of Defendants, concluding that Plaintiffs failed to create a genuine issue of material fact as to whether the earnings forecast lacked a reasonable basis, whether several intra-quarter statements were false or misleading, whether the alleged loss was caused by misrepresentations regarding a software suite, and whether the alleged loss was caused by the alleged misrepresentation of 2Q01 earnings.
4. As to claims about a certain product suite or an alleged overstatement of 2Q01 earnings, the Ninth Circuit found the District Court did not err in concluding that Plaintiffs had not developed evidence to allow a jury to reasonably conclude that the purported misrepresentations were a substantial cause of the price decline. “Plaintiffs cannot prove loss causation because they have not developed evidence sufficient to allow a jury to reasonably conclude that Defendants' purported misrepresentations were a substantial cause of the decline of Oracle's stock price on March 2, 2001.” *Id.* at 388.
5. The Ninth Circuit rejected the assertion that loss causation can be proved by showing that the market reacted to the “impact” of the alleged fraud, e.g. the earnings miss; “[l]oss causation requires more than an earnings miss.” 2010 WL 4608794, at *10.
6. The Ninth Circuit found that Plaintiffs were unable to create a triable dispute that Oracle's share price dropped as a result of the market learning of the problems with the product or of the overstated 2Q01 earnings. This deficiency defeats both the Section 10(b) and 20A claims.

Eleventh Circuit

G. *Edward J. Goodman Life Income Trust v. Jabil Circuit, Inc.*, 594 F.3d 783 (11th Cir. Jan. 19, 2010)

1. Appeal of an order by the District Court (M.D. Fla.) dismissing Plaintiffs' class action claims under §§ 10(b), 14(a) and 20A of the Exchange Act and Rule 10b-5 against Jabil Circuit, Inc. and its officers and directors. Plaintiffs alleged that Jabil violated its stated policy requiring the exercise price of options to be “at least equal to fair market value” by issuing backdated stock options. The District Court dismissed the claims for failure to plead falsity, failure to raise a sufficient inference of scienter and failure to plead loss causation. The Eleventh Circuit affirmed the dismissal.
2. To sustain a claim under § 14(a), which prohibits false statements in proxy

solicitations, a plaintiff must show “that the proxy solicitation itself, rather than the particular defect in the solicitation materials, was an essential link in the accomplishment of the transaction.” *Id.* at 796. The transaction itself must have caused the injury. In this case, the injury was caused by the failure to follow company policy, not the policies approved by the proxy solicitations. The election of directors who failed to follow company policy only indirectly caused Plaintiffs’ loss. The decision to violate policy was not accomplished via proxy. Thus, Plaintiffs’ § 14(a) claim fails.

Third Circuit

A. *Malack v. BDO Seidman, LLP*, 617 F.3d 743 (3d Cir. Aug. 16, 2010)

1. Appeal of an order denying class certification of putative class action for failure to show predominance on issue of reliance. Plaintiff investors sued accounting firm BDO Seidman, which was responsible for issuing audit opinions for a subprime mortgage originator, whose notes were later deemed “worthless” during the subprime mortgage meltdown. Plaintiffs brought claims under § 10(b) of the Exchange Act and Rule 10b-5. The Third Circuit affirmed the order denying class certification.
2. On an issue of first impression for the Third Circuit, Plaintiffs argued that reliance should be presumed based upon the newly proffered “fraud-created-the-market” theory. *Id.* at 745. The theory posits that “the securities laws allow an investor to rely on the integrity of the market to the extent that the securities it offers to him for purchase are entitled to be in the market place. A presumption of reliance is established where a plaintiff proves that the defendants conspired to bring to market securities that were not entitled to be marketed.” *Id.* at 747-48. Thus, under this theory, a plaintiff must prove that the mere existence of the security resulted from a successful fraud on the investment community and that he/she purchased the security in reliance on the market. The Third Circuit rejected the newly proffered theory for proving reliance and thus, affirmed the District Court’s order denying class certification.

Fifth Circuit

B. *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, 597 F.3d 330 (5th Cir. Feb. 12, 2010)

1. Appeal of an order by the District Court (N.D. Tex.) denying Plaintiff’s motion for class certification in a class action against Halliburton and its CEO alleging claims under §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Plaintiff claimed that Halliburton made false statements about three areas of its business: its potential liability in asbestos litigation, its accounting of revenue in its engineering and construction business, and the benefits of a proposed merger. Plaintiff alleged that it was damaged when subsequent disclosures correcting the false statements caused a market decline. Plaintiff relied on the fraud-on-the-market theory, which assumes an efficient market such that all public information about a company is known to the market and reflected in its stock price. The District Court denied class certification because it found that Plaintiff failed to prove loss causation, or that the corrected truth of the former falsehoods caused the stock price to fall. The Fifth Circuit affirmed.

Seventh Circuit

C. *Schleicher v. Wendt*, 618 F.3d 679 (7th Cir. Aug. 20, 2010)

1. Appeal of an order of the District Court (S.D. Ind.) granting Plaintiffs' motion for class certification. Investors brought a securities fraud class action against corporation's managers based upon allegations of false statements made while corporation's stock price was declining. The false statements allegedly slowed the rate of the stock price decline. The Seventh Circuit affirmed.
2. The Seventh Circuit affirmed that the fraud-on-the-market presumption of reliance applies despite the fact that allegedly false statements acted to slow the rate of the stock price decline. The stock at issue was actively traded in an efficient market. The fact that the class includes short sellers is irrelevant to the analysis, as short sellers also rely on the market price in making their trades.
3. A court need not decide whether false statements materially affected a stock price before certifying a class. While "a court may take a peek at the merits before certifying a class, Szabo insisted that this peek be limited to those aspects of the merits that affect the decisions essential under Rule 23. . . . Under the current rule, certification is largely independent of the merits . . . , and a certified class can go down in flames on the merits." *Id.* at 685.
4. The Seventh Circuit rejected the reasoning in *Oscar Private Equity Investments v. Allegiance Telecom, Inc.*, 487 F.3d 261 (5th Cir. 2007), which held that plaintiffs must show loss causation, showing the market's reaction to the corrective disclosure, in order to certify a class under Rule 23. The Seventh Circuit held that *Oscar Private Equity* goes too far, "reinterpreting Rule 23 to make likely success on the merits essential to class certification in securities-fraud suits." *Schleicher*, 618 F.3d at 686. Likewise, plaintiffs need not show that the false statements or omissions are material as a precondition to certification. "Falsehood and materiality are issues on the merits; whether a statement is materially false is a question common to all class members and therefore may be resolved on a class-wide basis after certification." *Id.* at 687.

Second Circuit

- A. *Iowa Public Employees' Ret. Sys. v. MF Global, LTD.*, 620 F.3d 137 (2d Cir. Sept. 14, 2010)
1. Appeal from an order of the District Court (S.D.N.Y.) dismissing shareholders' class action for alleged misrepresentations in MF Global, LTD's prospectus and registration statement. Plaintiffs asserted claims under §§ 11, 12(a)(2) and 15 of the Securities Act. MF Global's market capitalization dropped in excess of \$1.1 billion after it was revealed that a broker evaded trading restrictions and lost \$141.5 million speculating in wheat futures. The Second Circuit affirmed in part and vacated and remanded in part.
 2. On appeal, the Second Circuit examined two categories of alleged misrepresentations and omissions. The first category concerned alleged exaggerations of MF Global's risk-management measures in its offering documents. The second category concerned alleged failures to disclose deficiencies in MF Global's controls of client accounts.
 3. As to the first category, the District Court erroneously applied the bespeaks caution doctrine where the prospectus "failed to disclose the material fact that [MF Global's] Risk Management System protocols and procedures . . . did not apply to the Company's employees . . . [when] trading for their own accounts." *Id.* at 142. This allegation concerns an omission of present fact, to which the doctrine does not apply. "Here, characterizations of MF Global's risk-management system—that the system was 'robust,' for example—invite the inference that the system will reduce the firm's risk. However, bespeaks caution does not apply insofar as those characterizations communicate present or historical fact as to the measures taken." *Id.* at 144. The Second Circuit remanded to the District Court to analyze the remaining allegations under this standard.
 4. The District Court also dismissed claims relating to the second alleged category of misstatements because the losses related to a non-client account, and thus are unrelated to statements about controls for client accounts. The Second Circuit disagreed, explaining that loss causation is not an element of Plaintiffs' claims but rather an affirmative defense. The incident, while relating to a non-client account, exposed internal control problems that affected both client and non-client accounts. On the other hand, the incident did not reveal, as Plaintiffs alleged, that "anyone with a password could access client accounts." *Id.* at 145. The Second Circuit affirmed the dismissal insofar as it related to allegations concerning access to accounts, but vacated and remanded insofar as it related to other allegations relating to failures in risk management.

