Morgan Lewis

review

2011 Year in Review:
Selected Federal Securities Litigation Developments

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Table of Contents

Morgan Lewis is pleased to present our fourth annual review of selected decisions from the U.S. Courts of Appeal addressing private actions under the federal securities laws.[1]

We summarize below key decisions analyzing claims by private litigants under Sections 10(b), 14(a), 16, 20(a), and 20(A) of the Securities Exchange Act of 1934 and Sections 11, 12, and 15 of the Securities Act of 1933. Our review is 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.

Before turning to the broader summary, we take this opportunity to highlight several important cases and interesting trends in 2011.

The U.S. Supreme Court

The Supreme Court issued three important decisions, continuing its recent activity in the securities field. First, in *Erica P. John Fund, Inc. v. Halliburton Co.*, 563 U.S. —, 131 S. Ct. 2179, 180 L. Ed. 2d 24 (June 6, 2011), the Supreme Court rejected the Fifth Circuit's requirement that loss causation be established at the class certification stage in order to invoke the fraud-on-the-market theory of reliance. According to the opinion authored by Chief Justice Roberts, "[l]oss causation has no logical connection to the facts necessary to establish the efficient market predicate to the fraud-on-the-market theory." 131 S. Ct. at 2186.

Second, in *Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. —, 131 S. Ct. 2296, 180 L. Ed. 2d 166 (June 13, 2011), the Supreme Court built on its decisions 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 (1994), and *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 128 S. Ct. 761, 169 L. Ed. 2d 627 (Jan. 21, 2008), holding that a mutual fund investment adviser and parent company could not be held civilly liable under Rule 10b-5 for alleged misstatements in a mutual fund prospectus because the adviser did not make the statements. The Supreme Court observed—in a timely statement as we roll toward a presidential election—"[e]ven when a speechwriter drafts a speech, the content is entirely within the control of the person who delivers it. And it is

[1] This review was prepared by Morgan Lewis partners Brian Herman and John Vassos, of counsel Karen Pieslak Pohlmann, and associates Laura Hughes, Nicholas Schretzman, and Anthony Fassano with substantial assistance from senior paralegal Jan McGovern. This review is current as of December 31, 2011. Copyright 2012, Morgan, Lewis & Bockius LLP.

the speaker who takes credit—or blame for what is ultimately said." 131 S. Ct. at 2302.

Third, in *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. —, 131 S. Ct. 1309, 179 L. Ed. 2d 398 (Mar. 22, 2011), an important case for the medical and pharmaceutical industries, the Supreme Court addressed whether reports of adverse events associated with a pharmaceutical product are material "absent a sufficient number of such reports to establish a statistically significant risk that the product is in fact causing the events." 131 S. Ct. at 1318-19. The Supreme Court rejected the application of any bright-line rule, observing that statistical evidence may not always be available and that an absence of such data "does not mean that medical experts have no reliable basis for inferring a causal link between a drug and adverse events." *Id.* at 1319.

Statute of Limitations and the Impact of Merck

While it is too soon to predict the full effect of these three Supreme Court decisions, we are already observing the ripple effects of the 2010 decision in *Merck & Co., Inc. v. Reynolds*, 559 U.S. —, 130 S. Ct. 1784, 176 L. Ed. 2d 582 (Apr. 27, 2010). *Merck* addressed the critical question of when the clock begins to tick on the statute of limitations for a Rule 10b-5 action. The Supreme Court rejected the inquiry notice standard applied by the appellate court, holding that the limitations period does not begin to run until a plaintiff discovers, or a reasonably diligent plaintiff would have discovered, the facts constituting the violation. Importantly, the Supreme Court held that the "facts showing scienter are among those that 'constitut[e] the violation.'" 130 S. Ct. at 1796 (alteration in original).

In 2011, applying *Merck*, the Second and Ninth Circuits both reversed decisions in favor of defendants on statute of limitations grounds. *See City of Pontiac v. MBIA, Inc.*, 637 F.3d 169 (2d Cir. Feb. 28, 2011); *Strategic Diversity Inc. v. Alchemix Corp.*, — F.3d —, Nos. 10-15256, 10-16404, 2011 WL 6004607 (9th Cir. Dec. 2, 2011), *opinion withdrawn, reissued and reh'g denied*, — F.3d —, 2012 WL 164091 (9th Cir. Jan. 20, 2012). In *City of Pontiac*, the Second Circuit held that under *Merck*, "a fact is not deemed 'discovered' until a reasonably diligent plaintiff would have sufficient information about that fact to adequately plead it in a complaint" with sufficient particularity "to survive a 12(b)(6) motion to dismiss." *City of Pontiac*, 637 F.3d at 175.

