

Morgan Lewis

review

2008 Year in Review:
Selected Federal Securities Litigation Developments

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INTRODUCTION

This is our inaugural 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), and 20(a) of the Securities Exchange Act of 1934 and Sections 11, 12, and 15 of the Securities Act of 1933.¹

It goes without saying that 2008 was, in many ways, an historic year. The financial markets suffered major disruptions; venerable financial institutions closed and merged; investors in mutual funds, hedge funds, equities, and bonds lost money; a money market fund “broke the buck”; the auction rate market seized; billions of dollars seem to have disappeared in what is alleged to have been the largest and longest-running Ponzi scheme ever; and the federal government pumped hundreds of billions of dollars into the financial sector in an unprecedented effort to prevent further deterioration.

While it is never easy to predict the future, we expect that the unfolding economic crisis will continue to spawn new and complex theories and forms of securities litigation. As we prepare to protect and defend our clients in 2009, it is useful to look back at key decisions from 2008, in order not only to understand the current state of the law, but also to obtain guidance about trends for pending and future litigation. We therefore have prepared this desktop resource, summarizing key recent developments in private securities litigation at the appellate level.

Our review includes 66 opinions, organized by topic and, within each topic, by circuit in chronological order, allowing you to quickly identify the most recent authority on particular issues in any jurisdiction.² Topics include scienter, causation, SLUSA, class certification, *Stoneridge*, and other matters that are often dispositive in private securities litigation.

¹ Accordingly, we have not included enforcement actions and certain decisions where securities law issues are neither central to the case nor analyzed in a substantive manner.

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

As experience tells us that the Circuit Courts tend to affirm decisions of the District Courts, we are cautious about drawing premature conclusions or pointing to false trends. That said, we thought it interesting to note that, of the decisions we reviewed, 42 affirmed decisions by the District Courts (typically opinions on motions to dismiss, although there were some appeals of opinions relating to class certification and summary judgment motions). There were 16 reversals, seven opinions vacating and remanding to the District Court for further proceedings, and two opinions affirming in part and reversing in part. In each of the three decisions on interlocutory appeal of a denial of a motion to dismiss, the Circuit Court reversed or vacated the decision of the District Court.

The Circuit Courts appear to be applying *Tellabs* diligently, enforcing stringent standards to test the sufficiency of allegations of scienter. Of the 24 decisions addressing whether scienter was adequately pled, 19 either affirmed dismissal or determined that a case should be dismissed, while three determined that scienter had been adequately pled and two cases were remanded for additional findings.

Both the Second and Fifth Circuits vacated class certification orders, remanding for further factual development and highlighting the need for plaintiffs to provide evidence to support the propriety of class certification and prove matters that they used to presume.

On SLUSA, most of the Circuit Court opinions found that plaintiffs' claims could not proceed as a class action and were precluded by SLUSA, notwithstanding plaintiffs' artful efforts to plead around the statute. In two cases, SLUSA applied because of choices plaintiffs made about how to litigate, *i.e.*, whether to consolidate cases or whether to file joint motions and engage in joint discovery.

Certain issues were only addressed in one or two opinions, but they may be significant in coming years. For example, the Second Circuit addressed the standards for asserting jurisdiction in so-called "foreign-cubed" cases involving foreign issuers and foreign purchases of securities.

Similarly, the Circuit Courts are evaluating the interplay between CAFA and the federal securities laws. Anecdotally, we have seen plaintiffs bringing state court class actions asserting claims under the Securities Act, relying upon Section 22(a) of the Securities Act, which generally bars removal of such claims to federal court. In response, defendants have argued that such claims are removable to federal court pursuant to CAFA. In 2008, the Ninth Circuit concluded that CAFA does not allow for removal of such claims. However, in 2009 (in *Katz v. Gerardi*, 552 F.3d 558 (7th Cir. Jan. 5, 2009), which will be discussed in next year's review), the Seventh Circuit disagreed with the Ninth Circuit and concluded that CAFA does permit removal of claims under the Securities Act. This is just one of many issues we will be watching closely in the coming year.

We look forward to your feedback to make this resource as useful as possible in the years to come. Please let us know if you have questions about our review or if we can be of any other assistance to you.³

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Citations

For the purposes of the following 2008 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), 20(a), and 20(A) refer to the associated sections of the Exchange Act, 15 U.S.C. §§ 78j(b), 78t(a), and 78t-1. References to Rule 10b-5 refer to SEC Rule 10b-5, promulgated in 1942 pursuant to § 10(b) of the Exchange Act, 17 C.F.R. § 240.10b-5 (2007). References to the Securities Act refer to the Securities Act of 1933, 15 U.S.C. §§ 77a *et seq.*, and references to §§ 10(a), 11, 12, and 15 refer to the associated sections of the Securities Act, 15 U.S.C. §§ 77j(a), 77k, 77l, and 77o. References to the PSLRA refer to the Private Securities Law 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. § 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. --, 128 S. Ct. 761, 169 L. Ed. 2d 627 (Jan. 15, 2008). References to *Basic* refer to the Supreme Court decision *Basic Inc. v. Levinson*, 485 U.S. 224, 108 S. Ct. 978, 99 L. Ed. 2d 194 (Mar. 7, 1988). 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, 125 S. Ct. 1627, 161 L. Ed. 2d 577 (Apr. 19, 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.

First Circuit

A. *ACA Fin. Guar. Corp. v. Advest, Inc.*, 512 F.3d 46 (1st Cir. Jan. 10, 2008)

1. Appeal of an order by the District Court (D. Mass.) granting Defendants' motion to dismiss. Plaintiffs, purchasers and an insurer of Bradford College bonds sold in May 1998, brought suit after the college defaulted on its bond obligations in January 2000. Plaintiffs asserted claims against the underwriter investment banking firm, former president and vice president of the college, and members of the college's board of trustees, alleging violations of §§ 10(b), 20(a) and Rule 10b-5 for material misrepresentations and omissions in the Official Statement accompanying the offering. The District Court granted Defendants' motions to dismiss for failing to meet the pleading requirements for scienter imposed by the PSLRA. Plaintiffs filed motions with the District Court to vacate the dismissal under Rule 59(e) and for leave to amend under Rule 15(a). The District Court denied both post dismissal motions. The First Circuit affirmed.
2. Citing the PSLRA, the First Circuit confirmed that "a complaint alleging securities fraud shall, with respect to each [alleged] act or omission, state with particularity facts giving rise to a *strong inference* that the defendant acted with the required state of mind." *Id.* at 58–59. The First Circuit held that *Tellabs* confirms "that scienter should be evaluated with reference to the complaint as a whole rather than to piecemeal allegations." *Id.* at 59. The First Circuit further held that "where there are equally strong inferences for and against scienter, *Tellabs* now awards the draw to the plaintiff." *Id.*
3. Pursuant to these standards, the First Circuit analyzed the complaint's allegations for four categories of omissions and misrepresentations in the Official Statement. With respect to representations regarding the attrition rate, the First Circuit held that the college did not have a duty to disclose every possible material fact about its operations and finances, but rather: "The Official Statement needed only disclose enough accurate information and not omit pertinent information to allow investors to make an informed decision about whether to invest. It did so." *Id.* at 61.
4. The First Circuit also addressed Plaintiffs' claims that the Official Statement "artificially inflated the application numbers." *Id.* at 62. The First Circuit held that Plaintiffs could not rely solely on "fraud by hindsight" and "simply contrast a defendant's past optimism with less favorable actual results." *Id.* Thus, the allegations fell "short of establishing that the enrollment projections were materially misleading at the time of the Statement." *Id.*

5. Plaintiffs further alleged that Defendants “skewed the school’s future financial health by misrepresenting [the College’s] intentions regarding a planned equity contribution to the construction and renovation project.” *Id.* at 63. The First Circuit held that the Official Statement did not “speak in any way to the timing of the [equity] contribution” and that the allegations regarding a committee meeting did “not at all foreclose the college from making an equity contribution” in the future. *Id.* Thus, these “allegations simply do not establish any misrepresentation.” *Id.*
 6. The First Circuit addressed Plaintiffs’ allegations that certain projections were false and misleading. The First Circuit held that some of the allegations were not pled with particularity while others were more troublesome.
 7. Nonetheless, applying *Tellabs*, the First Circuit held that Plaintiffs’ allegations “fail to establish an inference of scienter that is cogent and at least as compelling as available competing inferences of non-fraudulent conduct.” *Id.* at 66-67. For one, the “Official Statement as a whole candidly laid out the sorry financial history of the college and, for most of its estimates and projections as to a happier future, it provided accurate and non-misleading information.” *Id.* In addition, the individual Defendants were “Officers and Trustees of a non-profit educational institution” and, therefore, were “unlike the paradigmatic securities fraud defendant, who is likely to be a corporate insider standing to profit from the sale of artificially inflated securities.” *Id.* Accordingly, “these are shaky grounds for leaping to the conclusion that there is a strong inference that the defendants intentionally or recklessly disregarded the facts available to them when quoting financial aid figures in an offering statement accompanying a multi-million dollar bond offering.” *Id.* at 67.
- B. *Mississippi Pub. Employees’ Ret. Sys. v. Boston Scientific Corp.*, 523 F.3d 75 (1st Cir. Apr. 16, 2008)
1. Appeal of an order by the District Court (D. Mass.) granting Defendants’ motion to dismiss. Plaintiff investor brought a putative class action alleging that the company, through its executives, both withheld material information about problems with its medical devices and decisions addressing those problems, and made misleading positive statements, in violation of §§ 10(b), 20(a) and Rule 10b-5. The District Court granted Defendants’ motion to dismiss, holding that Plaintiff failed to meet the heightened pleading requirements for scienter imposed by the PSLRA. The First Circuit reversed the holding that Plaintiff had failed to sufficiently plead a claim.

2. The District Court “held that plaintiff failed to plead facts providing a strong inference that at the time of the manufacturing change, defendants had the requisite scienter.” *Id.* at 84. The District Court’s decision, however, was issued before *Tellabs*, which “reversed a higher standard for scienter imposed by the prior law of this circuit.” *Id.* at 89. According to the First Circuit, *Tellabs* “clarified that scienter should be evaluated with respect to “the complaint in its entirety”” and that the “inquiry . . . is whether *all* of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard.” *Id.* at 86. Indeed, *Tellabs* directed that “courts consider not only inferences urged by the plaintiff . . . but also competing inferences rationally drawn from the facts alleged and held that a complaint survives when there are equally compelling inferences for and against scienter.” *Id.*
3. Applying *Tellabs*, the First Circuit held that “while there is support for defendants’ inferences” negating scienter, “we think, at this stage, that plaintiff’s inferences are at least equally strong.” *Id.* at 89. In addition, the First Circuit found that the “extremely short time” between the COO’s assurances that the products’ problems “were in the past” and the recall of the product one week later was “strong evidence” of scienter. *Id.* at 91.
4. The First Circuit also considered Plaintiff’s insider trading allegations in analyzing the “overall mix” of whether Plaintiff alleged the requisite scienter. *Id.* at 92. Although Plaintiff’s “insider trading claims as alleged [were] on the weaker end of the spectrum,” the First Circuit held that Plaintiff’s allegations fit “with Plaintiff’s theory that defendants would have sold stock at this time, knowing that the price would drop when the manufacturing change, acknowledging a defect, was announced.” *Id.* Accordingly, “plaintiff’s specific factual allegations” convinced the First Circuit that Plaintiff “has pled enough to give rise to inferences that are at least as strong as any competing inferences regarding scienter.” *Id.* at 92-93.

C. *New Jersey Carpenters Pension & Annuity Funds v. Biogen Idec Inc.*, 537 F.3d 35 (1st Cir. Aug. 7, 2008)

1. Appeal of an order by the District Court (D. Mass.) dismissing a class action complaint alleging securities fraud by Biogen Idec Inc. under §§ 10(b), 20(A), 20(a) and Rule 10b-5. Plaintiffs alleged that the company and senior executives intentionally misrepresented the safety of and the market for TYSABRI, a drug for the treatment of multiple sclerosis, by omission and commission. Plaintiffs alleged that in order to facilitate their sale of shares of company stock at inflated prices, Defendants misrepresented the safety and efficacy of the drug. The First Circuit noted that the “key theme of the suit is that Biogen and the defendants were aware or at least were recklessly unaware of greater safety risks with TYSABRI for opportunistic infections, particularly in combination with other MS therapies, than had been announced to the public, and then intentionally failed to disclose this information in order to keep share prices high.” *Id.* at 47. The First Circuit affirmed the dismissal, concluding that Plaintiffs failed to adequately meet the pleading requirements for scienter established by the PSLRA.
2. The First Circuit found important the principle that “[a] statement cannot be intentionally misleading if the defendant did not have sufficient information at the relevant time to form an evaluation that there was a need to disclose certain information and to form an intent not to disclose it.” *Id.* at 45 (citing *ACA Fin. Guar. Corp. v. Advest, Inc.*, 512 F.3d 46, 62 (1st Cir. 2008)). The First Circuit stated that “defendants cannot have committed fraud if they did not know *at the time* that the failure to provide additional information was misleading.” *Id.* at 48. The First Circuit found that “Plaintiffs’ amended complaint fails to allege facts both (1) as to *when* defendants had information about non-PML opportunistic infections and (2) that the information available sufficiently suggested a *causal relationship* between TYSABRI and non-PML opportunistic infections.” *Id.* at 49. Particularly damaging to Plaintiffs’ case was their failure to allege that Defendants knew of a “significant risk of non-PML opportunistic infections while the FDA was reviewing [the drug].” *Id.* at 50. Without such allegations, the First Circuit did not find the required “strong inference” of scienter. *Id.*
3. The First Circuit reviewed the factual allegations by Plaintiffs’ confidential sources and found that the allegations, even if assumed to be true, “still [did] not create a strong inference of scienter,” because they failed to indicate when during the trials the information about the infections became known. *Id.* at 52.

4. The First Circuit also considered Plaintiffs' allegations that "defendants affirmatively stated that TYSABRI was safe when used in combination with other drugs when in fact they had no reasonable basis to believe so." *Id.* at 53. The First Circuit found that, on the merits, Plaintiffs' theory was "not nearly as compelling as opposing inferences from the undisputed facts in the record." *Id.* at 54. The more compelling theory was Defendants': that "no significant safety risk had been associated with use of TYSABRI as a combination therapy." *Id.* at 55. The First Circuit rejected Plaintiffs' allegations of insider trading.
5. The First Circuit found that "[t]he situation involved here is paradigmatic of securities fraud cases against drug development companies where a promising drug or medical device is approved by the FDA and then later proves to have health risks which affect the market for the drug." *Id.* at 47. The First Circuit recognized that "the investing public is well aware that drug trials are exactly that: trials to determine the safety and efficacy of experimental drugs. And so trading in the shares of companies whose financial fortunes may turn on the outcome of such experimental drug trials inherently carries more risk than some other investments." *Id.* at 48.

Second Circuit

- D. *Bay Harbour Mgmt. LLC v. Jay Carothers*, 282 Fed. Appx. 71 (2d Cir. June 24, 2008)
 1. Appeal of an order by the District Court (S.D.N.Y.) dismissing Plaintiffs' § 10(b) and Rule 10b-5 claims against certain officers of Levitz Home Furnishings ("LHFI"), its outside auditors, and other Defendants. The Second Circuit affirmed.
 2. LHFI issued \$130 million in high-yield bonds less than one year prior to its filing for bankruptcy protection. Plaintiffs alleged that Defendants violated § 10(b) and Rule 10b-5 by making material misrepresentations in the Offering Circular and at a "road show" sales presentation concerning valuations of goodwill and leasehold interests.
 3. Plaintiff relied on financial reports issued after the offering that contained lower valuations than what was included in the Offering Circular. The Second Circuit found that these statements presented a "fraud by hindsight" theory, *i.e.*, claims of fraud based on a subsequent devaluation of the assets at issue. Such claims are not actionable in the Second Circuit.

4. Plaintiffs also alleged that Defendants misrepresented their relationships with vendors, misrepresented their inventory and inventory management skills, lacked a modern accounting system, paid more for inventory than their competitors, and manipulated their inventory statistics. While these statements may have been material, the Second Circuit found that Plaintiffs' complaint failed to include allegations that gave rise to a strong inference of scienter. Plaintiffs' complaint merely contained generalized allegations of economic self-interest that lacked particularized facts and were, therefore, insufficient to plead scienter. The Second Circuit similarly found that (1) the fact that one of the individual Defendants had resigned only four months before the debt offering was insufficient to establish scienter, and (2) mere allegations of inventory manipulation were not sufficient to establish "per se" scienter.

E. *Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital Inc.*, 531 F.3d 190 (2d Cir. June 26, 2008)

1. Interlocutory appeal of an order by the District Court (S.D.N.Y.) denying Defendants' motion to dismiss Plaintiffs' putative class action, including §§ 10(b), 20(a) and Rule 10b-5 claims. The Second Circuit vacated the District Court order, and remanded the case with instructions to dismiss the complaint but to allow Plaintiffs leave to replead.
2. Defendants Dynex Capital Inc. and Merit Securities Corp. issued certain bonds secured by housing loans. Borrowers subsequently defaulted on the underlying loans and the prices of the homes sold after foreclosure dropped. The ratings agencies then downgraded the bonds, and the bonds eventually decreased in value in amounts up to 85 percent.
3. Plaintiff bond purchasers filed a putative class action against Dynex, Merrit, and their senior executives, alleging that Defendants failed to disclose that they made loans to "uncreditworthy borrowers," willingly purchased high-risk loans, misrepresented the performance of the bond's collateral, misrepresented the reasons for restating its earnings, and failed to adequately disclose improper underwriting.
4. The District Court dismissed the claims against the individuals based on a failure to adequately plead scienter beyond alleging their positions within the companies. Nevertheless, the District Court concluded that Plaintiffs' claims adequately alleged scienter against the corporate Defendants.

5. The corporate Defendants filed an interlocutory appeal, arguing that the District Court's finding that the complaint did not raise a strong inference of scienter with regard to the individuals precludes, as a matter of law, finding collective scienter with regard to the corporate Defendants. The Second Circuit rejected this argument, noting that while the District Court found no evidence of scienter on the part of the specifically named officers, it found sufficient allegations as to other unnamed officers. The Second Circuit went on to note that, while Congress has imposed strict requirements on pleading securities fraud, it has not imposed a rule that "in no case can corporate scienter be pleaded in the absence of successfully pleading scienter as to an expressly named officer." *Id.* at 196.
6. Nonetheless, the Second Circuit determined that Plaintiffs did not adequately establish scienter with respect to their allegations that (1) senior executives had access to data that would show that public statements were inaccurate, (2) Defendants failed to review or check information that they had a duty to monitor, and (3) Defendants were motivated to avoid fully disclosing the impaired quality of the collateral. Applying *Tellabs*, the Second Circuit concluded that the inferences created by the allegations were not "at least as compelling" as the competing inference, *i.e.*, that the statements were not misleading or "were the result of merely careless mistakes at the management level based on false information fed it from below." *Id.* (citing *Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 513 F.3d 702, 709 (7th Cir. Jan. 17, 2008)).

Third Circuit

- A. *In re Discovery Labs. Sec. Litig.*, 276 Fed. Appx. 154 (3d Cir. Apr. 29, 2008)
 1. Appeal of an order by the District Court (E.D. Pa.) dismissing Plaintiffs' second amended complaint in a securities class action alleging violations of § 10(b) and Rule 10b-5. Plaintiffs alleged that Defendants made a series of false or misleading statements during the class period related to the development of a new product. The District Court dismissed each claim for failure to plead materiality and scienter under the heightened pleading standards of the PSLRA. Plaintiffs appealed the dismissal of the majority of their claims. The Third Circuit affirmed for the reasons set forth in the District Court's opinion. *See In re Discovery Labs. Sec. Litig.*, No. 06-1820, 2007 WL 789432 (E.D. Pa. 2007).
 2. Defendant was not required to disclose that the clinical trials it chose to conduct followed guidance from the FDA but not another relevant agency's recommendation, which may have decreased the chances for product approval. As explained by the District Court, companies are not obliged to disclose every decision that improves the likelihood of one successful outcome (here the approval of a new drug application) at the expense of another. The omission was not material.