B. *In re Morgan Stanley Info. Fund Sec. Litig.*, 592 F.3d 347 (2d Cir. Jan. 25, 2010)

1. Investors brought two class actions against mutual funds, funds' principal underwriter, funds' principal investment manager, funds' asset manager, holding company that was parent entity for certain defendants, and broker-dealers, alleging that funds' offering documents omitted or misstated certain material information about broker-dealers' operations and thus, violated §§ 11, 12(a)(2) and 15 of the Securities Act. The SEC submitted an amicus brief arguing that neither the Securities Act nor Form N-1A required the Defendants to disclose the information that Plaintiffs allege was omitted. The District Court (S.D.N.Y.) dismissed the claims, holding that Plaintiffs failed to identify unlawful omissions or misstatements in the funds' registrations statements. The Second Circuit affirmed.
2. The crux of Plaintiffs' complaint is that Defendants failed to disclose that the Morgan Stanley broker-dealers affiliated with the funds had internal conflicts of interest because the broker-dealers' compensation was based in part on the amount of money invested in the funds. Because the funds' managers relied on the stock research of these broker-dealers, the alleged conflict of interest supposedly increased the risk to investors purchasing shares of Morgan Stanley funds. Plaintiffs asserted that Defendants were required to disclose the conflict of interest in the funds' offering documents under Form N-1A and the Securities Act generally to avoid rendering the offering documents misleading.
3. Claims under §§ 11 and 12(a)(2) do not require scienter but do require an allegation of a misstatement or unlawful omission and materiality. This appeal relates only to the issue of omissions. The general instructions of Form N-1A did not require disclosure of information about the broker-dealer conflict of interest at issue. This Form is designed to provide general information about a fund for the average or typical investor and not supplemental disclosures beyond that required by the specific line items on the form.
4. Furthermore, the alleged conflict at issue was not required to be disclosed as a "principal risk" of the fund. *Id.* at 362. The Second Circuit found that there were insufficient allegations to show that the funds' managers pursued investment strategies designed to facilitate Morgan Stanley's generation of investment banking revenue. *Id.* Furthermore, Form N-1A does not require disclosure of general risks present throughout the markets or systemic risks. The pleadings do not allege that the fund managers breached their duty to investors by blindly following the potentially tainted recommendations of the broker-dealers.
5. Finally, failure to disclose the relationship between the broker-dealers and the fund managers did not render the offering materials misleading. Offering materials must be viewed holistically and in their entirety. The

offering document disclosure requirements do not require issuers to disclose “the entire corpus of their knowledge” or “the commonly understood risks associated with securities research.” *Id.* at 366.

C. *Operating Local 649 Annuity Trust Fund v. Smith Barney Fund Mgmt. LLC*, 595 F.3d 86 (2d Cir. Feb. 16, 2010)

1. Appeal of an order of the District Court (S.D.N.Y.) dismissing class action claims under § 10(b) of the Exchange Act and Rule 10b-5 and breaches of fiduciary duty in violation of the Investment Company Act. Investor in mutual funds brought class action alleging that Defendants failed to properly disclose an in-house fee arrangement with a newly created affiliate that allegedly improperly benefited the funds’ management over the interests of the funds’ investors. The District Court dismissed the claims. The Second Circuit affirmed in part, vacated in part and remanded, holding that investors sufficiently alleged a material representation and loss causation to support a claim under § 10(b). The Second Circuit affirmed the dismissal of the claim under the Investment Company Act.
2. Plaintiff alleged that Smith Barney negotiated a contract for transfer agent services that “saddled” Smith Barney mutual funds with “excessive, misleadingly disclosed fees, a significant portion of which were, in essence, kicked back to a Smith Barney affiliate.” *Id.* at 89.
3. The Second Circuit held that the allocation and explanation of certain fees associated with the funds, and not just their amount, was material to investors. Investors deserved to know the amount they were paying for transfer agent charges, especially when part of those charges went back to fund management. “In light of the importance the SEC attaches to the proper categorization of fees generally, and the importance Congress has attached to management fees in particular, we hold that defendant’s misrepresentations were material because there exists a substantial likelihood that a reasonable investor would consider it important that her fiduciary was, in essence, receiving kickbacks.” *Id.* at 95.

D. *Slayton v. Am. Express Co.*, 604 F.3d 758 (2d Cir. May 18, 2010) (en banc denied, July 23, 2010)

1. Appeal of an order by the District Court (S.D.N.Y.) dismissing claims pursuant to §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Plaintiffs alleged that American Express misled its investors as to the extent of its anticipated losses from its investment in high-yield debt securities. The District Court dismissed the claims, holding that certain claims were time-barred and dismissing the remaining claims for failure to state a claim. The Second Circuit vacated and remanded, holding that the

claims were not time-barred. 460 F.3d 215 (2006). On remand, the District Court dismissed the claims on different grounds, and the Second Circuit affirmed.

2. At issue on appeal is whether the statutory safe harbor applied to statements that total losses on investments are “expected to be substantially lower than in the first quarter.”
3. As a threshold matter, the Second Circuit determined that the statement at issue was a forward looking statement, included in the MD&A section of a Form 10-Q, rather than in the financial statement prepared in accordance with GAAP. *Slayton*, 604 F 3d at 767.
4. The Second Circuit then held that the statement was not accompanied by meaningful cautionary language. The cautionary language connected with the statement stayed the same over time despite the fact that American Express learned more about the stated risks. At the same time that American Express warned of “potential deterioration” of a certain investment sector, it knew of “actual deterioration” in that sector. *Id.* at 769. Indeed, it knew of a major and specific risk and did not give warning except for a very general, boilerplate statement that stayed the same over time. “[C]autionary language that is misleading in light of historical fact cannot be meaningful.” *Id.* at 770. Thus, the forward-looking statement is not protected by the cautionary meaningful language prong of the statutory safe harbor.
5. The Second Circuit did note, however, that there is a clear tension between the Conference Report accompanying the PSLRA, which makes clear that “it does not want courts to inquire into a defendant’s state of mind” in reviewing cautionary language, and the fact that cautionary language must be meaningful, which necessarily depends upon what defendant knew at the time. *Id.* at 771. It explained that “Congress may wish to give further direction on how to resolve this tension, and in particular, the reference point by which we should judge whether an issuer has identified the factors that realistically could cause results to differ from projections.” *Id.* at 772.
6. The Second Circuit then observed that the safe harbor requires dismissal if the plaintiffs do not “prove that the forward-looking statement ... was ... made or approved by [an executive officer] with *actual knowledge* by that officer that the statement was false or misleading.” *Id.* at 773. The Second Circuit held that Plaintiffs failed to show that the statement at issue was made with actual knowledge. “[B]ecause the safe harbor specifies an ‘actual knowledge’ standard for forward-looking statements, the scienter requirement for forward-looking statements is stricter than for statements of current fact. Whereas liability for the latter requires a showing of either knowing falsity or recklessness, liability for the former

attaches only upon proof of knowing falsity.” *Id.* Viewing the allegations holistically, the inference of scienter is not at least as compelling as any opposing inference of nonfraudulent intent. The Second Circuit concluded that circumstantial evidence of knowledge makes this a “close case,” but is not adequate. Thus, the statement at issue is protected by the statutory safe harbor, and the District Court properly dismissed the claim.