The Seventh Circuit also addressed the key question of when a "violation" occurs such that the statute of repose begins to run. In *McCann v. Hy-Vee, Inc.*, 663 F.3d 926 (7th Cir. Nov. 22, 2011), Plaintiff argued that the repose period runs from the time when she suffered injury. The Seventh Circuit rejected this argument, holding that the "violation" occurs at the time of the misstatement; otherwise

> a person who had bought a security could, having later discovered he'd been defrauded, wait indefinitely to determine whether his purchase had been a mistake (because of the fraud) on a windfall (because despite the fraud the price of the security had risen beyond expectations), since his two-year [statute of limitations period] would not run until the fraud causes him harm. This would be a heads I win, tails you lose proposition, which the law would be unlikely to countenance.

Id. at 931.

Financial Services and the Credit Crisis

In 2011, the circuit courts issued a number of decisions touching on the financial services industry and cases arising out of the credit crisis.

There were three decisions favorable to the financial industry arising out of the freeze in the auction rate securities (ARS) market. In *Ashland, Inc. v. Oppenheimer & Co., Inc.*, 648 F.3d 461 (6th Cir. July 28, 2011), the Sixth Circuit affirmed dismissal of an investor's claims based on insufficient allegations of scienter. Applying the holistic review of allegations required by *Tellabs v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007), the Sixth Circuit found that the investor's allegations failed to give rise to a strong inference of scienter; "the more compelling explanation is that the near-spontaneous collapse of the ARS market caught Oppenheimer and its employees off guard." *Oppenheimer*, 648 F.3d at 470. In *Ashland Inc. v. Morgan Stanley & Co., Inc.*, 652 F.3d 333 (2d Cir. July 28, 2011), and *Wilson v. Merrill Lynch & Co., Inc.*, No. 10-1528, 2011 WL 5515958 (2d Cir. Nov. 14, 2011), the Second Circuit twice affirmed the dismissal of claims that a dealer misrepresented the liquidity of auction rate securities where the dealer had posted certain disclosures concerning bidding practices and risks associated with auction rate securities in accordance with a prior Securities and Exchange Commission (SEC) settlement. In doing so in the *Merrill* action, the Second Circuit rejected the position of the SEC set forth in an amicus brief.

There were also two published appellate decisions concerning mortgage-backed securities (MBS). In *Plumbers' Union Local No. 12 Pension Fund v. Nomura Asset Acceptance Corp*., 632 F.3d 762 (1st Cir. Jan. 20, 2011), the plaintiffs challenged statements in MBS offering statements. The First Circuit held that the plaintiffs did not have standing to pursue claims with respect to trusts whose certificates they did not purchase and for offerings in which they did not participate. However, the First Circuit allowed to proceed those claims of alleged misstatements concerning underwriting standards, finding that the risk warnings disclosed in the offering materials did not address the plaintiffs' claims of "wholesale abandonment of underwriting standards." *Id.*

With respect to *In re Lehman Bros. Mortgage-Backed Sec. Litig.* 650 F.3d 167 (2d Cir. May 11, 2011), the Second Circuit affirmed the dismissal of claims against rating agencies under Sections 11 and 15 of the Securities Act of 1933 in connection with investments in mortgage pass-through certificates. The Second Circuit rejected the plaintiffs' claim that the rating agencies should be deemed liable as underwriters or control persons.

On the Bernie Madoff front, the Second Circuit rejected efforts to hold a financial institution liable under RICO for allegedly aiding and abetting the Madoff fraud, finding the claims were barred by the so-called "RICO Amendment" to the PSLRA. Plaintiff argued that the RICO Amendment does not apply to aiding and abetting claims because the securities laws do not provide a private right of action for such claims. The Second Circuit rejected this argument: "[S]ection 107 of the PSLRA bars civil RICO claims alleging predicate acts of securities fraud, even where a plaintiff cannot itself pursue a securities fraud action against the defendant." *MLSMK Inv. Co. v. JP Morgan Chase & Co*., 651 F.3d 268, 277 (2d Cir. July 7, 2011). The question of whether SLUSA applies to state law claims brought by victims of the Madoff scheme has been argued and is currently awaiting a decision by the Second Circuit. *Barron v. Igolnikov*, No. 101387 (2d. Cir. *argument heard* Mar. 1, 2011).

Also, in 2009 and 2010, we observed that claims against accounting firms were repeatedly failing on appeal. In 2011, the results were more mixed. In *In re DVI, Inc. Sec. Litig*., 639 F.3d 623 (3d Cir. Mar. 29, 2011), the Third Circuit affirmed an order certifying a class against an issuer's outside auditor, holding that loss causation need not be established to invoke the fraud-on-the-market presumption. This decision was consistent with the Supreme Court's decision in *Halliburton*, issued several months later. Shortly after *DVI*, the Ninth Circuit reversed an order of dismissal and reinstated claims against an outside auditor in connection with alleged stock option backdating by one of its clients. *See N.M. State Inv. Council v. Ernst & Young LLP*, 641 F.3d 1089 (9th Cir. Apr. 14, 2011). In doing so, the Ninth Circuit declined to set a special scienter standard for accountants. In contrast, the Tenth Circuit declined to reach the question of whether a more "stringent" scienter requirement should apply to outside auditors, but nonetheless affirmed dismissal of claims against an auditor in *Dronsejko v. Thornton*, 632 F.3d 658, 665 (10th Cir. Jan. 20, 2011).

