

## 2009 Year in Review: Selected Federal Securities Litigation Developments

January 28, 2010

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

We summarize below key decisions analyzing claims by private litigants under Sections 10(b), 14(a), 16, 20(a), and 20(A) of the Securities Exchange Act of 1934 and Sections 11, 12, and 15 of the Securities Act of 1933.<sup>1</sup> Our review includes 64 opinions, organized by topic and, within each topic, by circuit in chronological order, allowing you to quickly identify the most recent authority on particular issues in any jurisdiction.<sup>2</sup> A copy of the full review can be found at [http://www.morganlewis.com/pubs/LIT\\_2009SECLITDvlpmntsWP\\_Jan2010.pdf](http://www.morganlewis.com/pubs/LIT_2009SECLITDvlpmntsWP_Jan2010.pdf).

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

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

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

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1. We have not included certain decisions where securities law issues are neither central to the case nor analyzed in a substantive manner. For a review of enforcement actions, please see Morgan Lewis's *2009 Year in Review: SEC and SRO Selected Enforcement Cases and Developments Regarding Broker-Dealers*. A copy of the full review can be found at [http://www.morganlewis.com/pubs/LIT\\_SECandSROYearlyReviewWP\\_Jan2010.pdf](http://www.morganlewis.com/pubs/LIT_SECandSROYearlyReviewWP_Jan2010.pdf).
  2. Cases containing significant discussions of more than one of the topics highlighted in this outline have duplicative listings under each relevant topic heading.

inference. *See Zucco Partners, LLC v. Digimarc Corp.*, 552 F.3d 981 (9th Cir. Feb. 10, 2009); *see also Avon Pension Fund v. GlaxoSmithKline PLC*, No. 08-4363, 2009 WL 2591173 (2d Cir. Aug. 24, 2009).

- Nonetheless, a number of appellate decisions have held that the scienter requirement was not met through application of the second-level, holistic inquiry. Rather, the Circuit Courts have held that the allegations, even when viewed together, are insufficient. As the Second Circuit put it in the unpublished decision *Malin v. XL Capital, Ltd.*, 312 Fed. Appx. 400, 402 (2d Cir. Feb. 26, 2009): “[H]aving concluded that none of plaintiffs’ allegations showed even a weak inference of scienter, there is no logical way that the District Court could have determined that the combined effect of the allegations would have a *strong* inference of scienter.” *See also ECA and Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co.*, 553 F.3d 187 (2d Cir. Jan. 21, 2009); *Avon Pension Fund*, 2009 WL 2591173 at \*2 (“[P]laintiffs’ circumstantial pleadings, even when considered in the aggregate, do not permit an inference of defendants’ ‘conscious misbehavior or recklessness.’”); *Zucco Partners*, 552 F.3d at 1007 (“Although the allegations in this case are legion, even together they are not as cogent or compelling as a plausible alternative inference.”).
- The Second Circuit continues to hold that scienter may be established either by allegations of facts demonstrating that defendants had the motive and opportunity to commit fraud *or* by alleging strong circumstantial evidence of conscious misbehavior or recklessness. *See ECA*, 553 F.3d at 198–99; *Condra v. Pxre Grp. Ltd.*, No. 09-1370, 2009 WL 4893719 (2d Cir. Dec. 21, 2009). By contrast, the Third Circuit has concluded that, after *Tellabs*, “‘motive and opportunity’ may no longer serve as an independent route to scienter.” *Inst’l Investors Group v. Avaya, Inc.*, 564 F.3d 242, 277 (3d Cir. Apr. 30, 2009).
- In recent years, plaintiffs have attempted to use Sarbanes-Oxley certifications as evidence of scienter. Several Circuit Courts have rejected this argument. *See, e.g., Konkol v. Diebold, Inc.*, No. 08-4572, 2009 WL 4909110 at \*9 (6th Cir. Dec. 22, 2009); *Horizon Asset Mgmt. Inc. v. H&R Block, Inc.*, 580 F.3d 755, 766 (8th Cir. Sept. 9, 2009); *Zucco Partners*, 552 F.3d at 1002-04.
- The Circuit Courts appear reluctant to accept the claims that alleged insider stock transactions are evidence of scienter. Insider trading “is suspicious only when it is dramatically out of line with prior trading practices at times calculated to maximize the personal benefit from undisclosed insider information.” *Konkol*, 2009 WL 4909110, at \*6 (quoting *Zucco Partners*, 552 F.3d at 1005). In addition, plaintiffs “must provide a ‘meaningful trading history’ for purposes of comparison to the stock sales within the class period.” *Id.*
- The Circuit Courts remain cautious of the use of confidential witnesses to establish scienter. For example, the Ninth Circuit reiterated that a complaint relying on such statements must pass two hurdles: first, the confidential witnesses “must be described with sufficient particularity to establish their reliability and personal knowledge,” and second, those statements which are reported “must themselves be indicative of scienter.” *Zucco Partners*, 552 F.3d at 995.

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

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

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

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

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

Also, last year we included in our review a discussion of *Morrison v. Nat’l Australia Bank Ltd.*, 547 F.3d 167 (2d Cir. Oct. 23, 2008), one of several recent “Foreign Cubed” cases analyzing whether U.S. courts have jurisdiction over securities actions involving foreign plaintiffs suing foreign issuers concerning securities transactions in foreign countries. The Second Circuit applied a “conduct test” and determined that the District Court lacked subject matter jurisdiction. On November 30, 2009, the Supreme Court granted certiorari, and oral argument is scheduled for March 29, 2010.

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

under the “law of the case” doctrine (see *Public Employees’ Retirement Association of New Mexico v. PricewaterhouseCoopers LLP*, 305 Fed. Appx. 742 (2d Cir. Jan. 6, 2009)).

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

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

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