Third Circuit

E. *In re Aetna, Inc. Sec. Litig.*, 617 F.3d 272 (3d Cir. Aug. 11, 2010)

1. Appeal of an order of the District Court (E.D. Pa.) dismissing class action against medical insurance company. Investors brought claims under §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5, alleging that Aetna misled investors about a supposed pricing scheme to artificially inflate its stock. The District Court dismissed the claims, holding that the statements at issue were protected by the safe harbor as forward looking and immaterial as a matter of law. The Third Circuit affirmed.
2. The allegedly misleading statements at issue are generalized statements about “disciplined” pricing. *Id.* at 281. The term “disciplined” pricing refers to a policy of setting prices in relation to future medical costs, and thus is a form of financial projection. Therefore, statements about “disciplined” pricing fall within the safe harbor’s definition of forward-looking statements. Appropriate cautionary statements accompanied these statements.
3. The Third Circuit affirmed that the broad and general statements about a “dedication to disciplined pricing,” *id.* at 284, were immaterial as a matter of law.

Fifth Circuit

F. *Lone Star Fund V (U.S.), L.P. v. Barclays Bank PLC*, 594 F.3d 383 (5th Cir. Jan. 11, 2010)

1. Appeal of an order of the District Court (N.D. Tex.) dismissing claims of purchaser of mortgage-backed securities, under §§ 11, 12(a)(2) and 15 of the Securities Act, alleging that Defendant seller misrepresented the quality of the loans included in the purchased pool of loans. After purchasing, Lone Star discovered that many of the loans were delinquent, despite certain statements in the prospectus that implied that there would be no delinquent loans in Lone Star’s pool. The District Court dismissed the claims for failure to state a claim, and the Fifth Circuit affirmed.

2. The Fifth Circuit explained that the prospectus at issue must be read in its entirety. While there was an isolated statement in the prospectus stating that the mortgage should not be delinquent, this statement was qualified by other statements that explained that any loans discovered to be delinquent will be repurchased or replaced by seller. Thus, the fact that Plaintiff's initial bucket of loans included delinquent loans does not prove that there was a material misstatement, and the claims fail as a matter of law.

Eighth Circuit

G. *Detroit Gen. Ret. Sys. v. Medtronic, Inc.*, 621 F.3d 800 (8th Cir. Sept. 16, 2010)

1. Appeal of a District Court (D. Minn.) order dismissing class action claims under § 10(b) of the Exchange Act and Rule 10b-5 and denying Plaintiffs' right to amend the Complaint for futility. Shareholders alleged that Medtronic, Inc., a medical device manufacturer, and three of its officers made material misstatements and omissions regarding the efficacy of the company's defibrillator lead. The Eighth Circuit affirmed the dismissal, holding that Plaintiffs failed to sufficiently plead material falsity or omissions or to raise a strong inference of scienter, and that the proposed amendments would not cure the defects in the Complaint.
2. Medtronic designs, manufactures and markets the Fidelis lead, an FDA-approved medical device wire that connects a defibrillator to a patient's heart. On February 15, 2007, one doctor informed a vice-president at Medtronic that he was concerned about the failure rate of the Fidelis lead at his clinic and that he would no longer use the device. On February 27, 2007, the same doctor gave Medtronic a study he conducted and planned to publish regarding the Fidelis lead's failure rate. On March 21, 2007, Medtronic issued a letter to doctors telling them that some clinics had reported higher than normal failure rates and that Medtronic was investigating the reports. The letter also explained that the failure rate may be related to doctor error and that the Fidelis lead performance and failure rate was in line with its other devices. In May 2007, Medtronic applied to the FDA to modify the design of the lead, and in July 2007, it announced that it had identified a problem with the device. Medtronic subsequently suspended sales and issued a recall, after which its stock price dropped more than 11%.
3. Plaintiffs claimed that Medtronic misled investors when it issued its March 2007 letter to doctors concerning the device as well as promotional statements and earnings reports and projections.
4. While Medtronic's letter to its doctors failed to include specific information about failure rates and did say that failure rates might be related to doctor

error, this was not a material omission or misstatement. The letter also stated the Medtronic was in the process of investigating the reports of failures, which was true. Plaintiffs do not allege that Medtronic was aware that anything in the letter was actually false at the time it was made. Medtronic's omission of adverse data is not misleading if the data at issue is presented as inconclusive, which it was.

Ninth Circuit

H. *In re Cutera Sec. Litig.*, 610 F.3d 1103 (9th Cir. June 30, 2010)

1. Appeal of an order by the District Court (N.D. Cal.) dismissing Plaintiffs' class action claims under §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5 against Cutera, Inc. ("Cutera"), a medical laser device company, and certain of its officers. Plaintiffs alleged that Defendants provided false and misleading revenue statements and failed to disclose material information about the shortcomings of Cutera's sales staff. The District Court dismissed the complaint without prejudice, and the Ninth Circuit affirmed.
2. Cutera sells lasers and other related medical devices primarily through a direct salesforce. In late 2005, Cutera embarked on a strategy to market a lower-priced laser through junior sales representatives. In its January 2007 analyst call, Cutera stated that it did not get the productivity it expected from its junior sales staff, but nonetheless projected 25% growth in revenue. In April 2007, Cutera revised its projections downward, and subsequently announced revenue below that which was initially projected. These announcements were accompanied by stock price drops. *Id.* at 1106-07.
3. Based in part on information provided by confidential witnesses, Plaintiffs alleged that in January 2007, Cutera failed to adequately disclose the poor performance of the junior sales force, leading to an artificially inflated stock price.
4. The Ninth Circuit concluded that there was no material difference between the January and April disclosures concerning the weakness of the junior sales force. *Id.* at 1110. With respect to certain statements made by the company concerning "good" relations with its employees, the Ninth Circuit held that "[w]hen evaluating corporations . . . investors do not rely on vague statements of optimism like 'good,' 'well regarded,' or other feel good monikers. This mildly optimistic, subjective assessment hardly amounts to a securities violation. Indeed, 'professional investors, and most amateur investors as well, know how to devalue the optimism of corporate executives.'" *Id.* (citation omitted).

5. With respect to allegations about earnings projections, the Ninth Circuit concluded that they were protected by the PSLRA's safe harbor for forward looking statements. The Ninth Circuit rejected Plaintiffs' argument that the safe harbor may be overcome where there is a sufficiently strong inference of actual knowledge.
- I. *In re Oracle Corp. Sec. Litig.*, 627 F.3d 376 (9th Cir. Nov. 16, 2010).
1. Ninth Circuit affirmed several pre-trial rulings and grant of summary judgment in favor of Defendants by District Court (N.D. Cal.) in case involving claims of violations of §§ 10(b), 20(a) and 20(A) of the Exchange Act. Originally, the District Court had dismissed the complaint for failure sufficiently to allege scienter, but the Ninth Circuit reversed. *In re Oracle Corp. Sec. Litig.*, 380 F.3d 1226 (9th Cir. 2004). "Copious discovery ensued." 2010 WL 4608794 at *3.
 2. Oracle Corporation ("Oracle") missed its third quarter 2001 earnings per share ("EPS") forecast. Evidence showed that historically, the majority of Oracle's sales were in the final days of the quarter. Until approximately three weeks before the end of the quarter at issue, every internal forecast by Oracle showed it could meet its forecasts. Thereafter, the internal forecasts began to fluctuate. Earlier in the quarter, two Oracle executives had exercised and sold millions of options, but these sales predated the first internal forecast showing a potential EPS lower than the guidance. After Oracle announced the earnings miss, litigation followed.
 3. The District Court granted summary judgment in favor of Defendants, concluding that Plaintiffs failed to create a genuine issue of material fact as to whether the earnings forecast lacked a reasonable basis, whether several intra-quarter statements were false or misleading, whether the alleged loss was caused by misrepresentations regarding a software suite, and whether the alleged loss was caused by the alleged misrepresentation of 2Q01 earnings.
 4. The Ninth Circuit concluded that Plaintiffs failed to develop evidence that would allow a jury to reasonably conclude that the forecasts or intra-quarter statements constituted material misrepresentations because they could not show that the forecasts or statements lacked a reasonable basis. Plaintiffs cannot show that Defendants acted intentionally or recklessly. The Ninth Circuit reiterated that issuers need not reveal all internal projections. "We have previously said that issuers need not reveal all internal projections. *In re Stac Elecs. Sec. Litig.*, 89 F.3d 1399, 1411 (9th Cir. 1996) (citation omitted). Companies generate numerous estimates internally, and they may reveal the projection they think best while withholding others, as long as the projection revealed had a reasonable basis." *Id.* at 391.