Scienter

With respect to more general trends at the circuit court level, there were a number of defense-oriented decisions on scienter. For example, in the *City of Dearborn Heights Act 345 Police & Fire Ret. Sys. v. Waters Corp*., 632 F.3d 751 (1st Cir. Jan. 20, 2011), the First Circuit declined to find scienter based on an alleged failure of a technology company to disclose changes in regulations in a foreign market that subsequently affected product demand, where the defendants had made statements to the market about the decrease in demand. Similarly, in *Miss. Pub. Emps. Ret. Sys. v. Bos. Scientific Corp.,* 649 F.3d 5 (1st Cir. Aug. 4, 2011), the First Circuit issued a lengthy opinion tracking the history and manufacturing process of coronary stents before holding that the plaintiff failed to produce evidence at the summary judgment stage that would permit a reasonable inference of scienter in connection with alleged failures to disclose a product defect. “The investing public was not only aware of the no-deflate complaints, but also the risk of recall, which defendants openly discussed.” *Id*.at 29.

The Eighth Circuit also refused to find that a plaintiff adequately pleaded scienter arising in connection with an alleged failure to disclose problems at an operating plant, where the defendant had disclosed operating plant problems both before and after the class period. In *Minneapolis Firefighters’ Relief Ass’n. v. MEMC Elec. Materials, Inc*., 641 F.3d 1023 (8th Cir. June 17, 2011), the Eighth Circuit observed that there was no precedent supporting the plaintiff’s “pattern” theory of scienter. *Id.* at 1030.

However, claims against two executives associated with a now-bankrupt auto parts manufacturer were found be sufficient, in light of the holistic review of facts required under *Tellabs*. In *Frank v. Dana Corp*., 646 F.3d 954 (6th Cir. May 25, 2011), *reh’g and reh’g en banc denied* (July 1, 2011), the Sixth Circuit observed that the defendants “were the two top executives of an auto parts manufacturer, and they reported gangbuster earnings during a period of time when the entire auto industry was spiraling towards bankruptcy.” *Id*. at 961.

Reliance, Materiality, and Causation

As noted above, the Supreme Court concluded in *Halliburton* that a plaintiff need not establish loss causation at the class certification stage to invoke the fraud-on-the-market theory of reliance. The Ninth Circuit added that a plaintiff also need not prove materiality at class certification. “As for the element of materiality, the plaintiff must plausibly allege—but need not *prove* at this juncture—that the claimed misrepresentations were material.” *Conn. Ret. Plans & Trust Funds v. Amgen, Inc.*, 660 F.3d 1170, 1172 (9th Cir. Nov. 8, 2011).

Also focusing on materiality, the Second Circuit issued two important decisions. In *Litwin v. Blackstone Group, L.P*., 634 F.3d 706 (2d Cir. Feb. 10, 2011), the Second Circuit vacated an order of dismissal of claims brought on behalf of purchasers of initial public offering (IPO) shares of Blackstone alleging that the defendants knew about, but failed to disclose, alleged problems with two portfolio companies and a fund investment. The district court (S.D.N.Y.) applied both a qualitative and quantitative approach, comparing the alleged misstatement with the entire financial position of Blackstone, in assessing materiality. The Second Circuit criticized this approach, holding that a misstatement that appears "quantitatively small" compared with firm-wide financial results can still be material if it is significant to a "particularly important segment" of the firm's business. *Id*. at 720.

Several months later, the Second Circuit revisited the question of materiality in *Hutchison v. Deutsche Bank Sec. Inc*., 647 F.3d 479 (2d Cir. July 26, 2011). In *Hutchison*, the plaintiffs alleged misrepresentations and omissions concerning impairment of two mezzanine loans totaling approximately $51.5 million out of a total investment portfolio of $1.1 billion of the defendant real estate finance company. The Second Circuit stated: "If a particular product or product line, or division or segment of a company's business, has independent significance for investors, then even a matter material to less than all of the company's business may be material for the purposes of the securities laws." *Id*. at 488. The Second Circuit then observed that while the two loans represented a significant portion of the real estate entity's outstanding mezzanine loans, the plaintiffs failed to allege that mezzanine loans constituted a particularly important segment of the business and therefore the proper comparison was to the entire portfolio.