Fourth Circuit

- A. *Cozzarelli v. Inspire Pharm. Inc.*, 549 F.3d 618 (4th Cir. Dec. 12, 2008)
1. Appeal of an order by the District Court (M.D.N.C.) dismissing Plaintiffs' action for failure to plead facts giving rise to a strong inference of scienter. Plaintiffs' class action alleged violations of §§ 10(b), 20(a) Rule 10b-5, and §§ 11, 12(a)(2), and 15. The Fourth Circuit affirmed the order of the District Court.
 2. While seeking FDA approval to market a new drug, Inspire Pharmaceuticals Inc. made statements in its prospectus and during investor conference calls about a study requested by the FDA. While the study was ongoing, a number of directors sold shares in the company. The company subsequently announced that the study failed to reach its primary endpoint, and the stock dropped over 44 percent. Plaintiffs commenced a putative class action against the company and certain directors based on allegations that they misled investors regarding the likelihood of the drug study's success. The District Court dismissed Plaintiffs' claims for failure to establish a strong inference of scienter and for failing to plead false or misleading statements by Defendants.
 3. The Fourth Circuit applied *Tellabs*, and concluded that no strong inference of scienter existed because the inference that Defendants acted with non-fraudulent intent to protect its competitive advantage in making certain statements about the study is more powerful than the inference that Defendants acted with intent to deceive. Nor was Defendants' hands-on management style enough to impute scienter. The Fourth Circuit also rejected Plaintiffs' attempt to establish scienter by pointing to the company's alleged need to raise funds: "If we inferred scienter from every bullish statement by a pharmaceutical company that was trying to raise funds, we would choke off the lifeblood of innovation in medicine by fueling frivolous litigation—exactly what Congress sought to avoid by enacting the PSLRA." *Id.* at 627.
 4. The Fourth Circuit also rejected Plaintiffs' attempt to establish scienter by pointing to the individual Defendants' sales of shares noting that the individual holdings of each Defendant increased during the relevant time period.
 5. The Fourth Circuit then addressed Plaintiffs' §§ 11 and 12(a)(2) claims concerning the registration statements and prospectuses, which included statements that the company had "a clear understanding of the FDA's additional requirements" and that the study it was conducting was "confirmatory." *Id.* at 628-29. The Fourth Circuit determined that Plaintiffs had not alleged that such statements were false with the particularity required under Rule 9(b). Although §§ 11 and 12(a)(2) do not require plaintiffs to prove fraud as an element, the Fourth Circuit analyzes these claims under Rule 9(b) when allegations sound in fraud.

Fifth Circuit

- A. *Indiana Elec. Workers' Pension Trust Fund v. Shaw Group Inc.*, 537 F.3d 527 (5th Cir. July 29, 2008)
1. Interlocutory appeal from denial of Defendants' motion to dismiss by the District Court (E.D. La.). Plaintiffs filed this putative class action against Shaw Group Inc., its CEO, and its CFO alleging violations of §§ 10(b) and 20(a) and Rule 10b-5 by (1) artificially inflating its earnings by manipulating the purchase method of accounting, (2) prematurely recognizing revenue on long-term contracts, (3) failing to disclose material issues affecting the viability of a major construction project, (4) overstating the demand for its services, and (5) delaying or failing altogether to pay vendors to increase its cash flow. The Fifth Circuit reversed and remanded with instructions to dismiss the case.
 2. Defendant Shaw Group Inc., an engineering and construction firm, issued a press release announcing that the SEC was conducting an informal inquiry concerning the company and its accounting practices.
 3. The Fifth Circuit held that Plaintiffs' complaint failed to allege facts from which a "strong inference of scienter" may be drawn against Defendants under *Tellabs*, taking judicial notice that the SEC terminated its inquiry with no enforcement recommendation and that the company never issued a restatement. With respect to Plaintiffs' allegations concerning GAAP, the Fifth Circuit reiterated that a failure to follow GAAP, without more, does not establish scienter. Rather Plaintiffs must state with particularity facts giving rise to a strong inference that the party knew that it was publishing materially false information or was severely reckless. Plaintiffs' allegations against individual Defendants that they had a "hands-on management style" were insufficient, and their remaining allegations were insufficient and vague.
 4. The Fifth Circuit also noted that many of Plaintiffs' allegations were derived from confidential sources. *Tellabs* requires courts to discount the probative value of such statements.

Sixth Circuit

A. *Ley v. Visteon Corp.*, 543 F.3d 801 (6th Cir. Oct. 6, 2008)

1. Appeal of an order by the District Court (E.D. Mich.) dismissing investor Plaintiffs' class action alleging claims under § 10(b) and Rule 10b-5 against Visteon Corp., its officers and directors, and an outside auditor, and a claim under § 20(a) of the Exchange Act against the individual Defendants. The District Court dismissed the complaint for failure to allege any material misstatements or omissions of facts giving rise to a strong inference of scienter, and investors appealed. The Sixth Circuit affirmed.
2. Defendant Visteon is a global supplier of automotive systems, modules, and components to vehicle manufacturers and the automotive aftermarket. Visteon was incorporated as a wholly-owned subsidiary of Ford, and was later spun-off as a separate publicly traded company. The claims revolved around statements made in Visteon's spin-off prospectus and subsequent accounting errors in Visteon's public reports. Specifically, Plaintiffs alleged that Defendant failed to disclose the competitive disadvantage of the newly formed company due to its ties to Ford, as well as improper accounting manipulations.
3. A Sarbanes-Oxley certification is only probative of scienter if the person signing the certification was severely reckless in certifying the accuracy of the financial statements. Interpreting signed certifications alone as evidence of scienter would effectively hold company executives strictly liable for innocent accounting mistakes.
4. The nature and magnitude of the accounting improprieties at issue do not warrant an inference of recklessness. The accounting errors here, although large, were not "so simple, basic, or pervasive in nature" as to have been obvious to Defendants.
5. To allege that an independent accountant or auditor acted with scienter, the complaint must allege specific facts showing that the deficiencies in the audit were so severe that they strongly suggest that the auditor must have been aware of the fraud. Thus, "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 815.

B. *Frank v. Dana Corp.*, 547 F.3d 564 (6th Cir. Nov. 19, 2008)

1. Appeal of an order by the District Court (N.D. Ohio) dismissing claims brought by shareholders in a securities fraud class action against a corporation's current and former CEOs alleging that the CEOs caused the corporation to use certain accounting techniques to falsify its financial results in violation of § 10(b) and Rule 10b-5. The District Court dismissed the claims for failure to comply with the heightened pleading standards of the PSLRA. The Sixth Circuit vacated and remanded, correcting the District Court's statement of the scienter standard, and holding that Plaintiff was required to establish an inference of scienter that was at least as compelling as any competing inference.
2. The Sixth Circuit disagreed with the District Court's application of *Tellabs*. The District Court stated that it was required to accept Plaintiff's inferences of scienter only if those inferences are the most plausible of competing inferences, explaining that "under *Tellabs*, plaintiff must establish an inference of scienter that is more plausible and powerful than competing inferences of defendants' state of mind." *Id.* at 571. The Sixth Circuit explained that "[t]his standard plainly is at odds with the Supreme Court's holding in *Tellabs* that inferences of scienter that are 'at least as compelling' as competing non-culpable inferences are sufficient for the complaint to survive a motion to dismiss." *Id.*

Seventh Circuit

- A. *Makor Issues & Rights, LTD v. Tellabs Inc.*, 513 F.3d 702 (7th Cir. Jan. 17, 2008)
1. On remand from the United States Supreme Court. Plaintiff investors brought securities fraud claims under § 10(b) and Rule 10b-5 against manufacturers of fiber optic equipment and against individual officers. Investors claimed that the manufacturers misled investors when they announced that customers were buying more and more of their products, that the company's growth was robust, and that the company was not experiencing any weakness when, in fact, the manufacturers were sending customers products that they did not order to create an illusion of demand. The District Court (N.D. Ill.) granted Defendants' motion to dismiss and the Seventh Circuit reversed, finding that Plaintiffs had adequately pled both that Defendants made materially false statements and that they acted with the required scienter. The first holding was upheld by the Supreme Court. The second holding was vacated, as the Supreme Court disagreed with the Seventh Circuit's interpretation of the showing required to establish a "strong inference" of scienter, and the Court directed the Seventh Circuit to dismiss unless "a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged." *Id.* at 705 (quoting *Tellabs*). Accordingly, the case was remanded back to the Seventh Circuit. The Seventh Circuit found that the scienter element was met despite the Plaintiffs' reliance on information from confidential informants, reversing the District Court and remanding.
 2. Plaintiffs argued that Tellabs made materially false statements regarding its sales, company growth, and demand for company product during a time when its revenues were lower than the prior year. The Seventh Circuit repeated its previous ruling that the statements were adequately pled as materially false. The Seventh Circuit then presented two possibilities regarding scienter. "One is that the company knew . . . that the statements were false, and material to investors. The other is that although the statements were false and material, their falsity was the result of innocent, or at worst careless, mistakes at the executive level." *Id.* at 707. The Seventh Circuit noted that the Supreme Court declined to completely incorporate common law principles into § 10(b) and Rule 10b-5, but held that the doctrines of respondeat superior and apparent authority remain applicable to those claims. "The critical question, therefore, is how likely it is that the allegedly false statements that we quoted earlier in this opinion were the result of merely careless mistakes at the management level based on false information fed it from below, rather than of an intent to deceive or a reckless indifference to whether the statements were misleading." *Id.* at 709.

3. The Seventh Circuit asserted that it was extremely unlikely that none of the company's senior management was involved in authorizing or making public statements about the demand for company products. Similarly, the Seventh Circuit held that the alleged "channel stuffing" likely was not an innocent misunderstanding. In this case, the Seventh Circuit found that the huge number of returns was evidence that the purpose of the alleged stuffing was to conceal the disappointing demand for the product, and this purpose would have been formed or ratified at the highest level of management.
4. Regarding allegations of collective scienter, the Seventh Circuit commented, "The problem with inferring a collective intent to deceive behind the act of a corporation is that the hierarchical and differentiated corporate structure makes it quite plausible that a fraud, though ordinarily a deliberate act, could be the result of a series of acts none of which was both done with scienter and imputable to the company by the doctrine of respondeat superior." *Id.* at 707. In order to create collective scienter, the wrongs by each employee must be within the scope of his employment and performed in an attempt to further the employer's goals. Here, as discussed above, the facts pled sufficiently supported an inference of corporate scienter on the basis of individual actions. However, the Seventh Circuit stated that "it is possible to draw a strong inference of corporate scienter without being able to name the individuals who concocted and disseminated the fraud," giving the hypothetical example of a false statement by General Motors that it had sold one million SUVs when the actual number was zero, because "so dramatic an announcement would have been approved by corporate officials sufficiently knowledgeable about the company to know that the announcement was false." *Id.* at 710.
5. Despite Defendants' argument that they had no motive to paint the prospects in "rosy hues" because within months they acknowledged their mistakes and disclosed the true situation, the Seventh Circuit concluded that the inference of corporate scienter was not only as likely as its opposite (that there was a "cascade of innocent mistakes" or acts of subordinate employees), but more likely. *Id.* at 711.
6. The Seventh Circuit held that strong inferences could be drawn from the assertions of the confidential informants, explaining that the sources were numerous and consisted of persons who, from the description of their jobs, were in positions to know first hand the facts to which they were prepared to testify (such as the returns of the product, the drop in sales, and information about problems with the product). The information from the confidential informants was also pled in detail and corroborated by multiple sources.

B. *Pugh v. Tribune Co.*, 521 F.3d 686 (7th Cir. Apr. 2, 2008)

1. Appeal of an order by the District Court (N.D. Ill.) dismissing securities class action brought by shareholders of a newspaper publishing company against the newspaper, four of its executive officers, and five employees of its subsidiary, including one Defendant who pled guilty to criminal charges of fraud. Plaintiff shareholders alleged that Defendant subsidiary employees fraudulently boosted the newspaper's circulation figures in order to increase advertising revenue in violation of § 10(b) and Rule 10b-5. The Seventh Circuit affirmed, holding that Plaintiffs failed to establish a strong inference of scienter against all three groups of Defendants and that Plaintiffs' allegations of "scheme liability" were insufficient under *Stoneridge*.
2. The Seventh Circuit restated the *Tellabs* standard for scienter, that "a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged." *Id.* at 693. Additionally, the definition of scienter in the Seventh Circuit is "knowledge of the statement's falsity or reckless disregard of a substantial risk that the statement is false." *Id.* at 693 (quoting *Higginbotham v. Baxter Int'l, Inc.*, 495 F.3d 753, 756 (7th Cir. 2007)).
3. Plaintiffs alleged that the executive officers were recklessly indifferent to the quality of their SEC filing and press releases, because they could easily have verified the accuracy of their newspaper sales. The Seventh Circuit dismissed this argument, analogizing it to previous cases in which plaintiffs attempted to draw an inference of scienter from the fact that the individual defendants had access to a subsidiary's allegedly fraudulent financial information. "There is a big difference between knowing about the reports from a subsidiary and knowing that the reports are false." *Id.* at 694. The Seventh Circuit dismissed the argument as "wholly conclusory." *Id.*
4. Plaintiffs also alleged that the executive officers intentionally or recklessly created weak circulation controls. The Seventh Circuit emphasized that Plaintiffs were arguing that the controls must have been weak just because a fraud actually occurred. The Seventh Circuit rejected this argument as fraud by hindsight. The fact that the newspaper disclosed that in the future it would require certain executives to certify the accuracy of their circulation figures was irrelevant to the Seventh Circuit, as the Federal Rules of Evidence would not allow the consideration of subsequent remedial measures to be used as evidence of liability.

5. The Seventh Circuit found that Plaintiffs' allegations concerning the executive officers' stock sales, exercise of options, and receipt of bonuses did not create a strong inference of scienter, as they were not sufficiently unusual or suspicious to constitute circumstantial evidence of scienter.
6. Plaintiffs claimed that even if Defendants did not know of the fraud before the lawsuit against them was filed, they had such knowledge after the filing. At that time, they commenced an investigation to discover the truth of the allegations and when more information became available, Defendants disclosed the investigation to the public. The Seventh Circuit found that this was exactly what Defendants ought to have done, as they were entitled to investigate for a reasonable time so that they could report a complete story.
7. Plaintiffs also alleged primary liability on the part of the newspaper itself under the theory that a corporation may be held liable for statements by employees with apparent authority. The Seventh Circuit found that the corporate scienter inquiry must focus on the state of mind of the individual corporate officials who make or issue the statements (or order, approve, or furnish information for inclusion or the like), rather than on the collective knowledge that all of the corporation's officers and employees acquired in the course of their employment. The Seventh Circuit found that because the complaint failed to plead facts sufficient to support a strong inference of scienter on the part of any of the individual Defendants, the newspaper's scienter could not be based on any individual's state of mind. The Seventh Circuit also explained that even if primary liability of the individual who had pled guilty to criminal charges had been established, this would not be sufficient to impute liability to the newspaper. The misconduct of employees at a corporate subsidiary is not normally attributed to its corporate parent absent grounds for piercing the corporate veil. In this case, the allegations did not show that any individual knowingly overstated circulation figures intending to benefit the newspaper, but only to charge the subsidiary's advertisers. In fact, the individual employee took steps to conceal this scheme from the newspaper. Thus, the Seventh Circuit dismissed the attempt to impute liability to the newspaper under the doctrine of respondeat superior and found that the § 10(b) and Rule 10b-5 claims were correctly dismissed in their entirety.

Eighth Circuit

- A. *Cornelia I. Crowell GST Trust v. Posis Med. Inc.*, 519 F.3d 778 (8th Cir. Mar. 21, 2008)
1. Appeal of an order by the District Court (D. Minn.) dismissing a class action alleging securities fraud under § 10(b). Defendant corporation undertook a clinical trial to determine whether its non-surgical catheter system could be used in a larger number of medical procedures. During the study, Defendant made several public statements regarding the study's potentially favorable impact on company revenues. Upon the release of negative study results, the stock of the corporation declined. Plaintiff investors brought a class action against the corporation, alleging that the statements made by Defendant during the study amounted to securities fraud. The District Court dismissed the claim for failing to plead a strong inference of scienter. The Eighth Circuit affirmed.
 2. The complaint contained anonymous statements from three former employees of Defendant, alleging that they were aware that the study was not going as well as anticipated prior to the eventual public disclosure of the negative information. The Eighth Circuit held that because Plaintiffs did not allege that the executives who made the allegedly false or misleading statements "heard these rumors" or explain how the employees gained access to this information, the Eighth Circuit could not infer scienter. *Id.* at 783.
 3. Plaintiffs attempted to establish scienter by stressing the importance of the study to the corporation. The Eighth Circuit noted that while the importance of a study to a corporation has been sufficient in some cases to infer awareness of its negative results, and thus scienter, this case was distinguishable. The study in this case was conducted at several off-site locations. Further, there was no evidence of the executives' involvement in the design or administration of the study. Thus, the importance of the study did not support an inference of scienter.
 4. The insider stock sales at issue were not inherently suspicious and were not sufficient to support a strong inference of scienter.

B. *In re NVE Corp. Sec. Litig.*, 527 F.3d 749 (8th Cir. May 30, 2008)

1. Appeal of an order by the District Court (D. Minn.) denying Plaintiffs' motion to amend and granting Defendants' motion to dismiss. Plaintiff shareholders brought a putative class action against NVE Corporation and certain officers and directors, claiming violations of § 10(b) and Rule 10b-5 based on allegedly false or misleading statements about the development of a novel computer memory technology. The corporation had created a relationship with a manufacturer, which had created a subsidiary to develop and commercialize the technology. Defendants eventually divested the subsidiary, and investors claimed that Defendants had misled investors by inflating stock prices. Defendants moved to dismiss, claiming that Plaintiffs had failed to meet the pleading standards for falsity, scienter, and materiality. The District Court denied Plaintiffs' request to permit another amendment of the complaint and granted Defendants' motion to dismiss, finding that none of the contested statements by Defendants were actionable and that the complaint did not meet the heightened pleading requirements for securities fraud actions. The Eighth Circuit affirmed.
2. The Eighth Circuit, quoting *Tellabs*, reiterated that the relevant inquiry as to the required state of mind is "whether all of the facts alleged, taken collectively, give rise to a strong inference of scienter . . . which is cogent and at least as compelling as any opposing inference one could draw from the facts alleged." *Id.* at 752. The Eighth Circuit then affirmed the findings of the District Court that the complaint did not satisfy these requirements. See *In re NVE Corp. Sec. Litig.*, 551 F. Supp. 2d 871 (D. Minn. 2007).
3. The Eighth Circuit found that because Plaintiffs did not articulate any change they wished to make in an amended pleading, or demonstrate how revision would address the numerous pleading deficiencies identified by the District Court, leave to amend was properly denied.