Eleventh Circuit

J. *Edward J. Goodman Life Income Trust v. Jabil Circuit, Inc.*, 594 F.3d 783 (11th Cir. Jan. 19, 2010)

1. Appeal of an order by the District Court (M.D. Fla.) dismissing Plaintiffs' class action claims under §§ 10(b), 14(a) and 20A of the Exchange Act and Rule 10b-5 against Jabil Circuit, Inc. and its officers and directors. Plaintiffs alleged that Jabil violated its stated policy requiring the exercise price of options to be "at least equal to fair market value" by issuing backdated stock options. The District Court dismissed the claims for failure to plead falsity, failure to raise a sufficient inference of scienter and failure to plead loss causation. The Eleventh Circuit affirmed the dismissal.
2. Plaintiffs alleged that certain projections violated the Exchange Act because they were made with actual knowledge of their falsity. The Eleventh Circuit explained that the safe harbor provision of the PSLRA shields Defendants from liability even if Plaintiffs claim the forward-looking statement was made with actual knowledge of its falsity. "So long as the language accompanying the projections is meaningfully cautionary, the law requires us to be unconcerned with the speaker's state of mind at the time he makes the projections." *Id.* at 795.

K. *Badger v. Southern Farm Bureau Life Ins.*, 612 F.3d 1334 (11th Cir. July 30, 2010)

1. Shareholders brought derivative suit against insurance company after insurance company purchased debenture, which was selling company's (PSC's) primary asset, alleging violations of § 10(b) of the Exchange Act and Rule 10b-5 and Florida common law fraud. Shareholders of seller alleged that purchaser failed to disclose certain material facts about the debenture, which facts affected its value. After a jury found Defendant liable, the District Court (M.D. Fla.) denied Defendant's renewed motion for judgment as a matter of law and motion for a new trial. The Eleventh Circuit reversed and remanded.
2. During negotiations, the purchaser gave the seller an actuarial valuation it had commissioned of the debenture and stated that valuation represented "fair value." Shareholders of the seller brought a derivative action against the purchaser alleging that the valuation was misleading because it did not take account of certain leverage, and a jury found the purchaser liable in the amount of \$31.7 million. The Eleventh Circuit found the jury instructions flawed and reversed.

3. There can be no liability for failure to disclose a material fact under Rule 10b-5 in the absence of a duty to disclose. A duty arises both where the law imposes special obligations, as for accountants, brokers, and certain experts, and where a failure to speak would render the defendant's speech materially misleading. In this case, there was no special relationship between the purchaser and the selling company. Further, the only allegedly materially misleading statement was the purchaser's claim that the price for the debenture was fair. The jury instruction at issue was legally deficient, as it allowed the jury to find liability if the purchaser knew that material information was not disclosed without requiring a legal duty to disclose the information. Because the instruction "omitted the requirement that [the purchaser] must have had a legal duty to disclose material information to PSC shareholders in order to be held liable under Rule 10b-5 for withholding that information, the instruction contains an incorrect statement of the law." *Id.* at 1342.
4. The jury instruction was also improper because it imposed the duty to disclose the facts at issue directly to PSC shareholders, as opposed to PSC's officers or directors. "[C]ourts have uniformly declined to find a duty to disclose running from one party in an arm's-length securities transaction to the shareholders of the counter-party to the transaction, absent some fiduciary or other special relationship between them." *Id.* at 1343. There was no such special relationship in this case.
5. The evidence at trial showed that at least some of the alleged material omissions were known to PSC's attorney. Given that the duty to disclose ran to PSC's agents, and not its shareholders, these alleged omissions cannot form the basis of liability. The Eleventh Circuit also concluded that the case must be remanded because the jury's Special Interrogatories did not specify which omissions formed the basis for their verdict, and it is clear that at least some of the alleged omissions cannot support the verdict.

Second Circuit

A. *Romano v. Kazacos*, 609 F.3d 512 (2d Cir. June 29, 2010)

1. Appeal of order by the District Court (W.D.N.Y.) dismissing class action stating various state law claims based upon the alleged negligence of Morgan Stanley and certain of its employees for purportedly faulty advice in connection with Plaintiffs' retirement planning. Plaintiffs allege that they relied on supposedly faulty advice in electing to retire early, but were then surprised to find that they did not have sufficient funds to support their lifestyle. Defendants removed the action to federal court, and Plaintiffs moved to remand. The District Court dismissed the action. The Second Circuit affirmed based upon SLUSA's preclusion provision.
2. The Plaintiffs' Amended Complaint asserted claims for, among other things, negligence, breach of fiduciary duty, negligent misrepresentation and breach of contract. Plaintiffs maintain that, under the "master of the complaint" rule, they are free to avoid federal jurisdiction, and thus, SLUSA, by pleading only state law claims even if a federal claim is also available. *Id.* at 518. The Second Circuit rejected this assertion. Under the "artful pleading" rule, which applies to SLUSA, a plaintiff cannot avoid removal by declining to plead "necessary federal questions." *Id.* at 519. "If the artful pleading rule applies, courts look beyond the face of an 'artfully pled' complaint to determine whether plaintiff has 'cloth[ed] a federal law claim in state garb' by pleading state law claims that actually arise under federal law. If such is the case, the reviewing court will 'uphold removal even though no federal question appears on the face of the complaint.'" *Id.*
3. As to whether the action concerned "covered securities," it was permissible for the District Court to review account statements. *Id.* at 521.
4. As to whether SLUSA's "in connection with" element is satisfied, the alleged misrepresentation must "coincide" with plaintiff's purchase or sale of securities. *Id.* "The 'coincide' requirement is broad in scope." *Id.* The standard is met where the claims "turn on injuries caused by acting on misleading investment advice" or "induced" securities transactions. *Id.* at 522. Applying that standard, the Second Circuit held that the misrepresentations at issue here met this standard. The fact that Plaintiffs claimed they were seeking "only employment damages" and were not seeking damages related to the performance of investment, and the fact that the investments at issue were made 18 months after the alleged misrepresentation did not defeat the "in connection with" requirement in this case. *Id.* 523-24.

Sixth Circuit

B. *Demings v. Nationwide Life Ins. Co.*, 593 F.3d 486 (6th Cir. Feb. 3, 2010)

1. County Sheriff, who sponsored a deferred compensation plan for his employees, brought a class-action lawsuit individually and in his official capacity as sheriff on behalf of all public employees who sponsor such plans. Sheriff brought claims for unjust enrichment and breach of fiduciary duty based on the realization that the plan managing entity received revenue from the individual mutual funds in which the plan invested, and would only invest in such funds with such revenue-sharing payments. The District Court dismissed the claims as precluded by SLUSA. The Sixth Circuit affirmed.
2. After the District Court's dismissal of Plaintiff's original complaint under SLUSA, Plaintiff amended the complaint, conceding that his is a covered action under SLUSA, but alleging that the suit fits within SLUSA's state-actions exception, which exempts certain suits brought by "states, subdivisions thereof, and state pension plans." *Id.* at 490.
3. Relying on the plain language of SLUSA, the Sixth Circuit held that a county sheriff is not a state, political subdivision, or state pension plan on its own behalf. Further, Plaintiff did not bring this suit as a political subdivision "on its own behalf." *Id.* at 492. "The terms of the exception do not permit third-party suits on behalf of a plan, and we are given no reason to think that Congress meant to extend the exception to include such actions, contrary to the Act's plain terms." *Id.* Moreover, the Eleventh Circuit observed that the action was not brought on behalf of a "class comprised solely of other states, political subdivisions, or state pension plans that were named plaintiffs, and that had authorized participation in such actions." *Id.* at 493. Instead, Plaintiff tried to file a suit based upon a prospective, unnamed class, which falls outside of the state-actions exception.
4. In analyzing Plaintiff's claim, the Sixth Circuit traced the history of the state-action exemption to SLUSA. "This history confirms what the plain language of the exception explicitly conveys: that the exception applies only when there is a class of named plaintiffs who have authorized participation in the action. While this interpretation of the state-actions exception is admittedly quite narrow, such a reading is warranted. The state-actions exception was a narrow (and contentious) savings provision. As commentators correctly predicted when SLUSA was passed, '[i]n practice, the amendment is unlikely to be invoked with any frequency.'" *Id.* at 495 (citation omitted).