- C. *Little Gem Life Sciences LLC v. Orphan Med., Inc.*, 537 F.3d 913 (8th Cir. Aug. 11, 2008)
1. Appeal of an order by the District Court (D. Minn.) granting Defendant company's motion to dismiss based on the Plaintiff investor's failure to meet the heightened pleading standards required by the PSLRA. Investor Plaintiff filed a negligence-based class action under § 14(a) of the Exchange Act, alleging that Defendant pharmaceutical company and its officers violated the Exchange Act by failing to disclose early drug trial data before asking investors to approve a merger, in order to improve the stock price prior to the merger. The District Court found that Plaintiff failed to meet the heightened pleading standard. Plaintiff appealed on the grounds that the motion to dismiss should have been converted to a summary judgment motion, given the consideration of outside information. The Eighth Circuit affirmed the dismissal.
 2. The District Court's reliance on public records such as SEC filings does not convert a motion to dismiss into a motion for summary judgment.
 3. Defendants had no legal duty to seek out and disclose the results of a drug study before it would otherwise be disclosed and while it remained under professional analysis in accordance with FDA drug trial regulations. This is the case even though the disclosure of such results could have resulted in a higher stock price for investors.
- D. *In re Ceridian Corp. Sec. Litig.*, 542 F.3d 240 (8th Cir. Sept. 11, 2008)
1. Appeal of an order by the District Court (D. Minn.) dismissing a complaint for failure to state a claim under the PSLRA's heightened pleading requirements. Over a period of about one year, Ceridian announced that certain accounting errors necessitated multiple amendments and restatements of its published financial statements. Investor Plaintiffs filed securities fraud class actions against the corporation and former officers alleging violations of § 10 and Rule 10b-5 based on the multiple restatements. The District Court dismissed the complaint because Plaintiffs failed to "state with particularity facts giving rise to a strong inference that the defendant[s] acted with the required state of mind," as required under the PSLRA. The Eighth Circuit concluded that the dismissal was consistent with the Supreme Court's *Tellabs* decision and affirmed.
 2. While the Eighth Circuit previously applied a plain meaning interpretation of PSLRA's "strong inference" pleading requirement ("strong means strong"), *Tellabs* provides an "additional hurdle" by requiring that the inference be "cogent and at least as compelling as any opposing inference of nonfraudulent intent." *Id.* at 244.

3. Regarding Plaintiffs' use of multiple factors to allege scienter, the Eighth Circuit explained that "[w]hen a party asserts, for example, that six factors collectively warrant a particular conclusion [on the issue of scienter], we do not assume the District Court failed to view the six collectively merely because it discussed them one at a time." *Id.* at 246.
4. Even multiple GAAP violations are insufficient to support an inference of severe recklessness. GAAP violations must be coupled with evidence of corresponding fraudulent intent.
5. Insider stock sales are only inherently suspicious "when the level of trading is dramatically out of line with prior trading practices at times calculated to maximize the personal benefit from the undisclosed information." *Id.* at 246-47. During the relevant time period, the two Defendants together sold over 200,000 shares of stock when they had sold no stock for several years prior. The Eighth Circuit emphasized, however, that the officers sold their shares before publication of reported earnings for the time period when the earnings were allegedly inflated. "If they intended to 'cook the books' to increase insider trading profits, why would they only sell shares before the books were cooked?" *Id.* at 247.
6. The Eighth Circuit gave no weight to the effect of an ongoing SEC investigation where the investigation found no evidence of fraud, and any personnel responsible for GAAP violations were fired for incompetence rather than fraud. The Eighth Circuit concluded that the facts pled did not support a strong inference of scienter, and the more compelling opposing inference was that the controlling officer Defendants should have known about the accounting errors affecting the corporation, which would support a claim of negligence, but not of fraud.

E. *Elam v. Neidorff*, 544 F.3d 921 (8th Cir. Oct. 16, 2008)

1. Appeal of an order by the District Court (E.D. Mo.) dismissing a class action against a healthcare enterprise and corporate officers for allegedly false statements regarding medical costs in quarterly earnings in violation of § 10(b) and Rule 10b-5. In reporting its quarterly earnings, the healthcare enterprise included not only the costs incurred and billed during the quarter, but also an estimate of claims liability. After its first quarter for 2006, the company released guidance for the second quarter, stating its expected revenue. The company's CEO stated that the company's first quarter medical cost trends were improving and that the company was not projecting "anything that is devastating." *Id.* at 926. The second quarter earnings were substantially lower than expected due to additional medical costs, and the company adjusted its guidance for the remainder of the year. Investors filed securities fraud class actions against Defendant company and its officers for allegedly causing artificially inflated stock prices. The District Court dismissed the complaint, finding that Plaintiff investors failed to allege facts demonstrating that Defendants misrepresented a material fact or acted with scienter. The Eighth Circuit affirmed.
2. Conclusory allegations that the healthcare enterprise and its officers must have known of information conflicting with their allegedly false statements were insufficient to support a strong inference of scienter. The complaint did not allege that Defendants knew at the time the statements were made any specific fact indicating earnings would be substantially lower due to medical costs, but only alleged that they must have known based on the sophistication of the company's medical cost-estimating process.
3. Plaintiffs' allegation that the information at issue was at the "core" of the company's business, and that knowledge of information therefore could be attributed to the company and its key officers, was insufficient in this case. Plaintiffs did not allege that critical facts were actually known within the company at the time the statements were made. *Id.* at 929-30.
4. The close proximity between Defendants' statements and the announcement that caused the decline in stock value (one month) was found "troubling," but was insufficient on its own to support an inference of scienter. *Id.* at 930.

Ninth Circuit

- A. *In re Skechers U.S.A., Inc. Sec. Litig.*, 273 Fed. Appx. 626 (9th Cir. Apr. 10, 2008)
1. Appeal of an order by the District Court (C.D. Cal.) dismissing a complaint for securities fraud under §§ 10(b) and 20(a) against Skechers U.S.A., Inc. and four of its principal officers. Plaintiffs alleged that three of the officers committed fraud when they made optimistic earnings projections in press releases and conference calls, knowing that the company had been experiencing a decrease in sales. In a split decision, the Ninth Circuit affirmed the dismissal of Plaintiffs' complaint, concluding that Plaintiffs failed to meet their burden under the PSLRA.
 2. The Ninth Circuit found that Plaintiffs "failed to 'state with particularity facts giving rise to a strong inference that the defendant acted with' knowledge that their statements were false, as required by the PSLRA." *Id.* at 627. Although confidential witnesses alleged that Defendant officers knew that sales were down two months before the alleged false public statements, the record contained statements suggesting that the company's sales were experiencing an upswing one month later. The only link that Plaintiffs provided between Defendant officers' knowledge and the public statements two months later was the allegation of two confidential witnesses that, during those intervening weeks, Defendant officers received weekly updated projections of sales and knew that the company faced a sharp decline in sales. The Ninth Circuit found, however, that the complaint failed to describe with any detail the contents of those interim reports, who drafted them, or how the two confidential witnesses were in a position to know that Defendant officers received the reports.
 3. The Ninth Circuit also found that allegations of the company's push to shift sales from the third quarter into the second quarter were insufficient to plead scienter. The shifted sales were not necessary to meet second-quarter expectations because the company would have exceeded expectations with or without them. The Ninth Circuit agreed with the First Circuit's observation in *Greebel v. FTP Software, Inc.*, 194 F.3d 185, 202 (1st Cir. 1999), that "[t]here is nothing inherently improper in pressing for sales to be made earlier than in the normal course." *Id.* at 628.
 4. Finally, the Ninth Circuit found that Plaintiffs failed to demonstrate that Defendant officers' sales of stock during the time between the two allegedly false public statements were "dramatically out of line with prior trading practices at times calculated to maximize personal benefit from undisclosed inside information." *Id.* (citing *In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1117 (9th Cir. 1989)). Defendant officers had sold stock during the same two months of the previous year, and the quantity of stock sold did not support an inference of scienter.

5. The dissent concluded that, as a whole, the complaint established a strong inference of scienter, even though individual allegations scrutinized in isolation might have been insufficient.

B. *Berson v. Applied Signal Tech., Inc.*, 527 F.3d 982 (9th Cir. June 5, 2008)

1. Appeal of an order by the District Court (N.D. Cal.) dismissing Plaintiff investors' complaint against a securities issuer and two of its officers under § 10(b). Plaintiffs alleged that they were misled by the issuer's reporting of a company backlog, which reported the dollar value of work the issuer was contracted to perform but had not yet completed. Plaintiffs alleged that stop-work orders were issued and work was likely to be cancelled altogether, but the company improperly included the contracts on which stop-work orders had been issued in the company's "backlog"—a term defined as the dollar value of work the company had contracted to perform but had not yet performed. The Ninth Circuit reversed the dismissal and remanded.
2. The Ninth Circuit held that Plaintiffs pled with particularity the existence of stop-work orders and that the stop-work orders were included in the backlog report by relying upon four confidential witnesses who would testify about the existence and effect of the stop-work orders. The four confidential witnesses worked at the company as engineers and technical editors. The Ninth Circuit found that even though these confidential witnesses were not managers, they were in positions to infer the existence and effect of stop-work orders that would have the "obvious effect of putting numerous employees out of work," and the Complaint alleged that the stop-work orders were in effect when Defendants made statements regarding the company's backlog. *Id.* at 985.
3. The Ninth Circuit further held that Plaintiffs had stated facts with particularity that gave rise to a strong inference that Defendant officers were aware that the stop-work orders had halted significant amounts of work, yet counted the stopped work as backlog. Defendant officers were directly responsible for the company's day-to-day operations and the Ninth Circuit found it difficult to believe that they would not have known about stop-work orders that allegedly halted millions of dollars of the company's work.
4. Finally, the Ninth Circuit rejected Defendants' argument that the PSLRA barred liability for their statements about backlog, because those statements were "forward-looking." The Ninth Circuit determined that the company's backlog report was not a "projection" of earnings, but was a snapshot of the amount of work the company was under contract to perform at a given time, and "descriptions of the present aren't forward-looking." *Id.* at 990.

- C. *Metzler Investment GMBH v. Corinthian Colleges, Inc.*, 540 F.3d 1049 (9th Cir. Aug. 26, 2008)
1. Appeal of an order by the District Court (C.D. Cal.) dismissing Plaintiffs' third amended complaint with prejudice. Plaintiffs alleged that Defendants violated §§ 10(b), 20(a) and Rule 10b-5 by engaging in deceptive and fraudulent schemes designed to maximize Corinthian Colleges, Inc.'s ("Corinthian's") receipt of federal funding, including, among other things, falsifying financial aid applications and manipulating student enrollment numbers. Plaintiffs also alleged that Defendants violated GAAP by improperly recognizing revenue and that Defendants failed to disclose that Corinthian was under investigation by the Department of Education and the California Attorney General. The Ninth Circuit affirmed the District Court's dismissal on the grounds that Plaintiffs had failed sufficiently to allege falsity, loss causation, and scienter.
 2. Applying the *Tellabs* standard, and considering the complaint holistically to determine whether Plaintiffs' allegations gave rise to a strong inference of scienter, the Ninth Circuit held that Plaintiffs' allegations, even when considered collectively, were insufficient to meet the PSLRA's pleading standard with respect to scienter.
 3. The Ninth Circuit held that Plaintiffs' allegations of insider trading were insufficient to raise a strong inference of scienter, particularly when it considered the possible opposing inferences to be drawn from Defendants' pattern of trading.
 4. The Ninth Circuit held that Plaintiffs' allegations of the existence of a sophisticated information management system providing access to information lacked the specificity necessary to establish a strong inference of scienter. The Ninth Circuit noted that those allegations were premised on the inference that the existence of this system necessarily meant that the CEO, CFO, and COO were aware of the alleged fraudulent scheme. The Ninth Circuit rejected this notion, pointing out that it has previously held that management's general awareness of the day-to-day workings of a company's business is insufficient to establish scienter without some additional allegation of specific information conveyed to management that was related to the fraud. Applying *Tellabs*, the Ninth Circuit held that it was more "cogent and at least as compelling" to infer that the information systems were maintained for the necessary and legitimate purpose of running the company's business. *Id.* at 1068.

5. The Ninth Circuit also held that Plaintiffs' allegation regarding the CFO's insistence on certain revenue recognition practices failed to give rise to the strong inference of scienter because Plaintiffs failed sufficiently to allege that the CFO knowingly and recklessly engaged in an improper accounting practice. Plaintiffs also failed to tie the disputed revenue recognition practice, or Corinthian's financial restatements when the practice was changed, to Plaintiffs' overall theory that Corinthian inflated its student enrollment numbers to obtain additional federal funding for financial aid.
6. Finally, the Ninth Circuit noted that Plaintiffs' most persuasive scienter allegation stemmed from the CFO's alleged comments to admissions officers at a company meeting that "they were in the gray area" in dealing with unqualified students. Nonetheless, the Ninth Circuit held that this allegation was insufficient because, viewing the complaint as a whole, it failed to give rise to a strong inference of scienter. *Id.* at 1069. The Ninth Circuit noted that *Tellabs'* directive that the complaint must be read in its entirety "cuts both ways," and "[a]lthough a defendant cannot gain dismissal by decontextualizing every statement in a complaint that goes to scienter, a plaintiff cannot avoid dismissal by reliance on an isolated statement that stands in contrast to a host of other insufficient allegations." *Id.*

D. *South Ferry LP, #2 v. Killinger*, 542 F.3d 776 (9th Cir. Sept. 9, 2008)

1. Interlocutory appeal from an order by the District Court (W.D. Wash.) granting in part and denying in part Defendants' motion to dismiss based on failure to satisfy the PSLRA's pleading requirements. Plaintiffs, investors in Washington Mutual, Inc. ("WAMU") filed a securities fraud action against WAMU and certain of its officers alleging violations of §§ 10(b), 20(a) and Rule 10b-5. Plaintiffs alleged that Defendants made materially false or misleading statements concerning WAMU's ability to manage certain risks associated with WAMU's mortgage lending business. The District Court denied Defendants' motion to dismiss as to three of the individual officer Defendants. The District Court held that Plaintiffs had satisfied the PSLRA's heightened pleading standard because it could be inferred that the company's key officers knew about WAMU's problems with its information systems, as those were facts critical to a company's "core operations" (the "core operations inference"). The Ninth Circuit vacated the order with respect to the PSLRA's scienter requirement and remanded to the District Court.

2. In doing so, the Ninth Circuit reviewed its pre-*Tellabs* decisions of *In re Silicon Graphics Inc. Sec. Litig.*, 183 F.3d 970 (9th Cir. 1999), *In re Vantive Sec. Litig.*, 283 F.3d 1079 (9th Cir. 2002) and *In re Read-Rite Corp. Sec. Litig.*, 335 F.3d 843 (9th Cir. 2003), that generally prevented a Plaintiff from relying exclusively on the core operations inference to plead scienter under the PSLRA. The Ninth Circuit reasoned that *Tellabs* sets forth the “level of detail required under the PSLRA, and with its controlling and persuasive weight, it suggests that perhaps *Silicon Graphics*, *Vantive*, and *Read-Rite* are too demanding and focused too narrowly in dismissing vague, ambiguous, or general allegations outright.” *South Ferry LP, #2*, 542 F.3d at 784.
 3. Citing the reasoning in *Tellabs*, the Ninth Circuit held that allegations that rely on the core operations inference may satisfy the PSLRA scienter requirement, in whole or in part, in three situations. First, under *Tellabs*, “the allegations may be used in any form along with other allegations that, when read together, raise an inference of scienter that is ‘cogent and compelling, thus strong in light of other explanations.’” *Id.* at 785 (citing *Tellabs*). Second, the allegations may independently satisfy the PSLRA if they are particular and suggest that Defendants had actual access to the disputed information. *Id.* at 786 (citing *In re Daou Systems, Inc.*, 411 F.3d 1006, 1022-23 (9th Cir. Jan. 21, 2005); *Nursing Home Pension Fund, Local 144 v. Oracle Corp.*, 380 F.3d 1226, 1231 (9th Cir. 2004)). Third, the allegations may “conceivably satisfy the PSLRA standard in a more bare form, without accompanying particularized allegations, in rare circumstances where the nature of the relevant fact is of such prominence that it would be ‘absurd’ to suggest that management was without knowledge of the matter.” *Id.* (citing *Berson v. Applied Signal Tech., Inc.*, 527 F.3d 982, 988 (9th Cir. June 5, 2008)).
- E. *Glazer Capital Management, LP v. Sergio Magistri*, 549 F.3d 736 (9th Cir. Nov. 26, 2008)
1. Appeal of an order by the District Court (N.D. Cal.) dismissing Plaintiff shareholders’ class action against Defendants alleging violations of § 10(b), Rule 10b-5 and denying leave to amend. The Ninth Circuit affirmed.

2. Plaintiffs were shareholders of InVision Technologies, Inc. (“InVision”), which entered into a merger agreement with General Electric (“GE”). Several months after the merger agreement, InVision issued a press release casting doubt on the validity of the merger agreement because of the discovery of InVision’s potential violations of the Foreign Corrupt Practices Act (“FCPA”). The merger was later finalized, but, after the press release, InVision’s stock price immediately dropped and Plaintiffs filed a class action against InVision, its CEO, and its CFO. Plaintiffs alleged that there were three actionable misstatements in the merger agreement that InVision had attached to its Form 10-K. The District Court held that Plaintiffs had not adequately pled either falsity or scienter with respect to the alleged misstatements.
 3. The Ninth Circuit found that Plaintiffs had satisfied the pleading requirements of the PSLRA with respect to the issue of falsity because InVision had asserted in its Form 10-K that it was in compliance in all material respects with all laws when, in reality, Plaintiffs demonstrated that InVision was not in compliance with the provisions of § 13(b) of the Exchange Act.
 4. Recognizing that there was a split among other Circuits, but declining to address whether “collective scienter” should be recognized in the Ninth Circuit, the Ninth Circuit held that, given the limited nature and unique context of the alleged misstatements, the PSLRA requires Plaintiffs to plead scienter with respect to those individuals who actually made the false statements in the merger agreement, in this case the CEO. Plaintiffs were unable to plead facts directly demonstrating that the CEO possessed the requisite scienter, and the Ninth Circuit rejected Plaintiffs’ various attempts to argue that scienter should be inferred based on factors such as the small size and nature of InVision’s business, the Sarbanes-Oxley certification, the fact that the FCPA violations were discovered relatively quickly by GE in its due diligence process, the CEO’s motivation of personal profits, and subsequent DOJ and SEC settlements.
- F. *Shurkin v. Golden State Vintners, Inc.*, No. 07-15762, 2008 WL 5213592, 2008 U.S. App. LEXIS 26188 (9th Cir. Dec. 11, 2008)
1. Appeal of an order by the District Court (N.D. Cal.) dismissing Plaintiff’s securities fraud class action complaint for failure to adequately plead scienter and falsity. The Ninth Circuit affirmed.

2. Plaintiff Shurkin alleged violations of §§ 10(b), 20(A), 20(a), and Rule 10b-5 by Defendant Golden State Vintners' ("GSV") dissemination of a proxy statement and press release in which GSV allegedly manipulated data that was used in determining the fairness of a share buyout price. Specifically, Plaintiff alleged that GSV manipulated data that was used to determine a shareholder buyout price in the subject documents. In making this claim, Plaintiff relied particularly on confidential witness statements and a purported obligation by GSV to provide "real time" financial data to shareholders.
3. In upholding the dismissal, the Ninth Circuit found that Plaintiff failed to meet the PSLRA's heightened pleading requirements for using confidential witnesses, for, at most, Plaintiff's confidential witness statements showed merely a difference of opinion between the witness and Defendant.
4. Furthermore, the Ninth Circuit explained that GSV was only obligated to update the relied-upon financial data periodically, and not continuously. Thus, GSV's use of first quarter financial figures, when second quarter figures were unavailable, violated no securities law, and the dismissal of Plaintiff's claims was upheld on all counts.

Eleventh Circuit

- A. *Mizzaro v. Home Depot, Inc.*, 544 F.3d 1230 (11th Cir. Oct. 8, 2008)
 1. Appeal of an order by the District Court (S.D. Fla.) dismissing a putative class action alleging violations of §§ 10(b), and 20(a) and Rule 10b-5. The District Court granted Defendants' motion to dismiss for failure to plead scienter, and also denied leave to amend. The Eleventh Circuit affirmed the dismissal on all counts.
 2. Plaintiff investors brought a putative class action against Defendant Home Depot and certain of its officers. Plaintiffs alleged that Defendants failed to disclose that corporate earnings were inflated due to widespread store practices of falsely reporting that products delivered to stores were defective in order to obtain unwarranted chargebacks, when the goods were actually lost to shoplifters or sold to customers.
 3. Noting that the Supreme Court's decision in *Tellabs* had not addressed how courts should evaluate allegations based on unidentified confidential witnesses, the Eleventh Circuit held that while confidential sources are not *per se* invalid in securities fraud cases, Plaintiffs' complaint must provide a detailed basis for those sources' knowledge.

4. The Eleventh Circuit held that Plaintiffs' allegations drew impermissible conclusions between the chargeback scheme that occurred amongst low-level employees and the knowledge of high-ranking officials; scienter was inadequately pled. The Eleventh Circuit noted that while the complaint's allegations ultimately established that Home Depot stores processed improper chargebacks, simply alleging widespread fraud was not adequate to plead scienter. Plaintiffs failed to plead a strong inference that the individual high-ranking Defendants either orchestrated the fraud or knew about the fraud, and thus their securities claims fell short. Accordingly, the Eleventh Circuit upheld the dismissal of the claims against the individual Defendants. Because the complaint did not allege that any other Home Depot officials were involved in or knew of the alleged fraud, the Eleventh Circuit dismissed the allegations against the company itself.

Second Circuit

- A. *Masters v. GlaxoSmithKline*, 271 Fed. Appx. 46 (2d Cir. Mar. 26, 2008)
1. Appeal of an order by the District Court (S.D.N.Y.) dismissing shareholders' putative class action against Defendant drug manufacturer and CEO for securities fraud. The Second Circuit affirmed the dismissal for all claims. Plaintiffs' complaint alleged that GlaxoSmithKline ("GSK") and its CEO committed securities fraud under § 10(b) and Rule 10b-5 in four ways:
 - (a) suppressing information about Paxil's negative side effects of addictiveness and withdrawal;
 - (b) making false statements and omissions regarding the viability of drug patents for Paxil and Augmentin;
 - (c) overcharging Medicare and Medicaid for drugs; and
 - (d) misrepresenting Paxil's safety for use in treating children.
 2. The final claim was dismissed for failure to adequately allege materiality and loss causation. Plaintiffs also failed to plead loss causation because they failed to demonstrate a causal link between alleged stock losses and the alleged misconduct. Plaintiffs alleged two separate significant stock losses on June 24 and December 9, 2004. However, Plaintiffs' claims failed because the price of GSK stock actually increased between the time of the first alleged stock loss and the second. Furthermore, the December 9 stock drop occurred after the close of the class period, rendering it irrelevant.
- B. *Gordon Partners v. Blumenthal*, 293 Fed. Appx. 815 (2d Cir. Sept. 24, 2008)
1. Appeal of an order by the District Court (S.D.N.Y.) granting summary judgment of federal and state securities actions. The Second Circuit upheld the dismissal of all claims.
 2. Plaintiffs brought § 10(b), Rule 10b-5, and state law claims against Defendant NTL, Inc. and its corporate executives, alleging that they made false statements and omissions to the public through routine filings and to Plaintiffs privately in order to affirmatively mislead them, resulting in the loss of millions of dollars.

3. Beginning in 1993, NTL, a telecommunications company, pursued corporate growth through acquisitions and issued debt securities to finance them. As a result, NTL carried \$15.1 billion in debt by 2000. Plaintiffs alleged that NTL made materially misleading statements by failing to disclose internal financial stability problems in order to inflate NTL stock price. The District Court dismissed all federal claims for failure to prove loss causation and dismissed Plaintiffs' state securities claims as precluded by SLUSA. Plaintiffs appealed.
4. The Second Circuit upheld the dismissal of all claims. Alleging causation under § 10(b) or Rule 10b-5 requires a two-part showing: transaction causation and loss causation. Plaintiffs adequately showed transaction causation, but failed to allege any facts establishing loss causation. Loss causation is the "causal link" between the misconduct and the economic loss, and is a necessary element of any § 10(b) action, regardless of factual circumstances. Plaintiffs' argument, that demonstrating personal reliance on statements made to them is sufficient, failed. Plaintiffs must have alleged facts explaining why they lost money on their NTL stock purchases, not merely why they purchased the stock in the first place. In this case, Plaintiffs failed to provide any evidence on which the District Court could base a finding of loss causation.
5. The Second Circuit did not reach the question of whether SLUSA precluded Plaintiffs' common law fraud claims because in New York, loss causation is also an element of fraud. Thus, Plaintiffs' fraud claims failed for the same reason as the § 10(b) and Rule 10b-5 claims.

Ninth Circuit

A. *Berson v. Applied Signal Tech., Inc.*, 527 F.3d 982 (9th Cir. June 5, 2008)

1. Appeal from an order by the District Court (N.D. Cal.) dismissing Plaintiff investors' complaint against a securities issuer and two of its officers under § 10(b). Plaintiffs alleged that they were misled by the issuer's reporting of a company backlog, which reported the dollar value of work the issuer was contracted to perform but had not yet completed. Plaintiffs alleged that stop-work orders were issued and work was likely to be cancelled altogether, but the company improperly included the contracts on which stop-work orders had been issued in the company's "backlog" – a term defined as the dollar value of work the company had contracted to perform but had not yet performed. Plaintiffs claimed that the company's backlog reports misled them into believing that the company was likely to perform work that, in reality, had been stopped and was likely never to be performed. The Ninth Circuit reversed the dismissal and remanded.
2. The Ninth Circuit held that Plaintiffs had adequately pled that the backlog report was misleading using statements by confidential witnesses, and rejected Defendants' argument that they had adequately disclosed that the backlog report included stopped contracts.
3. The Ninth Circuit also held that Plaintiffs sufficiently pled loss causation by alleging that the misleading backlog report led to a decrease in the value of their shares. The parties disputed the standard for pleading loss causation. Plaintiffs claimed that Rule 8(a)(2) applied, and that a "short and plain statement" of their loss theory sufficed. Defendants argued that Plaintiffs were required to satisfy Rule 9(b), and to "state with particularity the circumstances constituting fraud." The Ninth Circuit noted that the Supreme Court has not yet answered the question presented, and held that it need not decide the question in this case because Plaintiffs had pled the element of loss causation with particularity. "[T]he complaint describes the orders in sufficient detail to give defendants ample notice of plaintiffs' loss causation theory, and to give us some assurance that the theory has a basis in fact." *Id.* at 989-90.

B. *In re Gilead Sciences Sec. Litig.*, 536 F.3d 1049 (9th Cir. Aug. 11, 2008)

1. Appeal of an order by the District Court (N.D. Cal.) dismissing Plaintiffs' fourth amended complaint with prejudice for failure to adequately plead loss causation. The Ninth Circuit reversed and remanded, holding that Plaintiffs alleged facts that plausibly established loss causation and that dismissal was thus improper.

2. Plaintiffs asserted claims for violations of §§ 10(b), 20(a) and Rule 10b-5 against Defendant Gilead, a biopharmaceutical company, based on the company's failure to disclose that a large portion of the company's pharmaceutical sales were based on an illegal scheme to promote and market off-label uses of its cornerstone drug. According to Plaintiffs, Gilead and its officers and directors represented to the public that the company complied with all federal and state regulations while knowing that the company was illegally marketing its drugs for off-label uses. The FDA later demanded that Gilead cease its off-label marketing, setting off a chain of events that, over the course of several months, allegedly led to a reduction of demand for Gilead's pharmaceutical products, lower sales projections, and a substantial drop in Gilead's stock price.
3. The Ninth Circuit held that Plaintiffs' allegations were sufficient to establish loss causation. The Ninth Circuit reasoned that "so long as plaintiff alleges facts to support a theory that is not facially implausible, the court's skepticism is best reserved for later stages of the proceedings when plaintiff's case can be rejected on evidentiary grounds." *Id.* at 1057. The Ninth Circuit further rejected a "bright-line rule requiring an immediate market reaction" to the disclosure of information correcting a fraud, holding that the "the market is subject to distortions that prevent the ideal of a free and open public market from occurring." *Id.* at 1057-58.
4. The Ninth Circuit did not decide whether Rule 8 or Rule 9(b) applied to pleading allegations of loss causation. Because Plaintiffs' complaint offered "sufficient detail to give defendants ample notice of their loss causation theory, and to give us some assurance that the theory has a basis in fact," the Ninth Circuit held that the allegations were sufficient under either Rule 8 or Rule 9(b). *Id.*

- C. *Metzler Investment GMBH v. Corinthian Colleges, Inc.*, 540 F.3d 1049 (9th Cir. Aug. 26, 2008)
1. Appeal of an order by the District Court (C.D. Cal.) dismissing Plaintiffs' third amended complaint with prejudice. Plaintiffs were purchasers of Defendant Corinthian Colleges, Inc.'s ("Corinthian's") stock. They alleged that Defendants violated §§ 10(b), 20(a) and Rule 10b-5 by engaging in deceptive and fraudulent schemes designed to maximize Corinthian's receipt of federal funding including, among other things, falsifying financial aid applications and manipulating student enrollment numbers. Plaintiffs also alleged that Defendants violated GAAP by improperly recognizing revenue and failed to disclose that Corinthian was under investigation by the Department of Education and the California Attorney General. Plaintiffs alleged that Corinthian was pervaded by fraudulent practices and that nearly every statement by Defendants regarding Corinthian's financial status was false. Without comment or analysis, the District Court dismissed the third amended complaint with prejudice. The Ninth Circuit affirmed in a unanimous decision on the grounds that Plaintiffs had failed to sufficiently allege falsity, loss causation, and scienter.
 2. The Ninth Circuit held that to plead loss causation adequately, a complaint must set forth allegations that, if assumed to be true, would provide some indication that the drop in Corinthian's stock price was causally related to Corinthian's alleged financial misstatements. Plaintiffs alleged that Corinthian's share price fell significantly following a news story disclosing the Department of Education's investigation of one of Corinthian's campuses and Corinthian's later earnings announcement. The Ninth Circuit held that neither the news story nor the earnings announcement could reasonably be read to reveal the alleged widespread fraudulent scheme. Therefore, the complaint did not adequately plead that it was the revelation of the alleged widespread fraudulent scheme, as opposed to something else, that precipitated the stock-price drop.
 3. With regard to the news story, the Ninth Circuit noted that the story only revealed an investigation of a single Corinthian campus and explicitly stated that the investigation did not affect the status of other Corinthian campuses. The Ninth Circuit further noted that the third amended complaint contended only that this news story disclosed to investors a "potential but real" risk that all of Corinthian's 88 campuses would be subject to sanction. The Ninth Circuit rejected the notion that loss causation was adequately pled where Defendant's disclosure revealed only a "risk" or "potential" for widespread fraud.

4. The complaint alleged that the company's earnings announcement reported "higher than anticipated attrition" and that this announcement was understood by the market as Corinthian's "euphemism for an admission that they had enrolled students who should not have been signed up at all." *Id.* at 1064. Plaintiffs alleged that this revelation, by way of "euphemism," resulted in the subsequent stock-price drop. The Ninth Circuit held that loss causation could not be pled "through 'euphemism' and thereby avoid alleging the necessary connection between defendant's fraud and the actual loss." *Id.* The Ninth Circuit noted that if loss causation could be pled through euphemism, so long as there was a stock-price drop, Plaintiffs would always be able to contend that investors understood Defendants' statements precipitating the loss to be a "coded message revealing the fraud." *Id.* The Ninth Circuit held that "[e]nabling a plaintiff to proceed on such a theory would effectively resurrect what *Dura* discredited—that loss causation is established through an allegation that a stock was purchased at an inflated price." *Id.*
5. The Ninth Circuit went on to hold that, while it assumed that the facts of the complaint were true, it did not need to indulge unwarranted inferences to save the complaint. With regard to the news story and earnings announcement, the Ninth Circuit pointed out that Plaintiffs' allegation that the market understood the disclosures to reveal systematic fraud was not a "fact," but rather an inference that Plaintiffs believed was warranted. However, the Ninth Circuit noted that Defendants pointed out that the modest ten percent drop precipitated by the news story regarding the Department of Education's investigation was very short lived and that the earnings announcement's disclosure of the company's failure to hit a prior earnings estimate was a more plausible reason for the stock price drop that followed the announcement. The Ninth Circuit also noted that the earnings announcement reported a 50-percent increase in student population growth and a 15-percent increase in same-campus population, thereby weakening the inference that the market understood the announcement's reference to attrition as a revelation of widespread fraud.

Eleventh Circuit

- A. *Lopez v. Rica Foods, Inc.*, 277 Fed. Appx. 931 (11th Cir. May 14, 2008)
 1. Appeal of an order by the District Court (S.D. Fla.) dismissing Plaintiffs' action with prejudice. The Eleventh Circuit affirmed the dismissal of Plaintiffs' § 10(b) and Rule 10b-5 claims but reversed the dismissal of the common law fraudulent and negligent misrepresentation claims.

2. The Eleventh Circuit, without providing information concerning the substantive nature of Plaintiffs' claims, determined that the federal and state securities fraud claims were properly dismissed because the complaint failed to adequately allege how Defendant's alleged misstatements were misleading and failed to adequately allege scienter.
3. The Eleventh Circuit then concluded that the District Court erred in dismissing Plaintiffs' common law fraudulent and negligent misrepresentation claims for failure to allege loss causation. Specifically, the Eleventh Circuit determined that the loss causation analysis required by *Dura* for federal securities fraud claims did not govern Plaintiffs' common law claims for fraudulent and negligent misrepresentation. Rather, the pleading requirements for those causes of action are governed by state law.

District of Columbia Circuit

- A. *Media Gen., Inc. v. Tomlin*, 532 F.3d 854 (D.C. Cir. June 27, 2008)
 1. Appeal of an order by the District Court (D.D.C.) granting summary judgment in favor of Defendant company. Plaintiff, a publicly owned communications company that acquired Defendant company in a merger, sued the acquired company under § 10(b), Rule 10b-5, and common law fraud based on alleged misrepresentations by the acquired company during merger negotiations. According to Plaintiff, the acquired company represented that there was no suit threatened against or affecting the acquired company that was reasonably expected to have a material adverse effect, and also represented that this would be true at the time of closing. During that same time period, the acquired company fired one of its vice presidents, who then threatened suit regarding his severance payment. The purchasing company was not made aware of this threatened suit. The District Court granted Defendants' motion for summary judgment, finding that the litigation was not "material" to the merger, because the purchasing company did not characterize it as such in its SEC filing. The D.C. Circuit reversed and remanded, concluding that a reasonable jury could find the litigation "material," and that the District Court's reliance on the SEC filing was misplaced because the document was filed after the merger had closed. The District Court again granted summary judgment for Defendants and found that Plaintiff's reliance upon the alleged omissions and misrepresentations was unreasonable because the purchasing company could have asked for correspondence between the acquired company and its auditors, and the testimony by the purchasing company's representatives was too vague. Plaintiff appealed, and the D.C. Circuit reversed and remanded with respect to the fraud claims.

2. The D.C. Circuit restated the three factors necessary for an action under Rule 10b-5 as (1) misrepresentation or misleading omissions made with an intent to deceive, manipulate, or defraud, (2) reasonable reliance, and (3) economic loss. The D.C. Circuit reiterated that, as it had held the first time, a reasonable jury could find the litigation to be material. Focusing on reasonable reliance, the D.C. Circuit found that if, as testified, representatives of the purchasing company asked the acquired company about the litigation at issue, they were not also required to ask for communications with the acquired company's auditor to determine the truthfulness of the statements. The D.C. Circuit instead held that the purchasing company could reasonably rely on the acquired company's duty to disclose the lawsuit and not to hinder the purchasing company from learning about the matter. Thus, the D.C. Circuit concluded that a reasonable jury could find that the acquired company was misled by the purchasing company and reasonably relied on the misrepresentations.

Class Certification

Second Circuit

- A. *In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474 (2d Cir. Sept. 30, 2008)
1. Interlocutory appeal of an order by the District Court (S.D.N.Y.) certifying class of Plaintiffs. The Second Circuit vacated the order of certification and remanded the matter to the District Court.
 2. Plaintiffs filed a putative class action alleging that Citigroup, Salomon Smith Barney, Inc. and research analyst Jack Grubman violated § 10(b) and Rule 10b-5 by defrauding investors in issuing research reports that allegedly contained materially false and misleading statements concerning Metromedia Fiber Network, Inc. (“Metromedia”). Pursuant to Rule 23, the District Court certified a class of Plaintiffs, a group of investors who purchased Metromedia stock between March 8 and July 25, 2001.
 3. The Second Circuit found that the “fraud-on-the-market” presumption can apply to secondary actors such as research analysts. *Id.* at 481-82. The Second Circuit noted that the premise of the fraud-on-the-market theory is that “in an efficient market, share prices reflect ‘all publicly available information.’” *Id.* at 481.
 4. In the time between the District Court’s decision certifying the class and this decision, the Second Circuit decided *In re IPO*, 471 F.3d 24 (2d Cir. 2006), requiring District Courts to make a “definitive assessment” that a Plaintiff class meets the Rule 23(b)(3) predominance requirement—an assessment that allows defendants the opportunity to rebut the “fraud-on-the-market” presumption.
 5. Defendants argued that Plaintiffs needed to prove that the alleged misrepresentations of the research analyst impacted the market price of the securities, but the Second Circuit noted that Plaintiffs do not bear the burden of showing an impact on price. However, the Second Circuit remanded the case to allow Defendants to rebut the fraud-on-the-market presumption so that the District Court could make a definitive assessment on class certification. The District Court must assess and determine whether defendants can successfully rebut the fraud-on-the-market presumption by any evidence presented before certifying a class.

Fifth Circuit

- A. *Luskin v. Intervoice-Brite Inc.*, 261 Fed. Appx. 697 (5th Cir. Jan. 8, 2008)
1. Interlocutory appeal by Defendant Intervoice-Brite Inc. and individual Defendants from an order of the District Court (N.D. Tex.) certifying a class in a securities fraud suit containing §§ 10(b) and 20(a) claims. The Fifth Circuit vacated the class certification order and remanded the case to the District Court.
 2. In June 2000, Intervoice announced that it would report a loss and that earnings would be lower than anticipated. Plaintiff shareholders filed this putative class action alleging material misrepresentations and securities fraud against the issuer and its chief officers, in connection with statements concerning the merger, earnings, revenue projections and results.
 3. The District Court certified a class, concluding, *inter alia*, that common issues of reliance predominate because Plaintiffs could invoke the fraud-on-the-market presumption under *Basic*.
 4. The Fifth Circuit vacated the class certification. Under *Oscar Private Equity Investments v. Allegiance Telecom Inc.*, 487 F.3d 261 (5th Cir. May 16, 2007) (which was decided after the District Court certified a class in this action), the Fifth Circuit requires plaintiffs to establish loss causation to trigger the fraud on the market presumption. Plaintiffs must show that a misstatement “*actually moved* the market” in order to prove causation and trigger the presumption. *Id.* at 265. Rule 23 “mandates that a district court undertake a complete analysis of fraud-on-the-market indicators, including loss causation, prior to certifying a plaintiff class.” *Id.* at 701. Further, *Oscar* is not to be limited to situations involving multiple negative disclosures. As the District Court did not provide a complete analysis pursuant to *Oscar*, the Fifth Circuit remanded the case for the District Court to determine whether Plaintiffs adequately demonstrated loss causation sufficient to invoke the fraud-on-the-market presumption.