Seventh Circuit

C. *Lincoln Nat'l Life Ins. Co. v. Bezich*, 610 F.3d 448 (7th Cir. June 25, 2010)

1. Insured filed a class action lawsuit in Indiana state court against insurer for allegedly breaching the terms of certain variable life insurance policies. The insurer tried to remove the case to federal court (N.D. Ind.) pursuant to the CAFA, but the District Court remanded the case based upon CAFA's exception to federal jurisdiction for actions relating to securities, as defined by § 2(a) of the Securities Act. The insurer petitioned to appeal the remand, and the Seventh Circuit denied the petition and dismissed for lack of jurisdiction.
2. The variable life insurance policies at issue allow insureds to allocate money between a general account, which accumulates value from premium payments, and a separate investment account, whose value depends upon the performance of the investments selected. This investment account is registered with the SEC. The Seventh Circuit held that, despite the fact that the claim at issue was basically a contract claim on a life insurance policy, a variable life insurance policy is a security as defined by § 2(a) of the Securities Act. Every holder of the policies at issue owns an interest in something that gives the holder the right to purchase a security. Thus, the entire policy at issue is a security for CAFA purposes, and the exception to federal jurisdiction applies.

Supreme Court

A. *Merck & Co. v. Reynolds*, -- U.S. --, 130 S. Ct. 1784 (Apr. 27, 2010)

1. Appeal from the May 26, 2009 decision of the Third Circuit reversing and remanding the District Court's (D.N.J.) order granting Defendants' motion to dismiss. Plaintiff investors alleged that statements and omissions of Merck 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 § 20A of the Exchange Act, and Rule 10b-5. The District Court dismissed the claims as time-barred. The Third Circuit 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 Third Circuit explained that the events at issue did not suggest that Merck had acted with scienter, a necessary element of a § 10(b) claim. The Supreme Court affirmed, holding that the limitations period only begins to run once a plaintiff discovers, or a reasonably diligent plaintiff would have discovered, the facts constituting the violation.
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). As set forth by the Third Circuit, 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 150, 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.
3. The Supreme 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 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 show Merck's alleged state of mind or scienter, as required to maintain a claim under § 10(b). The Supreme Court held that the limitations period does not begin to run until the plaintiff discovers, or a

reasonably diligent plaintiff would have discovered, the facts constituting the violation, which includes discovery of scienter.

4. The Supreme Court explained that “[i]t would therefore frustrate the very purpose of the discovery rule in this provision – which, after all, specifically applies only in cases ‘involv[ing] a claim of fraud, deceit, manipulation, or contrivance,’ §1658(b), – if the limitations period began to run regardless of whether a plaintiff had discovered any facts suggesting scienter. So long as a defendant concealed for two years that he made a misstatement with an intent to deceive, the limitations period would expire before the plaintiff had actually ‘discover[ed]’ the fraud.” *Merck*, 130 S. Ct. at 1796. Thus, “facts showing scienter are among those that ‘constitut[e] the violation,’” *id.*, and a plaintiff’s claim cannot accrue before discovery of scienter takes place.
5. The Supreme Court rejected “inquiry notice” — the point at which the facts would lead a reasonably diligent person to investigate further — as the standard, explaining that it was inconsistent with the statute’s language that “‘discovery’ is the event that triggers the 2-year limitations period.” *Id.* at 1798. Whether or not the plaintiff actually investigates is irrelevant.

Ninth Circuit

Simmonds v. Credit Suisse Sec. (USA) LLC, -- F.3d --, 2010 WL 488449 (9th Cir. Dec. 2, 2010)

6. Appeal of an order by the District Court (W.D. Wash.) granting motion to dismiss filed by Defendants in fifty-four related actions in which Plaintiff brought shareholder derivative claims alleging that lead underwriters on initial public offerings (“IPOs”) coordinated their activities with officers and directors of issuing companies in violation of § 16(b) of the Exchange Act by engaging in “short swing” transactions. The Ninth Circuit affirmed in part, vacated in part and remanded.
7. With respect to the statute of limitations, the Ninth Circuit reversed the decision of the District Court that the actions were not timely. Specifically, the District Court dismissed the twenty-four actions not dismissed for failure to present an adequate demand letter (these defendants had not joined that motion) as untimely under §16(b)’s two year limitations period. Defendants argued that the limitations period began to run when plaintiff “knew or should have known” of the conduct at issue and that such knowledge occurred more than two years before the Complaints were filed. The Ninth Circuit rejected this approach and reaffirmed its earlier rulings that the limitations period of §16(b) begins to run when an insider discloses the transactions at issue by filing a disclosure statement under §16(a). Because Plaintiff alleged that the defendants did not file any §16(b) reports, the Ninth Circuit Court concluded that the claims were not time-barred.

Third Circuit

A. *Marion v. TDI Inc.*, 591 F.3d 137 (3d Cir. Jan. 4, 2010)

1. Appeal of an order by the District Court (E.D. Pa.) denying Defendants' motion for judgment as a matter of law. Plaintiff, Receiver for retail broker of CDs through which an alleged Ponzi scheme was run, brought suit against a securities firm, wholesale broker, its principal, and warehouse of CDs and its principal, claiming that they harmed the now bankrupt broker, Bentley Financial Services, Inc. ("BFS"), by saddling it with extra liability through its scheme. The Ponzi scheme was allegedly run and devised by Robert Bentley. Defendants were Ted Benghiat, who owned wholesale CD broker SFG Financial, Inc., securities firm Southeastern Securities, Inc. ("SSI"), and Joseph Marzouca. Marzouca was vice-president of a bank that warehoused CDs for SFG and served as custodian on many of BFS's CD sales. On at least one occasion, Benghiat and Marzouca allegedly helped Bentley develop a CD warehousing transaction to generate cash, which prolonged Bentley's Ponzi scheme. Plaintiff claimed that Defendants helped Bentley infuse cash into his operation, and that Benghiat failed to properly supervise Bentley's CD brokerage operation while he worked for SSI. Plaintiff brought a claim under § 20(a) of the Exchange Act for Bentley's violations of Rule 10b-5. The District Court entered a verdict in Plaintiff's favor and denied Defendants' motion for judgment as a matter of law. The Third Circuit reversed and remanded, holding that, while Receiver had standing to bring suit, the merits of its claims failed.
2. While § 20(a) could make Benghiat liable for Bentley's violations of Rule 10b-5, it could not make Benghiat liable to BFS, and thereby Plaintiff. For a secondary liability claim under § 20(a) to be appropriate, BFS must have a legitimate Rule 10b-5 claim against Bentley. BFS, however, could not show that its reliance on Bentley's alleged misstatement caused it harm. Instead, the harm to BFS was its liability to its investors due to Bentley's alleged fraud. "The liability section 20(a) imposes on 'controlling persons' is specifically liability to those 'to whom [the] controlled person is [also] liable.'" *Id.* at 152. Thus § 20(a) does not impose a duty on Benghiat to supervise Bentley and prevent fraud for the benefit of BFS.

Eighth Circuit

B. *Lustgraaf v. Behrens*, 619 F.3d 867 (8th Cir. Aug. 20, 2010)

1. Investors brought action against insurance agency, Kansas City Life

Insurance Co. (“KCL”) and Sunset Financial Services, Inc. (“Sunset”) for damages arising out of a Ponzi scheme devised by Byran Behrens, a registered representative of Sunset and general agent of KCL pursuant to § 20(a) of the Exchange Act. The District Court dismissed Plaintiffs’ claims and denied leave to file amended complaints. The Eighth Circuit affirmed in part and reversed in part, remanding to the District Court to resolve the issue of control person liability under applicable state law.