Supreme Court

- A. *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S.--, 128 S. Ct. 761, 169 L. Ed. 2d 627 (Jan. 15, 2008)
1. Investors alleged violations of § 10(b) and Rule 10b-5 in a class action against a television services corporation, its executives, independent auditor, and its vendors and customers. The investors alleged, among other things, that the corporation, Charter, entered into sham transactions with vendors and customers that improperly inflated the corporation's reported operating revenues and cash flow. The District Court (E.D. Mo.) dismissed the claims against the vendors and customers, and the Eighth Circuit affirmed. The Supreme Court affirmed the appellate decision below, holding that the implied right of action does not reach the customer/supplier companies because the investors did not rely upon their statements or representations.
 2. Certain of Respondents supplied Charter with cable converter boxes that Charter furnished to its customers. Plaintiffs alleged that Charter arranged to overpay Respondents for each box it purchased, with the understanding that Respondents would return the overpayment by purchasing advertising from Charter. The transactions, it is alleged, had no economic substance, but would allow Charter to record the advertising purchases as revenue and capitalize its purchase of the boxes to fool its auditor into thinking that Charter met projected revenue and operating cash flow numbers. The box agreements were allegedly back-dated to make them appear separate from the advertising agreements. Charter's inflated revenue was included in public SEC documents. Respondents had no role in preparing or disseminating Charter's financial statements, and booked the same transactions in accordance with GAAP in their own financial statements. It is alleged Respondents knew or were in reckless disregard of Charter's intention to use the transactions to inflate its revenues and knew the resulting financial statements issued by Charter would be relied upon by research analysts and investors.
 3. First, the Court reiterated the holding in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 114 S. Ct. 1439, 128 L. Ed. 2d 119 (Apr. 19, 1994), that § 10(b) liability does not extend to aiders and abettors. Thus, the conduct of a secondary actor must satisfy each element of the claim to impose liability. While there is a rebuttable presumption of reliance where (1) there is an omission of a material fact by one with a duty to disclose, or (2) when the statements at issue become public, under the fraud-on-the-market theory, neither of these conditions applies here because Respondents had no duty to disclose, and the acts at issue were not disclosed to the investing public.

4. The Court then rejected imposition of “scheme liability,” whereby Respondents would be liable, even absent a public statement, because of their involvement in a scheme to misrepresent Charter’s revenue. Under such a theory, whereby investors “rely” not only upon the public statements relating to a security but also upon all of the transactions those statements reflect, the implied cause of action would reach the whole marketplace in which the issuing company does business. Instead, the Court explained, reliance is tied to causation. In this case, the acts at issue, creation of private contracts that inflated Charter’s revenue, were not disclosed to the investing public and are too remote to satisfy the reliance requirement. It was Charter, not Respondents, that allegedly misled its auditor and filed fraudulent financial statements. As further rationalization that the claim need not be expanded to cover such wrongful acts, the Court noted that secondary actors are subject to criminal penalties, *see, e.g.*, 15 U.S.C. § 78ff, and civil enforcement by the SEC, *see, e.g.*, § 78t(e).
5. Finally, the Court explained that the history of the § 10(b) private right of action, which was a judicial construct, provides another reason for restraint in its expansion. The decision to extend the reach of § 10(b) further is for Congress, not the Court.

Seventh Circuit

- B. *Pugh v. Tribune Co.*, 521 F.3d 686 (7th Cir. Apr. 2, 2008)
 1. Appeal of an order by the District Court (N.D. Ill.) dismissing a securities class action brought by shareholders of a newspaper publishing company against four of its executive officers and five employees of its subsidiary, including one Defendant who pled guilty to criminal charges of fraud in the matter. Plaintiff shareholders alleged fraudulent boosting of newspaper circulation figures by the subsidiary in order to increase advertising revenue in violation of § 10(b) and Rule 10b-5. The Seventh Circuit held that Plaintiffs failed to establish a strong inference of scienter against all three groups of Defendants and also that Plaintiffs’ allegations of “scheme liability” were insufficient under *Stoneridge*.
 2. Plaintiffs focused on one employee, Sito, whose job titles included vice president for circulation, president, publisher, and chief executive of the subsidiary company and vice president for Hispanic Media at the main newspaper company. Plaintiffs contended that Sito (and others) knowingly signed false circulation audits for the subsidiaries, which were submitted to ABC, and that these submissions were public statements upon which fraud can be based. Additionally, Sito pled guilty to directing subsidiary employees to falsely inflate paid circulation data, and Plaintiffs alleged that this plea was sufficient to show his state of mind and establish scheme liability.

3. Applying *Stoneridge*, the Seventh Circuit took note of Congress's emphasis on the phrase "in connection with the purchase or sale of any security," meaning that it did not intend to reach all fraudulent commercial transactions that affect the price of a security in some attenuated way. Because Sito had no role in preparing or disseminating the newspaper's financial statements or press releases, and because there were no allegations that investors were ever informed of Sito's false certifications, Sito's actions are too attenuated in the causal chain to establish primary liability.

⁴ SLUSA amended § 16 of the Securities Act and § 28 of the Exchange Act by providing for both removal and dismissal of (i) a “covered class action,” as that term is defined in SLUSA; (ii) based on state law; (iii) alleging either “a misrepresentation or omission of material fact” or “that the defendant used or employed any manipulative or deceptive device or contrivance”; (iv) “in connection with the purchase or sale of a covered security.” 15 U.S.C. §§ 77p, 78bb(f). SLUSA is frequently referred to as a law of “preemption.” However, the Supreme Court has noted that it is actually a law of “preclusion.” This is because SLUSA does not displace state law but rather makes some state law claims “nonactionable through the class action device in federal as well as state court.” *Kircher v. Putnam Funds Trust*, 547 U.S. 633, 636 n.1, 126 S. Ct. 2145, 165 L. Ed. 2d 92 (June 15, 2006). In accordance with the Supreme Court’s view, we refer to SLUSA throughout as a law of “preclusion,” notwithstanding the fact that certain of the Circuit Courts continue to refer to it as a law of “preemption.”

Second Circuit

- A. *Fisher v. Kanas*, 288 Fed. Appx. 721 (2d Cir. July 7, 2008)
1. Appeal of an order by the District Court (S.D.N.Y.) denying Plaintiff's motion to remand and dismissing action pursuant to SLUSA. The Second Circuit affirmed the order of the District Court.
 2. Plaintiff filed a putative class action in state court alleging that North Fork Bancorporation, Inc. ("North Fork") violated §§ 14(a) and 20(a) by disseminating misleading proxy statements that failed to accurately reflect the compensation received by certain North Fork executives. The complaint alleged that the dissemination of the false information constituted a breach of fiduciary duties owed to shareholders under Delaware law. Defendants removed the action to federal court pursuant to SLUSA, and Plaintiff moved to remand. The District Court denied the motion to remand and dismissed the action on the grounds that it is a "covered class action" within the meaning of SLUSA.
 3. On appeal, Plaintiff argued that she was not seeking damages for misrepresentations made "in connection with the purchase or sale of a covered security." *Id.* at 723. Defendants responded that the "in connection with" requirement of SLUSA was satisfied because Plaintiff was seeking damages based on the diminution in the value of stock resulting from a merger. Further, Defendants argued that the "in connection with" element was satisfied because Plaintiff alleged that, but for the misleading proxy statements, shareholders would have received increased consideration in connection with the merger, which is a sale of stock. The Second Circuit affirmed the order of the District Court, concluding that the allegations set forth in Plaintiff's complaint fell "squarely within SLUSA's scope" and that *Dabit*, which calls for a broad reading of the "in connection with" language of SLUSA, is controlling. The Second Circuit hastened to add that neither SLUSA nor *Dabit* precluded Plaintiff from bringing an individual action in state court for fraud or breach of fiduciary duty.

Third Circuit

- A. *LaSala v. Bordier et Cie*, 519 F.3d 121 (3d Cir. Mar. 11, 2008)
1. Appeal of an order by the District Court (D.N.J.) dismissing a diversity action against private Swiss banks brought by trustees of a bankrupt corporation's liquidating trust. Plaintiffs asserted state law claims for aiding and abetting breach of fiduciary duty and claims for violation of Swiss money-laundering laws. Plaintiff trustees were assignees of the original investors in the now defunct corporation's stock. The District Court dismissed the class action as precluded by SLUSA, explaining that this was a claim brought "on behalf of 50 or more persons."
 2. The Third Circuit reversed, holding that the state law claims at issue did not belong to the investors of the corporation, but were direct corporate claims assigned to the trust from the bankruptcy estate. As such, SLUSA did not apply. The Third Circuit also held that SLUSA did not prevent the trust from asserting Swiss law claims against the banks for violating Swiss money-laundering regulations.
 3. SLUSA only applies to "covered class actions," which include claims brought "on behalf of 50 or more persons." Because the claims at issue belonged to the trust, and not the assignor investors, the brought "on behalf of 50 or more persons" requirement of SLUSA was not satisfied. Congress did not intend SLUSA to reach direct, corporate-originated claims.
 4. By its terms, SLUSA only affects claims based upon the laws of a state or territory of the United States. Swiss law money-laundering claims are not "based upon the statutory or common law of any State." Nor do such claims arise under New Jersey law because of application of New Jersey choice-of-law rules.

Fifth Circuit

- A. *In re Enron Corp. Sec. Derivative & ERISA Litig.*, 535 F.3d 325 (5th Cir. July 10, 2008)
1. Appeal of an order by the District Court (S.D. Tex.) dismissing Plaintiffs' state securities law actions under SLUSA. The Fifth Circuit affirmed the order of the District Court.

2. Plaintiffs, former investors in Enron, brought nine putative class actions in state court and one putative class action in federal court alleging §§ 10(b), 20(a) and Rule 10b-5 violations, and state law claims *inter alia* for fraud, negligent misrepresentation, and negligence arising out of the collapse of Enron. The state actions were removed to federal court under “related to” bankruptcy jurisdiction, and prosecuted by the Fleming & Associates law firm in unison with the federal action. The District Court determined that the ten cases were precluded by SLUSA, and that the motion for leave to amend the complaints in the nine state court actions was futile and dismissed.
3. The principal issue on appeal was whether the ten actions constituted a “covered class action” under SLUSA. A group of lawsuits constitutes a “covered class action” for purposes of SLUSA if the suits (1) are pending in the same court, (2) involve common questions of law or fact, (3) damages are sought on behalf of more than 50 persons, and (4) the lawsuits are joined, consolidated or otherwise proceed as a single action for any purpose. The Fifth Circuit found that these conditions were met. Specifically, the actions were proceeding as a “single action” as Plaintiffs “filed nearly identical complaints; jointly scheduled discovery; filed joint motions; provided nearly identical discovery responses; and used the same experts and expert reports.” *Id.* at 340.

B. *Miller v. Nationwide Life Ins. Co.*, No. 07-31178, 2008 WL 3086783 (5th Cir. Aug. 6, 2008)

1. Appeal of an order by the District Court (E.D. La.) granting Defendant’s motion to dismiss Plaintiff’s individual claims for breach of contract and violations of §§ 11 and 12(a)(2) as barred by the doctrine of *res judicata*. The Fifth Circuit reversed and remanded to the District Court for further proceedings.
2. In 2003, Plaintiff filed a putative class action alleging that Defendant Nationwide Life Insurance Co. (“Nationwide”) violated securities laws and breached its contract with Miller by imposing certain fees in connection with the transfer of sub-account investments of variable annuity contracts. The District Court dismissed the securities claims with prejudice and dismissed the breach of contract claim pursuant to SLUSA.

3. In 2006, Plaintiff brought a second suit — this time as an individual — against Nationwide, alleging breach of contract based on the imposition of transfer fees and limitations on Plaintiff’s ability to make sub-account transfers via telephone, and violations of the Securities Act for failure to timely deliver a prospectus. The District Court dismissed the claims concerning transfer fees pursuant to Rule 12(b)(6), and dismissed the remaining claims as barred by *res judicata*.
4. On appeal, the Fifth Circuit reversed and remanded the case to District Court. With respect to the breach of contract claims concerning transfer fees, the Fifth Circuit determined that there was a question of fact as to whether the fees were imposed by Nationwide or by mutual funds in the underlying sub-accounts. Further, the Fifth Circuit concluded that *res judicata* did not bar the contract claims because, when the claims were initially brought as part of the putative class action, they were deemed precluded by SLUSA. The Fifth Circuit reasoned that a dismissal pursuant to SLUSA constitutes a “jurisdictional dismissal” and not a judgment on the merits. *Id.* at * 5. As such, SLUSA prevented the Fifth Circuit from reaching the merits of the claims when initially raised in the class action, and *res judicata* therefore does not apply now.
5. The Fifth Circuit also determined that the prospectus delivery claim was not barred by *res judicata* because the alleged conduct that gave rise to the claim occurred after the initial suit was dismissed.

C. *Newby v. Enron Corp.*, 542 F.3d 463 (5th Cir. Sept. 8, 2008)

1. Appeal of an order by the District Court (S.D. Tex.) denying law firm Fleming & Associates’ motion for leave to file 34 Enron-related state law actions as time barred under the applicable statutes of limitations. The Fifth Circuit affirmed in part, reversed in part, and remanded the case to the District Court.
2. In 2001, Fleming & Associates (the “Fleming Firm”) filed seven securities-related suits including §§ 10(b), 20(a) and Rule 10b-5 claims in Texas state courts on behalf of several hundred clients against Enron-related Defendants. Subsequently, the District Court overseeing several consolidated Enron-related cases issued an order enjoining the Fleming Firm from filing any new Enron-related actions without leave of the court. In October 2005, the Fleming Firm filed a motion for leave to file 34 Enron-related actions in Texas state courts on behalf of approximately 1,200 clients. The District Court ruled that the statute of limitations barred the purported claims and denied the motion for leave to file suit.

3. The Fifth Circuit held that the District Court properly denied the motion for leave to file suit for the proposed state law claims that have a two- or three-year statute of limitations, but reversed the denial of motion for leave to file the claims with four-year statutes of limitations because the Fleming Firm had filed the motion for leave to file suit within the four-year statute of limitations period.
4. Defendants argued that SLUSA would preclude all of the proposed state law claims, and that the state law suits constituted a “covered class action” because, in the aggregate, they asserted claims on behalf of more than 50 persons. Defendants speculated that the state court would likely consolidate the claims, which would then allow for removal under SLUSA, and that the Fleming Firm purposefully included fewer than 50 Plaintiffs in each suit in order to avoid SLUSA.
5. The Fifth Circuit disagreed, finding that a party is allowed to tailor a suit to avoid federal jurisdiction, including choosing how many parties to include in each suit. Further, it noted that Defendants’ argument rests on the presumption that the Texas courts will consolidate the cases, while “the Texas courts should be allowed to decide in the first instance how to manage their dockets.” *Id.* at 474.

Eighth Circuit

- A. *Siepel v. Bank of Am.* 526 F.3d 1122 (8th Cir. May 19, 2008)
 1. Appeal of an order by the District Court (E.D. Mo.) dismissing Plaintiffs’ state law claims as precluded by SLUSA. Plaintiff beneficiaries of trust accounts maintained by Defendant bank filed a class action against the bank, its holding corporation, and affiliated investment companies alleging violations under § 10(b) and Rule 10b-5 as well as state law claims that a trustee breached its fiduciary duty by failing to disclose conflicts of interest in its selection of nationally traded investment securities. The complaint alleged that Defendant bank implemented a plan to consolidate the trust management activities of other banks it had acquired, and that existing and prospective trust customers were led to believe, through misleading letters, that their assets were being managed on an individualized basis, when the assets were actually being invested and managed by an investment company substantially owned by the bank. Plaintiffs asserted federal jurisdiction over the state law claims based on the minimum diversity provisions of CAFA. Plaintiffs sought leave to amend rather than oppose Defendants’ motion to dismiss, and the District Court accordingly dismissed the federal claims on the merits, denying leave to amend based on futility. The District Court then dismissed the state law claims as precluded by SLUSA. The Eighth Circuit affirmed.

2. The Eighth Circuit focused on whether the alleged misrepresentations and omissions were “in connection with” the purchase or sale of securities. The Eighth Circuit explained that *Dabit* corrected any previous notions that the scope of SLUSA preclusion is equal to that of the right to a private Rule 10b-5 action. Instead, courts must interpret the scope of SLUSA to follow § 10(b) and Rule 10b-5 when enforced by an agency of the United States. Not bound by the policy considerations that limit the private right of action, the Eighth Circuit found that “in connection with” under § 10(b) is construed “flexibly, not technically or restrictively.” *Id.* at 1127. Under *Dabit*, it is enough for the alleged fraud to “coincide” with a securities transaction. *Id.* The Eighth Circuit held that the alleged non-disclosures clearly coincided with Defendant bank’s purchase of shares, and thus, Plaintiffs state law claims were precluded by SLUSA.

B. *Kutten v. Bank of Am.*, 530 F.3d 669 (8th Cir. June 16, 2008)

1. Appeal of an order by the District Court (E.D. Mo.) dismissing a class action brought by trust beneficiaries against a bank, as trustee, alleging breach of fiduciary duty, breach of contract and related claims in connection with the bank’s alleged plan to convert trust assets into mutual funds owned by the bank. The District Court, finding this case nearly identical to *Siepel v. Bank of Am.*, 526 F.3d 1122 (8th Cir. 2008), which it dismissed as precluded by SLUSA, dismissed. The Eighth Circuit affirmed, holding that the claims were precluded by SLUSA.
2. Plaintiffs attempted to distinguish their case from *Siepel* by claiming that their complaint did not contain any allegations that facts were concealed, or that there were any omissions of facts or misrepresentations made to Plaintiffs. However, their complaint contained general allegations that Defendant misrepresented and omitted material facts. The Eighth Circuit reiterated that SLUSA precludes state-law class actions that allege an untrue statement or omission of material fact, or the use of a manipulative or deceptive device or contrivance, in connection with the purchase or sale of a covered security. The Eighth Circuit would not rely on the names of the claims, but would look to the substance of the allegations. SLUSA is based on the conduct alleged, not the words that describe it. Any distinction between “deceiving” and “failing to be honest” or between “omitting a material fact” and “failing to disclose” does not bear on whether SLUSA precludes the claim containing those allegations. *Id.* at 671.

Ninth Circuit

- A. *Davis v. John Hancock Variable Life Insurance Co.*, 295 Fed. Appx. 245 (9th Cir. Oct. 3, 2008)
1. Appeal of an order by the District Court (D. Ariz.) granting John Hancock Variable Life Insurance Company's ("John Hancock's") motion to dismiss based on federal preemption, and awarding attorneys' fees. The appealing Plaintiff and others brought a class action in state court against John Hancock, alleging fraud and misrepresentation in the sale of variable whole-life insurance policies. The action was removed from state court, and the District Court dismissed the case on the basis that it was a "covered class action" precluded by SLUSA. The Ninth Circuit affirmed.
 2. Plaintiff did not dispute that his original complaint in state court was a "covered class action" under SLUSA. However, rather than amend his allegations to state a federal securities claim, he filed an amended complaint in which he removed his request for damages. Plaintiff contended that SLUSA did not apply to his amended complaint because its definition of "class action" extends only to those actions seeking money damages. The Ninth Circuit rejected that argument because Plaintiff's amended complaint sought to prevent John Hancock from collecting premiums (*i.e.* money) and, moreover, continued to seek other equitable relief that could have included a discretionary award of money damages.
 3. The Ninth Circuit also held that the District Court did not err in dismissing the action pursuant to SLUSA because Plaintiff reasserted his state law claims in his amended complaint and SLUSA cannot be circumvented by the artful drafting of a complaint, as by removing a request for damages.