2. KCL is an insurance dealer, and offers investments through its wholly-owned subsidiary, Sunset. Behrens was President and CEO of 21st Century Financial Group, Inc., which Plaintiffs alleged he operated as an office of Sunset. He was also a registered representative of Sunset and a general agent of KCL. Plaintiffs invested with Behrens through another entity he operated. Rather than invest the monies, Behrens allegedly misappropriated the funds.
3. Plaintiffs sued Sunset, and also filed a Complaint against Sunset and later against KCL for federal and state control person liability and for common law secondary liability.
4. Focusing on the federal claims under § 20(a), the Eighth Circuit reiterated that “a plaintiff must prove: (1) that a ‘primary violator’ violated the federal securities laws; (2) that ‘the alleged control person actually exercised control over the general operations of the primary violator’; and (3) that ‘the alleged control person possessed-but did not necessarily exercise-the power to determine the specific acts or omissions upon which the underlying violation is predicated.’” *Id.* at 873-74.
5. Finding that a primary violation had been alleged, the Eighth Circuit turned to the second and third prongs, which are governed by ordinary notice pleading standards. As to Sunset, the claims are adequately pled. “[A]lthough Behren’s fraud did not take place through Sunset [but through another entity controlled by Behren’s], it is Sunset that effectively provided Behrens access to the markets, and Sunset that had the duty to monitor his activities.” *Id.* at 876. “[T]he involvement of a separate brokerage firm does not render inadequate an otherwise properly pleaded prima facie case for federal control-person liability. . . . Sunset had the responsibility to oversee Behrens's activity with respect to his actions as a registered representative.” *Id.*
6. In contrast, the Eighth Circuit concluded that control person liability is not appropriate as to KCL. While the facts show that KCL could have controlled Behrens, they do not show that KCL actually did control Behrens. Ability to control is legally insufficient under § 20(a). KCL was too far removed from the transactions at issue to impose control person liability under applicable state law. The Complaint failed to state a claim under the doctrine of apparent authority.

Ninth Circuit

C. *Ledford v. Peeples*, 605 F.3d 871 (11th Cir. May 6, 2010)

1. 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. Plaintiffs petitioned for rehearing following an Eleventh Circuit decision affirming Defendant’s motion for summary judgment dismissing Plaintiffs’ claims and reversing the District Court’s (N.D. Ga.) refusal to grant sanctions against Plaintiffs’ attorneys under the PSLRA. See *Ledford v. Peeples*, 568 F.3d 1258 (11th Cir. May 22, 2009). Plaintiffs argued that the Eleventh Circuit applied the wrong standard in reviewing the District Court’s sanctions decision. The Eleventh Circuit granted the Petition in part and denied it in part.
2. Plaintiff, DynaVision, owned a 50% interest in Signature Hospitality Carpets, LLC (“Signature”). DynaVision also had four co-Plaintiffs (“co-Plaintiffs”), who were shareholders of DynaVision. The other 50% owner, 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 thirty days to accept the offer or elect to purchase the offeror’s interest at the same set price. 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 funds for the purchase, 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.
3. 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. On the initial appeal, 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 in making their decision to sell their 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. The Eleventh Circuit also held that, given the frivolity of the claims under the PSLRA, the District Court erred in not awarding sanctions against Plaintiffs' attorney.

4. On rehearing, the Eleventh Circuit held that the District Court lacked jurisdiction to address the Count 1 claims (§§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5) of all Plaintiffs except for DynaVision, as DynaVision was the only Plaintiff that actually sold a security, as required to bring a cause of action under Rule 10b-5.
5. The District Court erred in not ordering sanctions on Plaintiffs' counsel for filing a Rule 10b-5 complaint on behalf of co-Plaintiffs. In this case, the District Court was obligated, but failed, to analyze the merits of each individual claim for each individual Plaintiff in its sanctions analysis. There was clearly no legal merit to the co-Plaintiffs' securities claims. The PSLRA "strips the district Court of its discretion to excuse a Rule 11 violation." *Id.* at 920. The Eleventh Circuit affirmed the District Court's decision that no sanctions were warranted against Plaintiffs.
6. Remand is required to determine whether Rule 11 sanctions are warranted against Plaintiffs' counsel as to Plaintiffs' other claims.

D. *Thompson v. Relationserve Media, Inc.*, 610 F.3d 628 (11th Cir. June 30, 2010)

1. Appeal and cross-appeal of an order by the District Court (S.D. Fla.) dismissing with prejudice Second Amended Class Action Complaint and denying one Defendant's request for Rule 11 sanctions and attorney's fees. Plaintiff investors sued RelationServe Media, Inc. and eleven of its directors and employees, alleging violations of §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5 for failing to disclose that \$2,000,000 in stock had been privately offered for sale by unregistered brokers before the company went public. The District Court also dismissed Plaintiffs' state law claims without prejudice, explaining that it no longer had supplemental jurisdiction. The Eleventh Circuit affirmed the dismissal of Plaintiffs' claims and vacated and remanded Defendant's motion for sanctions.
2. On May 24, 2005, Defendant RelationServe entered into an agreement with Summit Financial Partners, LLC, whereby Summit sold shares of RelationServe through a private offering in exchange for its own shares of RelationServe stock and a seller's fee. On June 14, 2005, RelationServe filed a Form 10-QSB, indicating that Chubasco Resources Corp. had completed a reverse acquisition of RelationServe. On June 16, 2005, RelationServe disclosed its agreement with Summit. On June 30, 2005, RelationServe became a publicly traded company. The Second Amended Class Action Complaint alleges that RelationServe did not disclose that a

broker was involved in the initial securities sale to hide the fact that RelationServe sold securities through unregistered brokers. The shot-gun style claims, assuming all facts as true, were deemed by the District Court and the Eleventh Circuit as nonsensical and untrue under any rendition of the facts.

3. On the issue of sanctions under Rule 11, the Eleventh Circuit held that the District Court's order denying sanctions was insufficient to permit meaningful appellate review. The PSLRA "mandates" sanctions for frivolous litigation. *Id.* at 636. It also mandates "specific findings regarding compliance by each party and each attorney representing any party with each requirement of Rule 11(b)." *Id.* Because the District Court's conclusory order denying sanctions failed to include such findings, the Eleventh Circuit vacated the District Court's order and remanded to the District Court for a more thorough analysis of the sanctions issue.

Supreme Court

- E. *Morrison v. National Australia Bank Ltd. – U.S. –*, 130 S. Ct. 2869 (June 24, 2010)
1. Foreign investors appealed dismissal of putative class action against Australian bank, its director, and certain executives of HomeSide Lending, Inc., a Florida mortgage servicing company owned by National Australia Bank Ltd. (“National”). Investors brought claims under §§ 10(b) and 20(a) of the Securities Act and Rule 10b-5, alleging that National made material misstatements when it overvalued HomeSide in its annual reports and other public documents. The District Court (S.D.N.Y) dismissed the claims for lack of jurisdiction. The Second Circuit affirmed, explaining that “[t]he acts performed in the United States did not ‘comprise the heart of the alleged fraud.’” *Id.* at 2876 (citing 547 F.3d 167, 175-76). The Supreme Court affirmed the dismissal.
 2. National Australia Bank is a public company, with ordinary shares traded on several foreign markets and ADRs traded in the United States. In February 1998, National acquired HomeSide. National subsequently determined that certain interest calculations related to HomeSide’s mortgage servicing business were incorrect, leading to write-downs of approximately \$2 billion by National. The value of National’s ordinary shares and ADRs subsequently dropped. Foreign Plaintiffs, on behalf of purchasers of foreign ordinary shares, and a domestic Plaintiff, on behalf of ADR purchasers, brought a class action in the District Court. The District Court dismissed the foreign claims for lack of subject matter jurisdiction and the domestic claims for failure to state a claim.
 3. The Supreme Court observed that, in examining the extraterritorial application of a statute such as § 10(b), the Second Circuit has applied an “effects test,” weighing “whether the wrongful conduct had a substantial effect in the United States or upon United States citizens,” and a “conduct test,” weighing “whether the wrongful conduct occurred in the United States.” The Supreme Court criticized this approach, noting that these tests were “not easy to administer.” *Id.* at 2879.
 4. The Supreme Court stated that “§ 10(b) contains nothing to suggest it applies abroad,” *Id.* at 2881 and that, “[w]hen a statute gives no clear indication of an extraterritorial application, it has none.” *Id.* at 2878.
 5. The Supreme Court held that the Exchange Act regulates not just deception in general, but deception in connection with purchases and sales of securities. Therefore, “it is in our view only transactions in securities listed on domestic exchanges, and domestic transactions in other securities, to which § 10(b) applies.” *Id.* at 2884.
 6. “This case involves no securities listed on a domestic exchange, and all aspects of the purchases complained of by those petitioners who still have live claims

occurred outside the United States.” *Id.* at 2888. Thus, Petitioners have failed to state a claim on which relief can be granted.