Tenth Circuit

- A. *Anderson v. Merrill Lynch Pierce Fenner & Smith*, 521 F.3d 1278 (10th Cir. Apr. 7, 2008)
1. Appeal of an order by the District Court (D.N.M.) granting Defendant's motion to dismiss. Plaintiffs, shareholders of a defunct corporation, brought a class action in state court against Defendant investment bank asserting fourteen claims under New Mexico law, and alleging that Defendant had engaged in short selling that drove down the corporation's share price. Defendant removed the case to federal court and then moved to dismiss under SLUSA. The District Court granted Defendant's motion to dismiss, holding that Plaintiffs' claims were a "covered class action" under SLUSA, and denied Plaintiffs leave to amend. The Tenth Circuit affirmed.
 2. Plaintiffs argued that "because SLUSA employs language similar to that in Rule 10b-5, SLUSA only precludes state law claims that are 'virtually identical' to a federal securities claim." *Id.* at 1285. Thus, Plaintiffs argued, "SLUSA does not preclude any of their claims under New Mexico law, because none of their claims allege—or are required to allege—the elements of scienter." *Id.* The Tenth Circuit held that Plaintiffs' argument "parallels the argument that the Supreme Court rejected in *Dabit*" and that "courts have almost uniformly rejected [Plaintiffs' argument] as contrary to the structure, intent, and plain language of SLUSA." *Id.* As such, the Tenth Circuit held that the "district court was correct that SLUSA precluded Plaintiffs' claims, and that Plaintiffs did not have to allege scienter or reliance for SLUSA to apply." *Id.* at 1287.
 3. The Tenth Circuit held that Plaintiffs "most importantly" made "several allegations regarding misrepresentation[s] or omission[s] of a material fact and/or manipulative or deceptive device[s] or contrivance[s]." *Id.* As Plaintiffs did not contest that their claims constitute a "covered class action" based on state law, and made allegations "in connection with [the] purchase or sale of covered securit[ies]," the Tenth Circuit concluded that Plaintiffs' claims were barred by SLUSA. *Id.*
 4. The Tenth Circuit further held that "any amendment by Plaintiffs would be futile" because "SLUSA precluded all of the substantive counts that Plaintiffs alleged in their Complaint, so Plaintiffs could not have saved their Complaint by withdrawing a few of the counts." Moreover, Plaintiffs failed to explain "how they could transform their Complaint into a derivative action on behalf of [the defunct corporation]." *Id.* at 1288.

Eleventh Circuit

- A. *Instituto de Prevision Militar v. Merrill Lynch*, 546 F.3d 1340 (11th Cir. Oct. 29, 2008)
1. Appeal of an order by the District Court (S.D. Fla.) dismissing complaint asserting state law tort claims and federal securities fraud claims. The District Court dismissed the state law claims as precluded by SLUSA and the § 10(b) and Rule 10b-5 claims for inadequate pleading. The Eleventh Circuit affirmed.
 2. Plaintiff, an agency of the Republic of Guatemala that administered pension funds, brought state law and federal securities claims against Defendant Merrill Lynch for its role in an alleged fraud committed by investment adviser Pension Fund of America (“PFA”). PFA allegedly defrauded investors throughout Latin America by stealing their money rather than investing it. Plaintiff asserted that Defendant was liable for the fraud for allowing PFA to hold itself out as Defendant’s agent and because it failed to stop PFA from misappropriating Plaintiff’s funds. In separate actions, the SEC sued PFA for fraud, and several other PFA investors filed a putative class action against PFA and Merrill Lynch. Upon Plaintiff’s request, all actions were consolidated for discovery purposes.
 3. The Eleventh Circuit upheld the dismissal on all counts. Plaintiff’s state law claims were precluded by SLUSA because they were part of a “covered class action.” Under SLUSA, a “covered class action” encompasses several different types of claims. Here, Plaintiff’s case was part of a “group of lawsuits filed . . . in the same court and involving common questions of law or fact [that are] consolidated . . . for any purpose.” *Id.* at 1346. Although Plaintiff made a colorable argument that this clause should not apply because Congress did not intend to preclude bona fide individual actions, it ultimately failed because Plaintiff *itself* requested consolidation for discovery purposes in this case. The Eleventh Circuit left unaddressed the question of whether a consolidation ordered over an objection by Plaintiffs resulting in SLUSA preclusion would be an abuse of discretion.
 4. The Eleventh Circuit also concluded that the “in connection with” requirement of SLUSA was satisfied. Plaintiff essentially claimed inducement to invest through the use of Merrill Lynch’s name and reputation, which satisfies *Dabit*’s broad reading of the term “in connection with” the purchase or sale of securities.
 5. Finally, Plaintiff’s § 10(b) and Rule 10b-5 claims were properly dismissed. Plaintiff only challenged the ruling on the element of scienter, but the District Court had found five fatal flaws in Plaintiff’s federal securities claims, leaving further analysis unnecessary and leading the Eleventh Circuit to uphold dismissal on all counts.

Statute of Limitations

Second Circuit

- A. *Staeher v. Hartford Fin. Servs. Group, Inc.*, 547 F.3d 406 (2d Cir. Nov. 17, 2008)
1. Appeal of an order by the District Court (S.D.N.Y.) dismissing Plaintiffs' claims as barred by the statute of limitations. The Second Circuit vacated the dismissal and remanded.
 2. Plaintiffs brought a putative class action against The Hartford Financial Services Group, Inc. ("The Hartford") and its senior officers alleging that Defendants violated § 10(b), Rule 10b-5, and § 20(a) by entering into and failing to disclose alleged "kickback" arrangements with insurance brokers (known as "contingent commission" arrangements) and bid-rigging in order to increase The Hartford's market share and inflate insurance prices. The action was commenced the day after the New York Attorney General's Office initiated a lawsuit against Marsh, Inc. concerning similar allegations, which cited The Hartford for its role in paying undisclosed commissions and providing inflated bids.
 3. Defendants moved to dismiss on several grounds, including that the action was barred by the statute of limitations, and submitted various reports from the mainstream media, insurance newsletters, complaints filed in four lawsuits, and filings made by Defendants with state regulatory agencies, which, Defendants argued, should have put Plaintiffs on inquiry notice of the alleged conduct more than two years prior to the filing of the suit. The District Court concluded that the claims were time barred, relying on the "storm warning" doctrine, which imposes a duty of inquiry where "the circumstances would suggest to an investor of ordinary intelligence the probability that she has been defrauded." *Id.* at 411.
 4. Applying the standards to be used in "storm warning" cases, the Second Circuit concluded that the materials submitted by Defendants in support of the motion to dismiss were too vague and non-specific, and in certain instances, too obscure, to suggest to an investor of ordinary intelligence the probability of the alleged fraud by The Hartford.

B. *Domenikos v. Roth*, 288 Fed. Appx. 718 (2d Cir. June 5, 2008)

1. Appeal of a judgment by the District Court (S.D.N.Y.) dismissing Plaintiffs' claims as time-barred under the applicable statutes of limitations. The Second Circuit affirmed the dismissal of Plaintiffs' federal securities law claims including §§ 10(b), 20(a) and Rule 10b-5, and vacated that portion of the judgment that dismissed Plaintiffs' state law claims.
2. In February 2005, Plaintiffs in this action (the "Domenikos Plaintiffs") filed an action against Defendants Nortel Networks and certain individuals concerning financial reporting during certain periods of 1999 and 2000. Approximately four years earlier, in February 2001, a separate group of Plaintiffs filed a class action alleging that Nortel materially misstated its earnings for the third and fourth quarters of 2000. The Second Circuit held that the earlier action constituted "storm warnings" that placed the Domenikos Plaintiffs on inquiry notice. Although the Domenikos Plaintiffs' claims related to an earlier reporting period, the Second Circuit found that the class action that focused on financial reporting for the second half of 2000 triggered their duty to inquire.
3. The Domenikos Plaintiffs failed to conduct any form of inquiry in February 2001, and the Second Circuit determined that the clock started running on the statute of limitations then. At that time, the claims were subject to a one-year statute of limitations which expired in February 2002, three months prior to July 30, 2002 — the date that the extended statute of limitations under Sarbanes-Oxley became effective. Because Sarbanes-Oxley does not revive time-barred claims, the Second Circuit affirmed the dismissal of Plaintiffs' federal securities claims.
4. The District Court did not provide a basis for its dismissal of Plaintiffs' state law claims. Therefore, the Second Circuit vacated this portion of the judgment and remanded the case.

C. *Masters v. GlaxoSmithKline*, 271 Fed. Appx. 46 (2d Cir. Mar. 26, 2008)

1. Appeal of an order by the District Court (S.D.N.Y.) dismissing shareholders' putative class action against Defendant drug manufacturer and CEO for securities fraud. The Second Circuit affirmed the dismissal for all claims. Plaintiffs' complaint alleged that GlaxoSmithKline ("GSK") and its CEO committed securities fraud under § 10(b) and Rule 10b-5 in four ways:
 - (a) suppressing information about Paxil's negative side effects of addictiveness and withdrawal;
 - (b) making false statements and omissions regarding the viability of drug patents for Paxil and Augmentin;

- (c) overcharging Medicare and Medicaid for drugs; and
 - (d) misrepresenting Paxil's safety for use in treating children.
2. In determining when Plaintiffs were put on inquiry notice regarding Paxil's alleged side effects, the Second Circuit found that an earlier consumer class action based on the alleged side effects was sufficient to put Plaintiffs on notice of the issues cited in their complaint. Plaintiffs' argument that they were not put on notice because the earlier action was not securities related was unpersuasive.
 3. The Second Circuit held that the patent claims were also properly dismissed. The overcharging claim was held untimely based upon the fact that separate lawsuits, asserting violations of The False Claims Act, had been filed nearly three and one-half years before the class action. The Second Circuit rejected Plaintiffs' argument that this claim had not accrued until the settlement of the prior litigation.

Third Circuit

- A. *In re Merck & Co., Sec., Derivative & "ERISA" Litig.*, 543 F.3d 150 (3d Cir. Sept. 9, 2008)
 1. Appeal of an order by the District Court (D.N.J.) granting Defendant's motion to dismiss. The complaint alleged that statements and omissions during the class period materially misrepresented the safety and commercial viability of Vioxx, in violation of §§ 11, 12(a)(2), and 15; §§ 10(b), 20(A) and 20(a) and, 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.
 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).
 3. 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." 543 F.3d at 161. "If the existence of storm warnings is adequately established the burden shifts to the plaintiffs to show that they exercised reasonable due diligence and yet were unable to discover their injuries." *Id.* "[W]hether the plaintiffs, in the exercise of reasonable diligence, should have known of the basis for their claims depends on whether they had sufficient information of possible [as opposed to probable] wrongdoing to place them on inquiry notice or to excite storm warnings of culpable activity." *Id.* at 164.

4. In this case, the Third Circuit 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. While these events exposed data showing that there was an increased risk of cardiovascular events with VIOXX, they did not refute Merck's hypothesis that the cardiovascular data was not caused by VIOXX, but by something that would not impact VIOXX's commercial viability.
5. Judge Roth issued a dissenting opinion, arguing that "storm warnings" alerting a reasonable investor of possible culpable activity on the part of Merck were evident more than two years prior to the filing of appellants' complaint.

Ninth Circuit

- A. *Betz v. Trainer Wortham & Co.*, 519 F.3d 863 (9th Cir. Feb. 26, 2008); 504 F.3d 1017 (9th Cir. Oct. 4, 2007)
 1. Appeal of an order by the District Court (N.D. Cal.) entering summary judgment in favor of Defendants. Plaintiff, a client of a securities firm, sued the firm, its parent, and firm employees alleging that Defendants' mismanagement of her account constituted securities fraud. The District Court granted summary judgment on the basis that Plaintiff had inquiry notice of Defendants' alleged violations of § 10(b) more than two years before she filed suit, and her claims were therefore time-barred. The Ninth Circuit reversed and remanded based on the existence of a genuine issue of material fact. The Ninth Circuit's original opinion, reported at 504 F.3d 1017, was amended slightly on February 26, 2008, when the Ninth Circuit denied Defendants' petition for rehearing *en banc*. The amended opinion did not alter the substance of the opinion; however, Chief Judge Kozinski filed a dissenting opinion, in which Judges O'Scannlain and Bea joined.
 2. The Ninth Circuit held that the grant of summary judgment was improper because a reasonable factfinder could conclude that Plaintiff did not discover that Defendants intentionally misled her until less than two years before she filed her lawsuit.

3. The Ninth Circuit outlined the applicable inquiry notice standard. First, the Ninth Circuit held that inquiry notice, like actual notice, can trigger the running of the statute of limitations on a securities fraud claim. The Ninth Circuit based this determination on the opinions of ten other Circuits and the widespread practices of the District Courts within the Ninth Circuit. The Ninth Circuit noted that “every circuit to have addressed the issue since *Lampf* has held that inquiry notice is the appropriate standard.” *Id.* at 1023. The Ninth Circuit also was persuaded that an inquiry standard is appropriate based on the judicial interpretation of the similarly worded former § 9(e) of the Exchange Act. When Congress extended the limitations period for § 10(b) suits from one to two years in the Sarbanes-Oxley Act of 2002, it used language nearly identical to the language previously in effect in § 9(e) of the Securities Exchange Act. Prevailing case law in the lower federal courts interpreted § 9(e)’s limitations period to begin upon inquiry notice. The Ninth Circuit held that, by choosing language nearly identical to that in § 9(e), Congress implicitly approved the same interpretation of the statute of limitations and inquiry notice.
4. The Ninth Circuit also held that its inquiry notice standard for § 10(b) suits will follow the two-prong “inquiry-plus-reasonable-diligence test” used by the Tenth Circuit. Under the first prong, to determine when the statute of limitations begins running, the court determines when plaintiff had inquiry notice of the facts giving rise to his or her securities fraud claim. A plaintiff is on inquiry notice when there exists sufficient suspicion of fraud to cause a reasonable investor to investigate the matter further. Under the second prong, once a Plaintiff has inquiry notice, the court asks when the investor, in the exercise of reasonable diligence, should have discovered the facts constituting the alleged fraud. The answer to the second question determines when the statute of limitations begins to run.
5. The Ninth Circuit held that, in general, the question of whether inquiry notice exists is objective and contemplates a “reasonable investor” or “reasonable person” standard. However, at the second stage of the inquiry, the question of whether Plaintiff exercised reasonable diligence in investigating the facts underlying the alleged fraud entails an assessment of Plaintiff’s particular circumstances from the perspective of a reasonable investor. During the second stage of this inquiry, one of the factors to be considered is whether Plaintiff was given any assurances by the Defendant after beginning to investigate the suspicious circumstances that would have delayed discovery of the fraud by a reasonable person in Plaintiff’s position. The Ninth Circuit indicated that it was especially hesitant to approve summary judgment in securities fraud cases where Plaintiff alleges that Defendants’ reassurances convinced Plaintiff to postpone his or her legal action.

6. Turning to the specific facts of this case, and applying the inquiry notice standard outlined above, the Ninth Circuit held that a rational jury could conclude that a reasonable investor in Plaintiff's position would not necessarily have initiated further inquiry. Moreover, even if Plaintiff was on inquiry notice of fraud, the Ninth Circuit could not say that, as a matter of law, Plaintiff, in the exercise of reasonable diligence, should have discovered the facts constituting the alleged fraud, especially because Defendants assured her that they would take care of any problems and asked her not to file suit.
7. The dissent argued that the Ninth Circuit had "hacked a gaping hole into the statute of limitations" by adopting an inquiry notice standard that says an investor is not on inquiry notice until he has concrete proof of every element of his claim, including scienter. *Id.* at 870. The dissent argued that the only question should be whether the underlying facts were sufficient to put a reasonable investor on inquiry notice and that, here, there was no factual dispute as to when the statute began to run, because Plaintiff learned that her investment was not risk free as early as February 2000, when she received an account statement from the bank showing a balance far below her initial investment. The dissent argued that the majority "pretends to adopt" the same standard as other Circuits but, in reality, holds that Plaintiff could not be on inquiry notice until she had solid proof of every single element of her Rule 10b-5 claim, including scienter. The dissent took further issue with the majority's holding that "the statute stops running the moment defendant makes a cheerful noise." *Id.* at 870. They concluded that "[b]usinesses unfortunate enough to be sued in this circuit for securities fraud might as well forget about 28 U.S.C. § 1658(b)(1); it is nothing but a filigree on the statutory page." *Id.*

Eleventh Circuit

- A. *Berman v. Blount Parish & Co., Inc.*, 525 F.3d 1057 (11th Cir. Apr. 23, 2008)
 1. Appeal of an order by the District Court (M.D. Ala.) dismissing Plaintiffs' § 12(a) and 15(a) claims as barred under the applicable statute of limitations. Plaintiff bond purchasers brought a securities action on March 14, 2003 alleging that Defendant city's industrial development board made numerous false statements and omissions of material fact in a prospectus for bonds issued in 1998 to finance a manufacturing facility. The Eleventh Circuit affirmed.

2. Plaintiffs did not dispute that their claims would have been time-barred under the three-year statute of limitations that had previously controlled such claims as set forth in § 13 of the Securities Act. However, Plaintiffs argued that the Sarbanes-Oxley Act, which took effect on July 30, 2002, revived their claims because the statute extended the limitations period for securities claims to the earlier of two years after discovery of the alleged violation or five years after such violation.
3. The Eleventh Circuit upheld the dismissal of Plaintiffs' claims. In doing so, the Eleventh Circuit noted that Plaintiffs' argument that Sarbanes-Oxley revived their claims had been soundly rejected by each of the other circuit courts that had considered the issue. Neither the language in the statute nor any legislative history gave any indication that Sarbanes-Oxley was intended to be retroactive.

First Circuit

A. *ACA Fin. Guar. Corp. v. Advest, Inc.*, 512 F.3d 46 (1st Cir. Jan. 10, 2008)

1. Appeal of an order by the District Court (D. Mass.) granting Defendants' motion to dismiss. Plaintiffs, purchasers and an insurer of Bradford College bonds sold in May 1998, brought suit after the college defaulted on its bond obligations in January 2000. Plaintiffs asserted claims against the underwriter investment banking firm, former president and vice president of the college, and members of the college's board of trustees alleging violations of §§ 10(b), 20(a) and Rule 10b-5 for material misrepresentations and omissions in the Official Statement accompanying the offering. The District Court granted Defendants' motion to dismiss for failing to meet the pleading requirements for scienter imposed by the PSLRA. Plaintiffs filed motions with the District Court to vacate the dismissal under Rule 59(e) and for leave to amend under Rule 15(a). The District Court denied both post-dismissal motions. The First Circuit affirmed.
2. The First Circuit analyzed the complaint's allegations of omissions and misrepresentations in the Official Statement. With respect to representations regarding the attrition rate, the First Circuit held that the college did not have a duty to disclose every possible material fact about its operations and finances, but rather: "The Official Statement needed only disclose enough accurate information and not omit pertinent information to allow investors to make an informed decision about whether to invest. It did so." *Id.* at 61.
3. The First Circuit also addressed Plaintiffs' claims that the Official Statement "artificially inflated the applications numbers" and that the stated goal of 225 new students was allegedly unrealistic. *Id.* at 62. The First Circuit held that Plaintiffs could not rely solely on "fraud by hindsight" and "simply contrast a defendant's past optimism with less favorable actual results." *Id.* Thus, the allegations fell "short of establishing that the enrollment projections were materially misleading at the time of the Statement." *Id.*

4. Plaintiffs further alleged that Defendants “skewed the school’s future financial health by misrepresenting [the College’s] intentions regarding a planned equity contribution to the construction and renovation project.” *Id.* at 63. The First Circuit held that the Official Statement did not “speak in any way to the timing of [the equity] contribution” and that the allegations regarding a committee meeting did “not at all foreclose the college from making an equity contribution” in the future. *Id.* Thus, these “allegations simply do not establish any misrepresentation.” *Id.*
5. The First Circuit found that the 1998-1999 projections were the “most troublesome issue[s] in the case”; they were “not mere optimistic projections because the statement is that ‘the College’s financial plan *currently* calls for a further reduction of financial aid spending for [the] 1998-1999 academic year to 28.8% of student income.’” *Id.* at 64. Accordingly, the First Circuit held that “we cannot say that the discrepancy between the 28.8% figure in the Statement and the 31.3% figure alleged in the amended complaint is immaterial as a matter of law.” *Id.* at 65.

Second Circuit

- A. *Masters v. GlaxoSmithKline*, 271 Fed. Appx. 46 (2d Cir. Mar. 26, 2008)
 1. Appeal of an order by the District Court (S.D.N.Y.) dismissing shareholders’ putative class action against Defendant drug manufacturer and CEO for securities fraud. The Second Circuit affirmed the dismissal for all claims. Plaintiffs’ complaint alleged that GlaxoSmithKline (“GSK”) and its CEO committed securities fraud under § 10(b) and Rule 10b-5 in four ways:
 - (a) suppressing information about Paxil’s negative side effects of addictiveness and withdrawal;
 - (b) making false statements and omissions regarding the viability of drug patents for Paxil and Augmentin;
 - (c) overcharging Medicare and Medicaid for drugs; and
 - (d) misrepresenting Paxil’s safety for use in treating children.

2. The final claim was dismissed for failure to adequately allege materiality and loss causation. Plaintiffs' assertion of materiality focused on allegedly misleading reports published by Defendant concerning the safety of Paxil's use in treating children. Plaintiffs' allegation of materiality failed because (1) the reports were not statistically significant, and (2) reports of harmful drug effects are immaterial for securities claims unless a claimant can show their significance to the company's future earnings. Plaintiffs showed no financial impact and they failed to meet the materiality requirement.

Sixth Circuit

A. *Saxe v. Dlusky*, 268 Fed. Appx. 438 (6th Cir. Mar. 10, 2008)

1. Appeal of an order by the District Court (S.D. Ohio) granting summary judgment in favor of Defendant. The executor of the estate of a former 25 percent owner of a financial planning firm sued another 25 percent owner, claiming securities fraud in violation of § 10(b). The District Court granted summary judgment in favor of Defendant based on its determination that Plaintiff had not raised a genuine issue of material fact with regard to her § 10(b) claim. The alleged misstatements at issue were not material. The Sixth Circuit affirmed.
2. A statement that a firm "never made much money" is not material because it is vague and subjective and, in this case, not necessarily false. *Id.* at 441. The fact that Defendant resold the business for substantially more a short time later can be explained by other circumstances.
3. There was no material omission based upon Defendant's failure to disclose a plan to resell the business, as there was no evidence to suggest that Defendant knew of the possibility of a resale at the time of the transaction with Plaintiff.

B. *Zaluski v. United Am. Healthcare*, 527 F.3d 564 (6th Cir. May 27, 2008)

1. Appeal of an order by the District Court (E.D. Mich.) granting Defendants' motion to dismiss. Plaintiffs brought this class action against United American Healthcare Corporation ("UAHC") and certain individuals alleging that Defendants violated § 10(b) and Rule 10b-5 by failing to disclose that UAHC was making illegal payments to then-Tennessee Senator John Ford. Plaintiffs also brought claims against the individual Defendants pursuant to § 20(a). The District Court granted Defendants' motion to dismiss, holding that the potential consequences of payments to a state senator in support of a state contract, which turned on decisions made by actors outside of the corporation's control, were the type of predictions and soft information that did not give rise to a duty of disclosure. The Sixth Circuit affirmed.

2. In determining whether or not the duty to disclose exists, the Sixth Circuit distinguished between “soft information” and “hard information,” explaining that a company has a duty to disclose hard information, but not soft information, unless other criteria are met. “The failure to disclose soft information is actionable only if it is virtually as certain as hard facts.” *Id.* at 572. In this case, while the payment to Ford was arguably hard information that was subject to disclosure, the potential consequences of the payments, which were at issue, were the type of predictions and soft information that do not give rise to a duty of disclosure. There was no evidence that Defendants anticipated that the Ford payments would lead to a termination or modification of the contract.

C. *Ley v. Visteon Corp.*, 543 F.3d 801 (6th Cir. Oct. 6, 2008)

1. Appeal of an order by the District Court (E.D. Mich.) dismissing investor Plaintiffs’ class action lawsuit alleging claims under § 10(b) and Rule 10b-5 against Visteon Corp., its officers and directors and outside auditor, and a claim under § 20(a) of the Exchange Act against the individual Defendants. The District Court dismissed the complaint for failure to allege any material misstatements or omissions, or facts giving rise to a strong inference of scienter, and investors appealed. The Sixth Circuit affirmed.
2. Defendant Visteon is a global supplier of automotive systems, modules, and components to vehicle manufacturers and the automotive aftermarket. Visteon was incorporated as a wholly-owned subsidiary of Ford, and was spun-off as a separate publicly traded company. The claims revolved around statements made in Visteon’s spin-off prospectus and subsequent accounting errors in Visteon’s public reports. Specifically, Plaintiffs alleged that Defendant failed to disclose the competitive disadvantage of the newly formed company due to its ties to Ford as well as improper accounting manipulations.
3. The Sixth Circuit held that the allegations at issue, which revolved around the corporation’s alleged failure to disclose the competitive disadvantage of the newly formed company due to its ties to Ford, were not material. Most of the facts at issue were disclosed. A company is not required to draw subjective conclusions about a company’s chances of commercial success based on such facts. The failure to do so is not a material omission.

D. *J & R Mktg., SEP v. Gen. Motors Corp.*, 549 F.3d 384 (6th Cir. Dec. 5, 2008)

1. Appeal of an order by the District Court (E.D. Mich.) dismissing claims by purchasers of bonds registered by GMAC, who brought suit under §§ 11 and 12(a)(2) against GMAC and its control persons, alleging that Defendants omitted material facts they had a duty to disclose and misstated material facts with regard to a bond offering of Defendant General Motors. The District Court dismissed the claims, and the Sixth Circuit affirmed, finding that Plaintiffs lacked standing to bring claims regarding offerings other than the one in which they had purchased. The District Court also found that Plaintiffs had no claim regarding a duty to disclose. There was no duty to disclose the information sought by Plaintiffs because it was not “firm specific” to GMAC. Additionally, the District Court found that there was no material omission because the affirmative statements made by GMAC were not rendered misleading by the absence of the information cited by Plaintiffs. Lastly, the District Court held that most of GMAC’s statements were not false, and the ones that were arguably false were not material to bond investors. The Sixth Circuit affirmed.
2. The Sixth Circuit held that GMAC was not required to disclose information about the financial health of its parent company, GM, despite the fact that GM’s health affects GMAC’s future performance. Plaintiffs do not allege that the undisclosed information had an effect on GMAC’s current, reported financial condition, but only that it would affect its future condition. Further, Plaintiffs do not contend that GMAC had knowledge of GM’s financial state, but contend only that such information was “knowable” to GMAC. This is insufficient for liability.
3. The Sixth Circuit further held that GMAC’s disclosure of its credit rating and coupon rate are not actionable because they are merely true statements of historical fact and not opinions regarding GMAC’s creditworthiness.
4. According to the Sixth Circuit, a company has to disclose additional information only when the information it has disclosed would be rendered misleading without that additional information. Thus, statements that GMAC has “inextricable links” with GM are not misleading. Indeed, Plaintiffs did not allege what other, untrue fact investors were misled into believing by that statement.
5. Finally, the Sixth Circuit held that an issuer has a different (lower) standard for disclosure of non-public information than a person engaging in insider trading. “There is no general duty on the part of a company to provide the public with all material information. Indeed, there needs to be ‘healthy limits’ on the duty to disclose. . . . We are not authorized to impose a wide-ranging duty to disclose anything that a person can allege was non-public, material information.” *Id.* at 397.

Eighth Circuit

A. *In re Hutchinson Tech., Inc. Sec. Litig.*, 536 F.3d 952 (8th Cir. Aug. 5, 2008)

1. Appeal of an order by the District Court (D. Minn.) dismissing a purported class action. Investor Plaintiffs brought claims under § 10(b) and Rule 10b-5 against the corporation and its officers and directors based on alleged overstatements of corporate earnings. The corporation, a leading manufacturer and supplier of suspension assemblies for computer hard disk drives, reported that it expected to exceed its predicted earning per share for the fourth quarter of 2004, and expected an increase in demand for the first quarter of 2005. Instead, the corporation's stock prices fell. The complaint rested in part on statements from confidential witnesses concerning business practices and customer demand. The District Court found that the claim did not meet the heightened pleading standards for falsity and scienter as required by the PSLRA. The Eighth Circuit affirmed.
2. The Eighth Circuit found that allegedly misleading public statements by the company stating that it was well positioned for the future were "too vague and too much like puffing to be material." *Id.* at 960. According to the Eighth Circuit, no reasonable investor would rely on such statements.
3. Finally, Plaintiffs claimed that the company's statements about future sales and earnings were materially false or misleading. The Eighth Circuit found no facts in the complaint to support the inference that such statements were false when made. Without such an inference, the Eighth Circuit could not find the statements materially false or misleading.

Ninth Circuit

A. *Miller v. Thane Int'l, Inc.*, 519 F.3d 879 (9th Cir. Mar. 18, 2008)

1. Appeal of an order by the District Court (C.D. Cal.) entering judgment in favor of Defendants Thane International ("Thane"), and its officers and directors. The Ninth Circuit reversed and remanded.

2. Plaintiffs, a putative class of shareholders, brought claims under §§ 12(a)(2) and 15 against Defendants for alleged losses arising out of a merger agreement. Thane, a privately held corporation, merged into Reliant Interactive Media Corporation (“Reliant”), a publicly held corporation whose stock was traded on the Over-the-Counter Bulletin Board. Plaintiffs alleged that the initial and final prospectuses issued in connection with the merger contained material misstatements of fact because they implied that, after the merger, Thane’s common stock would be listed on NASDAQ. In response, Defendants argued that the prospectuses represented only that the shares would be approved or qualified for listing, not that they would definitely be listed.
3. In reversing the District Court, the Ninth Circuit emphasized that “literal truth is not the standard for determining whether statements in a prospectus are misleading” and instead courts look to the meaning statements carry in context. *Id.* at 886. The final prospectus was misleading because it strongly implied that Thane shares would be listed on NASDAQ, regardless of what the words literally stated. Thus, the District Court’s analysis, which considered only the literal meaning of the statements, was incorrect.
4. Furthermore, the Ninth Circuit found that the misleading statements were material, and were therefore a proper basis for Plaintiffs’ claims. NASDAQ listing carries objective benefits that directly affect corporate earnings and investor returns, by decreasing compliance requirements, reducing price spreads, and increasing liquidity. NASDAQ-listed stocks are also much more attractive to institutional investors. Thus, whether a company’s stock is, or would be, listed on the NASDAQ exchange would be material information to a reasonable investor. The Ninth Circuit remanded to determine loss causation.

QUESTIONS OF JURISDICTION: “FOREIGN-CUBED,” CAFA, AND PERSONAL JURISDICTION

Second Circuit

- A. *Estate of Barbara Pew v. Cardarelli*, 527 F.3d 25 (2d Cir. May 13, 2008)
1. Appeal of an order by the District Court (N.D.N.Y.) remanding Plaintiffs’ class action to state court. The Second Circuit reversed the District Court’s remand order and remanded the matter for further proceedings.
 2. Plaintiffs, holders of money market certificates issued by Agway, commenced a class action in state court alleging that certain Agway officers and its outside accountants violated § 11(a) by fraudulently concealing the issuer’s insolvency in violation of New York’s consumer fraud law. Defendants removed the action pursuant to CAFA. On Plaintiffs’ motion, the District Court remanded the case to state court under an exception to CAFA, which provides that CAFA does not apply to actions “that relate[] to the rights, duties (including fiduciary duties), and obligations relating to or created by or pursuant to any security.” *Id.* at 26.
 3. The Second Circuit held that claims that “relate to the rights . . . and obligations” of a security must be claims “grounded in the terms of the security itself,” such as when an interest rate changes or a bond series is discontinued. *Id.* at 32. Here, Plaintiffs’ claims, grounded on alleged violations of the state consumer protection act, did not enforce the rights of the certificate holders, and therefore the exception to CAFA did not apply. The Second Circuit also noted that its jurisdiction to review the order of remand turned on the same question of whether the case fell within the exception to CAFA.
 4. The dissent concluded that the exception to CAFA applied, *inter alia*, because Plaintiffs alleged they were deprived of their “rights” under the certificates to receive payments.
- B. *Robert Morrison v. Nat’l Australia Bank Ltd.*, 547 F.3d 167 (2d Cir. Oct. 23, 2008)
1. Appeal of an order by the District Court (S.D.N.Y.) dismissing Plaintiff investors’ putative class action brought under §§ 10(b) and 20(a) and Rule 10b-5 for lack of subject matter jurisdiction and failure to state a claim.

2. Defendant National Australia Bank (“NAB”) is a public company, with ordinary shares traded on several foreign markets and ADRs traded in the United States. In February 1998, NAB acquired HomeSide Lending Inc. (“HomeSide”), a Florida mortgage service provider. NAB subsequently determined that certain interest calculations related to HomeSide’s mortgage servicing business were incorrect, leading to write-downs of approximately \$2 billion by NAB. The value of NAB’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. This action is referred to as a “foreign-cubed” action as it involves a *foreign* plaintiff suing a *foreign* issuer for violations of American securities laws for securities transactions in *foreign* countries.
4. The Second Circuit declined to apply a bright-line rule precluding foreign-cubed actions. Rather, to determine whether jurisdiction exists over extraterritorial cases, the Second Circuit applies a “conduct test” and “effects test,” to examine whether the wrongful conduct occurred in the United States, and whether the wrongful conduct had a substantial effect in the United States or upon United States citizens. *Id.* at 171. While the court applies both prongs of this test where appropriate, Plaintiffs relied solely on the “conduct test,” which asks whether “activities in this country were more than merely preparatory to a fraud and culpable acts or omissions occurring here directly caused losses to investors abroad.” *Id.*
5. The Second Circuit determined that “[t]he issue for us to resolve here boils down to what conduct comprises the heart of the alleged fraud.” *Id.* at 175. The Second Circuit concluded that NAB’s public statements were compiled in Australia and disseminated there and, therefore, were “significantly more central to the fraud and more directly responsible for the harm to investors than the manipulation of the numbers in Florida.” *Id.* at 176. Therefore, under the “conduct test,” the District Court lacked subject matter jurisdiction.

Fifth Circuit

A. *Luallen v. Higgs*, 277 Fed. Appx. 402 (5th Cir. May 2, 2008)

1. Appeal of an order by the District Court (N.D. Tex.) denying Defendants’ motion to dismiss certain claims, including claims under § 10(b), for lack of personal jurisdiction and entry of default judgment for Plaintiff. The Fifth Circuit affirmed the dismissal.

2. Plaintiff, an investor from Texas, alleged that Defendants, based in Nevada, sold fraudulent mining claims located on public land in the Mojave Desert. Defendants' sales were made as fractional shares of unregistered securities. Plaintiff alleged that Defendants made false and misleading statements regarding the securities, and that Defendants' operation was merely a Ponzi scheme.
3. Defendants moved to dismiss Plaintiff's complaint for lack of personal jurisdiction, arguing that their contacts with Texas were insufficient to support either specific or general personal jurisdiction over them.
4. The Fifth Circuit upheld the District Court's denial of Defendants' motion to dismiss. The Exchange Act contains a provision providing for nationwide service of process. Therefore, the minimum contacts analysis considers whether Defendants' contacts with the United States in general is sufficient, and not contacts to any specific state. Each of Defendants was a resident of the state of Nevada; thus, the minimum contacts test was satisfied.

Ninth Circuit

- A. *Luther v. Countrywide Home Loans Servicing LP*, 533 F.3d 1031 (9th Cir. July 16, 2008)
 1. Appeal of an order by the District Court (C.D. Cal.) granting Plaintiffs' motion to remand the case to state court. The Ninth Circuit affirmed.
 2. Investors filed a state court class action against Defendants alleging violations of §§ 11, 12(a)(2), and 15 of the Securities Act. Defendants removed the action to federal court under CAFA. Once in federal court, the lead Plaintiff moved successfully to remand the case back to state court under § 22(a) of the Securities Act which prohibits removal of claims filed in state court arising under the Securities Act. Defendants argued that the § 22(a) removal bar does not prevent removal under CAFA.
 3. The District Court granted Plaintiffs' motion to remand, holding that CAFA and § 22(a) cannot mutually coexist and that the specific bar against removal in the Securities Act trumps CAFA's general grant of diversity and removal jurisdiction.
 4. The Ninth Circuit affirmed, holding that CAFA, which generally permits the removal to federal court of high-dollar class actions involving diverse parties, does not supersede § 22(a)'s specific bar against removal of cases arising under the Securities Act.

THE DUTY TO DISCLOSE OR ABSTAIN

Second Circuit

- A. *Vacold LLC v. Cerami*, 545 F.3d 114 (2d Cir. Oct. 2, 2008)
1. Appeal of an order by the District Court (S.D.N.Y.) granting partial summary judgment in favor of Defendants on Plaintiffs' §§ 10(b), 20(a) and Rule 10b-5 claims. In a split decision, the Second Circuit affirmed the judgment of the District Court.
 2. Plaintiff Immunotherapy formed a joint venture, Applied Vaccine Technologies, Inc. ("AVT"), with Defendant Cerami Consulting Corporation ("CCC") to collaborate on biomedical research projects and commercialize their developments. Immunotherapy subsequently faced financing difficulty and negotiated a sale of its interest in AVT for \$1 million plus certain ongoing royalty payments to CCC through a subsidiary of CCC, VLN LLC, set up for purposes of the sale. The terms of the sale were memorialized in an agreement dated April 9, 1999, (the "April Agreement"), and the sale was subsequently accomplished through a stock purchase agreement dated June 1, 1999 (the "Stock Purchase Agreement").
 3. After the sale, Immunotherapy learned that on the same date it executed the Stock Purchase Agreement, AVT and VLN entered into a separate agreement with a subsidiary of Johnson & Johnson ("J&J"), whereby VLN & AVT would receive from J&J \$3 million in fees (including \$1 million to finance the Stock Purchase Agreement) and millions of dollars going forward. Immunotherapy sued CCC, VLN, and individuals associated with CCC, alleging that Defendants were liable under §§ 10(b) and 20(a), Rule 10b-5, and other common law claims by purchasing the stock without disclosing its negotiations with J&J as of the time of the April Agreement and the Stock Purchase Agreement. The District Court granted summary judgment to Defendants on Plaintiffs' claims concerning alleged omissions in connection with the Stock Purchase Agreement, and a jury subsequently concluded that Defendants were not liable for alleged omissions in connection with the April Agreement.

4. On appeal, the Second Circuit addressed whether Defendants were under a duty to disclose or abstain in connection with the Stock Purchase Agreement, based on their knowledge of the pending deal with J&J. The Second Circuit noted that under Rule 10b-5, the “purchase or sale” of securities occurs “when the parties to the transaction are committed to one another,” and not necessarily when a securities exchange actually occurs. *Id.* at 122 (quoting *Radiation Dynamics, Inc. v. Goldmuntz*, 464 F.2d 876, 891 (2d Cir. July 5, 1972)). Once the parties were committed, there was no longer a duty to disclose or abstain.
5. The Second Circuit then determined that (notwithstanding a financing contingency and contemplation of future performance) the drafting and negotiating history between the parties, as well as the language of the April Agreement, demonstrate that the April Agreement fully committed the parties to the planned securities exchange. As such, Defendants’ duty to disclose ended when the April Agreement was executed, and Defendants were not under a duty thereafter to disclose negotiations with J&J.
6. The dissent concluded that the April Agreement was a “Type II” agreement, which committed the parties to complete negotiation of further issues in good faith, and not a fully binding preliminary agreement, known as a “Type I” agreement. As such, the dissent concluded that the April Agreement did not require the parties to consummate the sale.

PURCHASE OF SECURITIES

Fifth Circuit

- A. *Dorsey v. Portfolio Equities Inc.*, 540 F.3d 333 (5th Cir. Aug. 11, 2008)
 1. Appeal of an order by the District Court (N.D. Tex.) granting Defendants’ motion to dismiss Plaintiff’s action, which included § 10(b) and Rule 10b-5 claims and state statutory and common law claims. Plaintiff investor appealed after voluntarily dismissing his petition for class certification. The Fifth Circuit affirmed the District Court’s dismissal of Plaintiff’s federal securities claims and reversed the dismissal of Plaintiff’s state law claims.