Demand

Ninth Circuit

A. *Simmonds v. Credit Suisse Sec. (USA) LLC*, -- F.3d --, 2010 WL 488449 (9th Cir. Dec. 2, 2010)

1. Appeal of an order by the District Court (W.D. Wash.) granting motion to dismiss filed by Defendants in fifty-four related actions in which Plaintiff brought shareholder derivative claims alleging that lead underwriters on initial public offerings ("IPOs") coordinated their activities with officers and directors of issuing companies in violation of § 16(b) of the Exchange Act by engaging in "short swing" transactions. The Ninth Circuit affirmed in part, vacated in part and remanded.
2. With respect to the District Court's decision that the Plaintiff had failed to present an adequate demand to each of the respective issuing companies before filing the lawsuits, the Ninth Circuit affirmed the District Court's decision (rendered in the thirty cases in which the issue was raised) and remanded those cases to be dismissed with prejudice. The Ninth Circuit agreed with the District Court's ruling that the demand letters sent were inadequate because they failed to adequately allege the wrong perpetrated and the legal action the shareholder wanted the board to take. In particular, Plaintiff's demand letters presented factual theories that varied significantly from the facts alleged in the Complaints. Furthermore, because the demand letters and the Complaints contained different factual assertions, the Ninth Circuit concluded that the letters failed to identify the legal action the shareholder wanted the board to take on the corporation's behalf.
3. The Court also rejected Plaintiff's attempt to raise demand futility on appeal, holding that the shareholder conceded demand was not futile by having submitted a demand to the board.

RICO

Ninth Circuit

B. *Rezner v. Bayerische Hypo-Und Verinsbank AG*, 2010 WL 5300803 (9th Cir. Dec. 28, 2010)

1. Appeal of an order of the District Court (N.D. Cal.) granting summary judgment in favor of Plaintiff as to RICO and state law claims. Plaintiff participated in a transaction allegedly designed to avoid payment of

federal income taxes. Plaintiff was subsequently audited, which resulted in the denial of Plaintiff's claimed capital losses. Plaintiff sued the entities that structured the transaction. The Ninth Circuit affirmed in part, reversed in part and remanded.

2. The Ninth Circuit held that the District Court did not err in determining that Plaintiff's claims were not preempted by the PSLRA. The Ninth Circuit stated that the transaction was not in connection with the purchase or sale of a security. Plaintiff's pledge of municipal bonds was insufficient because there were no allegations about any misrepresentations concerning the value of the securities. The misrepresentations related to the tax treatment of the underlying loan; "the securities were merely a happen-stance cog in the scheme." 2010 WL 5300803, at *5.
3. On the RICO and state law claims, the Ninth Circuit reversed the District Court's grant of summary judgment to Plaintiff because it held that Plaintiff could not show proximate cause based on Defendants' fraud against the United States. Because the grant of partial summary judgment on the state law claim was based on the conclusion that Defendants violated RICO, that holding was vacated.

Tenth Circuit

C. *Bixler v. Foster*, 596 F.3d 751 (10th Cir. Feb. 22, 2010)

1. Minority shareholders of mining company METCO sued the company's directors and lawyers alleging violations of RICO when Defendants arranged to transfer company assets to an Australian corporation with no return of stock compensation to the shareholders, as had been originally promised. The District Court (D.N.M.) dismissed the claim, holding that Plaintiffs lacked standing to bring the RICO claim on METCO's behalf and that the PSLRA precluded RICO claims based on securities fraud. The Tenth Circuit affirmed.
2. Plaintiffs' claim was essentially one for diminution of the value of their shares. In general, a claim for such damage to a corporation belongs to the corporation, not its shareholders. While there is an exception to this rule for shareholders that show a direct and personal interest in the claim, Plaintiffs failed to fall within this exception.
3. The PSLRA amended RICO such that "no person may rely upon any conduct that would have been actionable as fraud in the purchase or sale of securities to establish a violation of [RICO]." *Id.* at 759. Thus, this exception bars claims alleging fraud in connection with the sale or purchase of securities. In the case at hand, Plaintiffs alleged that Defendants defrauded them by preventing them from receiving certain

stock as provided in the transaction. The other predicate acts are also connected to this stock transaction at issue. Thus, Plaintiffs' claims cannot support a civil RICO claim.

Sarbanes-Oxley

Second Circuit

D. *Cohen v. Viray*, 622 F.3d 188 (2d Cir. Sept. 30, 2010)

1. Appeal from an order of the District Court (E.D.N.Y.) approving settlement of shareholder derivative litigation. The settlement included a provision releasing certain former officers from liability under § 304 of the Sarbanes-Oxley Act ("SOX"), which governs reimbursement by a CEO and CFO of bonus and incentive based compensation in the context of certain restatements. The Second Circuit vacated and remanded.
2. DHB Industries, Inc.'s stock price dropped following revelations that body armor manufactured by the company contained an alleged defect. Derivative and class action lawsuits were filed against DHB and certain of its former officers and directors. The actions were consolidated and settled.
3. The Department of Justice, in consultation with the SEC, intervened and objected to provisions in the derivative settlement releasing certain former officers from liability under § 304 and indemnifying them from liability they may incur under that provision. The District Court approved the settlement over the objections.
4. As a threshold matter, the Second Circuit, consistent with previous decisions in the Ninth Circuit and the D.C. Circuit, determined that § 304 does not contain a private right of action.
5. The Second Circuit held that the settlement's release from liability under § 304 violates both SOX and public policy because it would nullify the SEC's authority to enforce § 304. "In sum, companies themselves do not have the authority effectively to exempt persons from § 304 liability." *Id.* at 195. Thus, the order approving the settlement was vacated, and the case was remanded to the District Court for further proceedings.

Settlement

Ninth Circuit

- E. *In re Mercury Interactive Corp. Sec. Litig.*, 618 F.3d 988 (9th Cir. Aug. 18, 2010)
1. Appeal of an order of the District Court (N.D. Cal.) awarding Plaintiffs' counsel attorney's fees of 25% of the settlement fund negotiated by counsel. The Ninth Circuit vacated and remanded the case.
 2. Following a negotiated settlement of this action, the District Court certified a settlement class, preliminarily approved the settlement and ordered notice to the class. Notice informed the class members of the general terms of the proposed settlement including an attorney's fee award of 25% of the amount of the settlement. Objections to the settlement were to be sent or received by September 4. Plaintiffs' counsel's motion for its fees was to be filed on September 18, and the fairness hearing regarding the settlement was set for September 25. The New York State Teachers' Retirement System ("Teachers") filed an objection to the proposed fee award, arguing that Plaintiffs' counsel should not receive a fee of greater than 18% of the settlement amount. Representatives of Teachers did not attend the fairness hearing, and the District Court approved the requested fee from the bench.
 3. On appeal, Teachers argued that the District Court erred by setting the deadline for the filing of class members' objections to the fee request on a date before the deadline for filing the fee motion itself. First, the Ninth Circuit rejected the argument of lead counsel that Teachers had waived its right to appeal by failing adequately to raise its objections with the District Court (including by failing to attend the fairness hearing).
 4. Second, the Ninth Circuit ruled that the District Court had abused its discretion by setting the objection deadline for class members before the deadline for lead counsel to file its fee motion, finding that the practice (which the Ninth Circuit Court believed was common) "borders on a denial of due process because it deprives objecting class members of a full and fair opportunity to contest class counsel's fee motion. The Ninth Circuit refused to adopt a bright-line rule of a time period that would be appropriate for class members to have an adequate opportunity to oppose class counsel's fee motion." *Id.* at 993. The Ninth Circuit Court vacated the District Court's fee award and remanded the case for further consideration.