2. Plaintiff filed a putative class action against Portfolio Equities Inc. (“PEI”), Charter Home Funding Inc. (“CHF”), and certain directors of both companies. Plaintiff purchased promissory notes in February 1998 from PEI, which used the proceeds to fund real estate purchases by CHF. PEI represented to Plaintiff that its loans to CHF were secured by mortgages or assignments of beneficial ownership from CHF to PEI. In addition, Plaintiff claimed that Defendants solicited additional purchases from them periodically after the initial February 1998 purchases. When the principal on the promissory notes came due in 2002, PEI failed to pay and had no ability to repay any principal or accrued interest due. Plaintiff and other investors discovered that PEI never received a security interest for its promissory notes and brought suit.
3. The Fifth Circuit held that Plaintiff failed to state a claim under Rule 10b-5 because he failed to allege the purchase of a security. Plaintiff merely alleged that Defendant solicited him to purchase securities, which is not adequate. In addition, Plaintiff’s failure to state the date when any such purchases were made could have given rise to grounds for dismissal as those claims could be time-barred. Plaintiff’s initial purchase of securities was barred under the applicable statute of repose; the Fifth Circuit only considered claims related to the purported additional purchases allegedly solicited by Defendants.
4. The Fifth Circuit reversed the dismissal of the Texas securities law and common law fraud claims. The District Court improperly dismissed Plaintiff’s common law fraud claim because it wrongly determined that Plaintiff was required to plead scienter. Neither the provision governing fraud liability for sellers under state law nor a common law fraud claim under Texas law requires a showing of scienter.

PRIVATE RIGHTS OF ACTION

Fifth Circuit

- A. *Motient Corp. v. Dondero*, 529 F.3d 532 (5th Cir. May 27, 2008)
1. Appeal of an order by the District Court (N.D. Tex.). Plaintiff brought suit under § 13(d) for damages and injunctive relief. The District Court dismissed the complaint for failure to state a claim, and Plaintiff appealed. The Fifth Circuit affirmed the dismissal in part, and remanded in part with instructions to dismiss.
 2. Plaintiff corporation was the target of an attempted corporate takeover by Defendant. Plaintiff alleged that Defendant filed six Schedule 13D amendments that contained false, incomplete, and misleading information about Plaintiff and its management on three issues (1) a stock exchange offer, (2) a roll-up transaction, and (3) an investigation by Motient's Audit Committee.
 3. The Fifth Circuit upheld the dismissal with regard to Plaintiff's request for declaratory judgment, equitable relief, and monetary relief. No other circuit has found a private right of action under § 13(d), and Plaintiff provided no compelling reason for the Fifth Circuit to do so.
 4. The Fifth Circuit remanded Plaintiff's request for injunctive relief, with instructions to dismiss. At the time the appeal was heard, Defendant no longer held any of Plaintiff's stock, and the request for injunctive relief was rendered moot.

COLLATERAL ISSUES ARISING IN CONNECTION WITH JUDGMENTS AND SETTLEMENTS, AND PROPORTIONATE LIABILITY

Seventh Circuit

- A. *Harry Larson v. JPMorgan Chase & Co.*, 530 F.3d 578 (7th Cir. June 23, 2008)
1. Appeal of an order by the District Court (N.D. Ill.) denying motion to intervene by a pension fund in a class action by investors asserting federal securities fraud relating to a bank merger. The Seventh Circuit affirmed.

2. Plaintiff investors brought a class action alleging that the prospectus for a merger transaction between two banks contained misrepresentations. The District Court, before certifying a class, granted summary judgment in favor of Defendant against early purchasers, finding that they could not have been harmed by any misrepresentations, but instead likely benefited from exaggerations in the value of the stock. The District Court then certified a class of late purchasers, and the parties settled. The settlement included a release of claims of the named Plaintiffs and a class of late purchasers, but not of the unnamed early purchasers.
3. Three years after the granting of summary judgment, a pension fund, which was both an early and late purchaser, moved to intervene for the purpose of appealing any orders affecting the early purchasers, mainly the partial summary judgment initially entered against the early purchasers. The District Court denied the motion, and the pension fund appealed.
4. The Seventh Circuit held that the pension fund either knew or should have known that summary judgment had been entered, and the motion to intervene was therefore not timely.

Eighth Circuit

- A. *In re Charter Communications, Inc. Sec. Litig.*, 519 F.3d 730 (8th Cir. Mar. 3, 2008)
 1. Remand from the order of the Supreme Court of the United States affirming the dismissal of Plaintiffs' class action. Plaintiff investors brought securities fraud claims against Defendant corporation. The District Court dismissed the claims, entering a separate final judgment in favor of Defendants under Rule 54(b). Plaintiffs appealed, and the Eighth Circuit affirmed. Plaintiffs then petitioned for a writ of certiorari, and the Supreme Court granted the writ, affirmed the Eighth Circuit, and remanded for further proceedings consistent with its opinion in *Stoneridge*. Upon remand, Plaintiffs argued that under the PSLRA, upon final adjudication of a private securities action, the court must record specific findings regarding compliance by each party and each attorney with Rule 11(b). The Eighth Circuit held that Rule 11(b) findings were properly waived on appeal and ordered that the initial final judgment of the District Court be affirmed.

2. Plaintiffs argued that because neither party raised a Rule 11(b) issue and the record did not include the required Rule 11(b) finding, the final judgment was in violation of the PSLRA. The Eighth Circuit, however, noted that Defendants expressly waived their right to assert a Rule 11(b) claim, and that the statute does not require that the Rule 11 findings be part of the judgment. Noting that courts differ as to whether the absence of the statutory findings require remand to the District Court, the Eighth Circuit found that “the Rule 11(b) issue may still be waived on appeal, either when it is not timely raised by any party or when, as here, it is affirmatively waived by the parties who prevailed in the District Court.” *Id.* at 731. The Eighth Circuit noted that a broader reading could implicate Article III federal jurisdiction concerns.

Ninth Circuit

- A. *Talley v. U.S. Trust Corp. (In re Heritage Bond Litig.)*, 546 F.3d 667 (9th Cir. Oct. 1, 2008)
 1. This case arose from the settlements of complex securities fraud cases referred to as *In re Heritage Bond Litigation*. The District Court (C.D. Cal.) approved multiple settlement agreements pursuant to Rule 23, California Code of Civil Procedure § 877.6 (“§ 877.6”) and the PSLRA. In approving the settlements, the District Court issued bar orders that prohibited non-settling Defendants from bringing against Settling Defendants any future claims “arising out of or related to . . . any of the transactions or occurrences alleged.” *Id.* at 670. A non-settling Defendant (“Defendant”) objected to the scope of the bar orders on the ground that he wished to pursue independent state law claims against several of the Settling Defendants. The Ninth Circuit vacated the challenged bar orders and remanded to the District Court to modify them in a manner consistent with its opinion.
 2. The District Court first applied an “interrelatedness” test and determined that Defendant’s anticipated claims were related to and arose out of the litigation involving the Heritage Bonds. Thus, the bar orders specifically barred Defendant’s claims. Defendant argued that, to the extent the bar orders exclude him from bringing independent, non-indemnity or contribution claims in state court, the bar orders exceed the scope allowed by the PSLRA and § 877.6. The Ninth Circuit agreed.
 3. The Ninth Circuit vacated the bar orders and remanded for modification. In doing so, it followed the approach of the Second Circuit in *Gerber v. MTC Electronics Technologies Co.*, 329 F.3d 297 (2d Cir. May 15, 2003), and limited the scope of a permissible bar order issued as part of a securities fraud class action settlement to claims for contribution and indemnity, or disguised claims for such relief. Independent claims, such as Defendant’s, where the injury is not the non-settling Defendant’s liability to Plaintiff, may not be barred under either federal law or § 877.6.

B. *Thompson v. Paul*, 547 F.3d 1055 (9th Cir. Oct. 27, 2008)

1. Appeal of an order by the District Court (D. Ariz.) granting a motion to dismiss Plaintiffs' federal securities law claims and state law claims, and denying Plaintiffs' request for certification of state law issues to the Arizona Supreme Court. Plaintiff Thompson and her children brought claims pursuant to § 10(b) and Rule 10b-5 alleging that attorneys for YP.net and its CEO made material misrepresentations to Thompson during settlement negotiations in which the parties agreed to a settlement payment. Thompson was the former CFO of YP.net and resigned because of allegedly questionable accounting and auditing practices at YP.net. After resigning, Thompson allegedly notified the SEC of her concerns. YP.net then brought a civil suit against Thompson, and Thompson asserted counterclaims. As part of the settlement of the case, Thompson was to receive YP.net common stock. In the course of settlement negotiations, YP.net's attorneys allegedly knowingly misrepresented to Thompson that there was no pending criminal investigation of YP.net's CEO. Shortly after the settlement was finalized, YP.net's CEO was indicted on criminal charges, and YP.net's stock price fell sharply. The District Court dismissed Plaintiffs' claims. The Ninth Circuit reversed the dismissal, and affirmed the denial of Plaintiffs' request for certification.
2. The Ninth Circuit noted that it was "apparent . . . that the District Court dismissed Thompson's Section 10(b) claim because, in the court's view, she had no right under Arizona law to rely on opposing counsel's statements, even when those statements were made 'in connection with the purchase or sale of any security.'" *Id.* at 1059. The Ninth Circuit held that "Section 10(b) is not an exception to the general rule that '[a] claim which arises under a federal statute and implicates federal policy is appropriately decided under federal law.'" *Id.* at 1061. The Ninth Circuit held that, under federal law, attorneys can be held liable to parties other than their own clients under Rule 10b-5 for material misrepresentations made in connection with the purchase or sale of securities. It further held that YP.net's attorneys were not protected from liability because they represented a party opposing Thompson when they made the alleged misrepresentations. The Ninth Circuit also held that Plaintiffs had adequately pled their justifiable reliance on the alleged misrepresentations, and had stated a claim for relief under federal securities law.
3. The Ninth Circuit rejected the argument that the District Court found that Thompson knew about the criminal investigation of YP.net's CEO at the time that the alleged misrepresentations were made. The Ninth Circuit noted also that the question was not whether Thompson knew that YP.net's CEO had ever been criminally investigated, but whether Thompson knew of the investigation on the day that YP.net's attorneys made the alleged misrepresentations.

Tenth Circuit

- A. *New England Health Care Employees Pension Fund v. Woodruff*, 512 F.3d 1283 (10th Cir. Jan. 16, 2008)
1. Appeal of an order by the District Court (D. Colo.) approving a settlement between Plaintiff class and Qwest, a telecommunications company, and certain of its officers of part of a class action alleging § 11 violations. Two Defendant employees who were not part of the settlement appealed. The Tenth Circuit held that the two non-settling Defendants had standing to challenge the settlement and remanded the case to the District Court to provide a more extensive explanation of its decision.
 2. The settlement agreement contained three provisions that were at issue in the appeal. First, as required by the PSLRA, the settlement agreement contained a Reform Act Bar provision, which barred contribution claims between and among the settling and non-settling Defendants. The second provision was a Complete Bar, which prohibited the non-settling Defendants from bringing any claim against the settling Defendants related to the claims released by the settlement. The third provision, deemed the Contractual Provisions, required Plaintiffs in any settlement with the non-settling Defendants to obtain a release from the non-settling Defendants of any claims against the settling Defendants. The Contractual Provisions further required Plaintiffs to reduce any amounts they received from the non-settling Defendants by any amounts that the non-settling Defendants may receive from the settling Defendants.
 3. Qwest argued that the non-settling Defendants did not have standing to challenge the Reform Act Bar, the Complete Bar or the Contractual Provisions. Qwest claimed the Contractual Provisions were simply an agreement by which Plaintiffs would not collect money from the non-settling Defendants for which the settling Defendants are liable, and thus the non-settling Defendants were not deprived of their rights and could not show “an injury-in-fact.” *Id.* at 1288. Qwest further argued that the non-settling Defendants could not show an “injury-in-fact” with respect to the “independent claims” and claims by “non-parties who were not before the court” that were barred by the Complete Bar and the Reform Act Bar. *Id.*

4. The Tenth Circuit disagreed. “As to the Complete Bar and the Reform Act Bar, clearly, [the non-settling Defendants] have standing to challenge these provisions: both Bar Orders strip [the non-settling Defendants] of their contribution and indemnification rights, in addition to certain claims.” *Id.* The Tenth Circuit further held that the “Contractual Provisions clearly impact [the non-settling Defendants’] contribution and indemnification rights by requiring them to release their claims against Qwest and then lose the benefit of any possible indemnification in a settlement with Plaintiffs.” *Id.* at 1288-89. The Tenth Circuit then remanded the case to the District Court so that “it might make appropriate findings and conclusions with respect to the [non-settling Defendants’] objections to settlement.” *Id.* at 1286.
5. In dissent, Judge Briscoe “agree[d] with the majority that Non-Settling Defendants have standing to contest the Complete Bar Order and Reform Act Bar Order.” *Id.* at 1291. Judge Briscoe disagreed, however, that the non-settling Defendants “have standing to contest the two Contractual Provisions.” *Id.*

Eleventh Circuit

- A. *LaPierriere v. Vesta Ins. Group, Inc.*, 526 F.3d 715 (11th Cir. Apr. 30, 2008)
 1. Interlocutory appeal of an order by the District Court (N.D. Ala.) denying Plaintiffs’ motion to strike two of Defendant’s affirmative defenses concerning PSLRA’s “proportionate liability” scheme as applied to control persons under § 20(a) of the Exchange Act. The Eleventh Circuit affirmed the District Court order.
 2. Plaintiffs commenced a securities class action against Vesta Insurance Group, Inc. (“Vesta”) and certain of its officers and directors, Vesta’s outside auditor, and Torchmark Corporation (“Torchmark”), the former parent company of Vesta. After Vesta and the auditors reached court approved settlements, Plaintiffs moved to strike two of Torchmark’s affirmative defenses which sought to draft the PSLRA’s scheme of “proportionate liability,” set forth at § 21D(f) of the Exchange Act, onto the joint and several liability scheme existing between a controlling person and a controlled person under § 20(a).
 3. Under § 21D(f), a “covered person” is liable jointly and severally for the entirety of plaintiffs’ damages only if a factfinder specifically determines that such covered person knowingly committed a violation of the securities law. If the factfinder does not specifically make such a finding, then the covered person shall be liable solely for the portion of the judgment that corresponds to the covered person’s percentage of responsibility. Section 20(a) exposes a controlling person to derivative liability for the acts of its controlled person where the controlling person cannot prove that it did not act in bad faith or with recklessness.

4. The District Court, in a matter of first impression, concluded that the “proportionate liability” scheme set forth in § 21D(f) “trumped” § 20(a), and certified the question for interlocutory appeal.
5. Reviewing the text of both sections, the Eleventh Circuit determined that as a matter of statutory construction (1) the term “covered persons” includes controlling persons under § 20(a), and therefore § 21D(f) applies to § 20(a), but (2) the PSLRA does not amend the joint and several liability provisions of § 20(a). The Eleventh Circuit then harmonized the two provisions as follows: A controlling person is liable under § 20(a) unless the person affirmatively establishes that it acted in good faith. If the control person is unable to establish that it acted in good faith, then, for purposes of determining whether the controlling person is liable for the entire amount of damages or only its proportionate share, courts look to the proportionate liability provisions of § 21D(f). Under that provision, joint and several liability will attach for a controlling person only if the factfinder specifically determines that the controlling person knowingly committed the violation.

FALSITY AND PARTICULARITY

Eighth Circuit

- A. *In re Hutchinson Tech., Inc. Sec. Litig.*, 536 F.3d 952 (8th Cir. Aug. 5, 2008)
 1. Appeal of an order by the District Court (D. Minn.) dismissing a purported class action. Investor Plaintiffs brought claims under § 10(b) and Rule 10b-5 against the corporation and its officers and directors based on alleged overstatements of corporate earnings. The corporation, a leading manufacturer and supplier of suspension assemblies for computer hard disk drives, had reported that it expected to exceed its predicted earnings per share for the fourth quarter of 2004, and expected an increase in demand for the first quarter of 2005. Instead, the corporation’s stock prices fell. The complaint rested in part on statements from confidential witnesses concerning business practices and customer demand. The District Court found that the claim did not meet the heightened pleading standards for falsity and scienter as required by the PSLRA. The Eighth Circuit affirmed.

2. Plaintiffs cited statements from five confidential witnesses in support of the claim that the company's financial statements were false or misleading. The Eighth Circuit stated that in order to meet the PSLRA standards, a complaint must necessarily show that Defendants' statements are misleading. In this case, however, the claims by Plaintiffs were "either bare allegations or allegations supported by anecdotal information about specific customers with no historical context." *Id.* at 959. The Eighth Circuit went on to say that the statements by the confidential witnesses did not suggest more than normal business fluctuations and did not reveal the witnesses' basis of knowledge.

Ninth Circuit

- A. *Safron Capital Corp. v. Leadis Tech., Inc.*, 274 Fed. Appx. 540 (9th Cir. Apr. 18, 2008)
 1. Appeal of an order by the District Court (N.D. Cal.) dismissing with prejudice Plaintiffs' class action complaint alleging violations of §§ 11, 12(a)(2), and 15 of the Securities Act. The Ninth Circuit reversed and remanded.
 2. The Ninth Circuit observed that fraud was not an essential element of the claims raised in Plaintiffs' complaint; nor did the complaint specifically allege fraud or allege facts that necessarily constitute fraud.
 3. The Ninth Circuit held that, because fraud is not an essential element of the claims raised and the complaint alleges neither fraud nor facts that necessarily constitute fraud, the particularity requirements of Rule 9(b) do not apply. Conversely, if the complaint had used the word "fraud" to describe Defendant's actions or if the complaint "sounded in fraud" or was "grounded in fraud," the heightened pleading requirements of Rule 9(b) would apply. *Id.* at 541.

LIBERAL AMENDMENT POLICY

First Circuit

- A. *ACA Fin. Guar. Corp. v. Advest, Inc.*, 512 F.3d 46 (1st Cir. Jan. 10, 2008)
1. Appeal of an order by the District Court (D. Mass.) granting Defendants' motion to dismiss. Plaintiffs, purchasers and an insurer of Bradford College bonds sold in May 1998, brought suit after the college defaulted on its bond obligations in January 2000. Plaintiffs asserted claims against the underwriter investment banking firm, former president and vice president of the college and members of the college's board of trustees alleging violations of the Exchange Act and Rule 10b-5 for material misrepresentations and omissions in the Official Statement accompanying the offering. The District Court granted Defendants' motion to dismiss for failing to meet the pleading requirements for scienter imposed by the PSLRA. Plaintiffs filed motions with the District Court to vacate the dismissal under Rule 59(e) and for leave to amend under Rule 15(a). The District Court denied both post-dismissal motions. The First Circuit affirmed.
 2. The First Circuit held that "the PSLRA does not itself modify the liberal amendment policy of Rule 15(a)." *Id.* at 56. The First Circuit agreed with the D.C. Circuit, and held that the "text of the Act neither purports to affect Rule 15(a), nor does it require that all dismissals be with prejudice" and thus "in the absence of a legislative directive to the contrary, Rule 15 applies as in the normal course." *Id.* Interpreting the PSLRA as constricting the operation of Rule 15(a) "would disturb the legislative balance struck by the Act" and "would tip the scales too far, compromising plaintiff's ability to have meritorious claims presented in court." *Id.*
 3. The First Circuit held that "[e]ach case will turn on its own circumstances" and that the District Court "had abundant reason to deny the motion, however the request to amend is characterized." *Id.* at 57. The First Circuit emphasized Plaintiffs' significant delay in amending the complaint, holding that "the plaintiffs do not get leisurely repeated bites at the apple" and "may not, having the needed information, deliberately wait in the wings for a year and a half with another amendment to a complaint." *Id.* Thus, the District Court did not err because "it was black letter law that regardless of the context, the longer a plaintiff delays, the more likely a motion to amend will be denied, as protracted delay, with its attendant burdens on the opponent and the court, is itself a sufficient reason for the court to withhold permission to amend." *Id.*

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