Summary Chart of Certain Unreported Decisions

Citation	Claims	Resolution
<i>In re Am. Funds Sec. Litig.</i> , 2010 WL 3679351 (9th Cir. Sept. 27, 2010)	§§ 12(a)(2) and 15 of the Securities Act and §§ 10(b) and 20(a) of the Exchange Act	Remanded to the District Court for evaluation in light of <i>Merck & Co., Inc. v. Reynolds</i> , 130 S. Ct. 1784 (2010).
<i>Arkoma Basin Project Ltd. P'ship v. West Fork Energy Co. LLC</i> , 384 Fed. App'x 375 (5th Cir. June 29, 2010)	§§ 10(b) of the Exchange Act, Rule 10b-5 and Texas securities laws	Affirmed dismissal; no evidence that projections were knowingly false when made.
<i>Calamore v. Juniper Networks, Inc.</i> , 364 Fed. App'x 370 (9th Cir. Feb. 5, 2010)	§14(a) of the Securities Act	Affirmed dismissal of complaint; court did not agree that alleged proxy disclosure violations were derivative claims, but dismissal was proper because Plaintiff waited too long to bring claims and failed to request relief that could be granted, and suggested amended relief was unlikely to produce a different result.
<i>Campo v. Sears Holdings Corp.</i> , 371 Fed. App'x 212 (2d Cir. April 6, 2010)	§§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5	Affirmed dismissal; alleged misstatements were mere speculation, alleged motive was too speculative and far-fetched, and testimony of confidential witnesses was insufficient to establish scienter.
<i>In re Centerline Holding Co. Sec. Litig.</i> , 380 Fed. App'x 91 (2d Cir. June 9, 2010)	§§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5	Affirmed dismissal; no duty to disclose future plans for company.
<i>Chilton v. Smith Barney Fund Mgmt. LLC</i> , 365 Fed. App'x 298 (2d Cir. Feb. 16, 2010)	Lead plaintiff appointment in class action	Court acted within its discretion in lead plaintiff appointment pursuant to PSLRA as appointee established significant financial interest in outcome of litigation.

<i>City of Dearborn Heights Act 345 Police & Fire Ret. Sys. v. Axonyx, Inc.</i> , 374 Fed. App'x 83 (2d Cir. Mar. 23, 2010)	§ 10(b) of the Exchange Act and Rule 10b-5	Affirmed dismissal for failure to raise strong inference of scienter.
<i>First New York Sec. LLC v. United Rentals Inc.</i> , 391 Fed. App'x 71 (2d Cir. Aug. 30, 2010)	§ 10(b) of the Exchange Act and Rule 10b-5	Affirmed dismissal for failure to raise strong inference of scienter.
<i>Gerstner v. Sebig, LLC</i> , 386 Fed. App'x 573 (8th Cir. July 16, 2010)	§ 5(a) of the Securities Act (pro se)	Reversed and remanded; court disagreed that Appellants did not sufficiently allege the interstate commerce element of their unregistered securities claim.
<i>Illinois State Board of Inv. v. Authentidate Holding Corp.</i> , 369 Fed.App'x 260 (2d Cir. Mar. 12, 2010)	§ 10(b) of the Exchange Act and Rule 10b-5	Affirmed in part and vacated and remanded in part; investors alleged with sufficient particularity material omission that rendered prior statement misleading, but defendant had no duty to reveal that it was not going to meet its previously stated goal.
<i>In re Jones Soda Co, Sec. Litig.</i> , No. 09-35732, 2010 WL 3394274 (9th Cir. Aug. 30, 2010)	Federal securities fraud	Over dissent of Reinhardt, C.J., affirmed dismissal for failure to meet heightened pleading requirements of PSLRA.
<i>In re Karkus</i> , No. 09-1500, 2010 WL 358974 (10th Cir. Jan. 27, 2010)	Writ of mandamus to vacate order denying motion to serve as lead plaintiff in securities class action	Affirmed denial (with dissenting opinion); Karkus failed to show that he was the largest stakeholder in the case, as the court was not convinced that he could combine his personal losses with those of his investment vehicle.

<p><i>Kelley v. Rambus, Inc.</i>, 384 Fed. App'x 570 (9th Cir. June 16, 2010)</p>	<p>§§ 10(b), 14(a), 18(a) and 20(a) of the Exchange Act and Rule 10b-5</p>	<p>Affirmed dismissal; court found that the District Court's page limit for Complaint was appropriate to prevent an unnecessary strain on Defendants and the Court and that Plaintiffs failed to: (1) show a link between Defendants' allegedly false proxy statements and corporate actions that had occurred years before; (2) allege actual reliance on Defendants' financial and proxy statements; and (3) allege facts giving rise to a strong inference of deliberate recklessness.</p>
<p><i>Kelter v. Associated Fin. Group, Inc.</i>, 382 Fed. App'x 632 (9th Cir. June 8, 2010)</p>	<p>PSLRA Sanctions</p>	<p>Affirmed denial of sanctions after District Court granted summary judgment to Defendants because Plaintiff's counsel conducted investigation beyond reading newspaper article and had good faith arguments for position.</p>
<p><i>Kosovich v. Metro Homes, LLC</i>, No. 10-0206, 2010 WL 5113128 (2d Cir. Dec. 16, 2010)</p>	<p>§ 10(b) of the Exchange Act and Rule 10b-5</p>	<p>Affirmed dismissal with prejudice for failure to allege reliance and because claim is time-barred.</p>
<p><i>Libaire v. Kaplan</i>, No. 09-2659, 2010 WL 3894711 (2d Cir. Oct. 6, 2010)</p>	<p>§ 10(b) of the Exchange Act and Rule 10b-5</p>	<p>Affirmed grant of summary judgment for Defendant and sanctions against Plaintiff and Plaintiff's counsel; payment for membership dues was not a security, and any claim associated with a security was time-barred.</p>
<p><i>One Commc'ns Corp. v. SBIC LLC</i>, 381 Fed. App'x 75 (2d Cir. June 18, 2010)</p>	<p>§§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5</p>	<p>Affirmed dismissal of claims; no proper reliance on statements made pre-merger and no allegations of scienter as to post-merger statements.</p>

<p><i>Scotto v. Brady</i>, 2010 WL 4903954 (2d Cir. Dec. 2, 2010)</p>	<p>Jury trial on § 10(b) of the Exchange Act and Rule 10b-5</p>	<p>Cross-appeals after jury trial finding Defendants liable on claims of securities and common law fraud; judgment affirmed in part; compensatory damage award vacated because it cannot be reconciled with court's instructions of law that damages must be based on actual losses. Remand to determine damages and so that District Court can enter specific findings regarding Rule 11 as required by PSLRA.</p>
<p><i>Sharenow v. Impac Mortgage Holdings, Inc.</i>, 385 Fed. App'x 714 (9th Cir., June 29, 2010)</p>	<p>§ 10(b) of the Exchange Act and Rule 10b-5</p>	<p>Affirmed dismissal; court held that the allegations of the complaint, standing alone or considered together, did not create the strong inference of scienter required by the PSLRA.</p>
<p><i>Thesling v. Bioenvision, Inc.</i>, 374 Fed. App'x 141 (2d Cir. April 7, 2010)</p>	<p>§§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5</p>	<p>Affirmed dismissal; company had no legal duty to disclose merger negotiations.</p>
<p><i>Truk Int'l Fund LP v. Wehlmann</i>, 389 Fed. App'x 354 (5th Cir. Aug. 4, 2010)</p>	<p>§§ 11, 12(a)(2), 15 of Securities Act</p>	<p>Affirmed dismissal; cautionary statements in prospectus rendered alleged misrepresentations immaterial.</p>

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