As for loss causation, the Eleventh Circuit held that "confirmatory information that wrongfully *prolongs* a period of inflation—even without increasing the *level* of inflation—may be actionable under the securities laws." *FindWhat Investor Group v. FindWhat.com*, 658 F.3d 1282, 1314 (11th Cir. Sept. 30, 2011).

Popular Culture

Finally, in a part of the story not reflected in the Hollywood movie depicting the founding of the social computer network, the Ninth Circuit affirmed a district court (N.D. Cal.) decision enforcing a global settlement between the founders of Facebook. In *Facebook, Inc. v. Pacific Northwest Software, Inc*., 640 F.3d 1034 (9th Cir. Apr. 11, 2011, amended May 16, 2011), the court rejected an attempt by three individuals to rescind a settlement agreement between them and Facebook by invoking Section 29(b) of the Exchange Act of 1934.

As for 2012, we are monitoring whether the circuit courts continue the trend of limiting the types of defendants that may be targeted by the securities laws, as reflected in *Janus Capital*. We are similarly focused on cases reflecting restrictions on limitations defenses as a result of *Merck*, and we continue to analyze decisions addressing complex financial products and the impact of the financial crisis. As always, we welcome your feedback, and we look forward to working with you this year.

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For the purposes of the following securities case law summary, references to the Exchange Act refer to the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a et seq., and references to §§ 10(b), 14(a), 16(b), 20(a), and 20(A) refer to the associated sections of the Exchange Act, 15 U.S.C. §§ 78j(b), 78n(a), 78p(b), 78t(a), and 78t-1. References to Rule 10b-5 refer to SEC Rule 10b-5, promulgated in 1942 pursuant to § 10(b) of the Exchange Act, 17 C.F.R. § 240.10b-5. References to the Securities Act refer to the Securities Act of 1933, 15 U.S.C. §§ 77a et seq., and references to §§ 11, 12, and 15 refer to the associated sections of the Securities Act, 15 U.S.C. §§ 77k, 77l, and 77o. References to the PSLRA refer to the Private Securities Litigation Reform Act of 1995. *See, e.g.*, 15 U.S.C. §§ 78u-4, 78u-5. References to SLUSA refer to the Securities Litigation Uniform Standards Act of 1998, 15 U.S.C. §§ 77p, 78bb(f). References to CAFA refer to the Class Action Fairness Act of 2005, 28 U.S.C. §§ 1711-1715. References to *Tellabs* refer to the Supreme Court decision *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 127 S. Ct. 2499, 168 L. Ed. 2d 179 (June 21, 2007). References to *Stoneridge* refer to the Supreme Court decision *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 128 S. Ct. 761, 169 L. Ed. 2d 627 (Jan. 21, 2008). References to *Dabit* refer to the Supreme Court decision *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 126 S. Ct. 1503, 164 L. Ed. 2d 179 (Mar. 21, 2006). References to *Dura* refer to the Supreme Court decision in *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336, 125 S. Ct. 1627, 161 L. Ed. 2d 577 (Apr. 19, 2005). References to *Merck* refer to the Supreme Court decision *Merck & Co., Inc. v. Reynolds*, 130 S. Ct. 1784 (Apr. 27, 2010). References to GAAP are to generally accepted accounting principles. Opinions published in the Federal Appendix were not chosen for publication in West's Federal Reporter, see Fed. R. App. P. 32.1. In certain instances, where a circuit court opinion has quoted from or cited to an underlying authority, we have omitted the citation to the underlying authority.

Supreme Court

A. *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. —, 131 S. Ct. 1309, 179 L. Ed. 2d 398 (Mar. 22, 2011)

1. The Supreme Court affirmed the decision of the Ninth Circuit reversing and remanding the district court's (D. Ariz.) order granting Defendants' motion to dismiss. Plaintiff investors alleged that Matrixx Initiatives, makers of Zicam cold remedy products, made material misstatements and omissions in violation of § 10(b) of the Exchange Act and Rule 10b-5. The district court dismissed the complaint, concluding that Plaintiffs had not adequately pleaded materiality and scienter. The Ninth Circuit reversed and remanded, holding that the district court erred in requiring Plaintiffs to allege statistical significance to establish materiality. The Supreme Court affirmed, holding that there is no bright-line rule requiring Plaintiffs to allege a statistically significant number of adverse events to establish materiality, and that Plaintiffs had adequately alleged scienter.

2. Matrixx develops, manufactures, and markets over-the-counter pharmaceutical products including its core brand, Zicam cold remedies. The complaint alleged that Defendants were aware of but failed to disclose information that a Zicam product allegedly caused a loss of the sense of smell in patients. Specifically, that Matrixx allegedly received communications from physicians (including the neurological director at the Smell & Taste Treatment and Research Foundation, Ltd.) concerning loss of smell, was alerted to studies linking an ingredient in Zicam to loss of smell, was aware of a presentation on the issue by the American Rhinologic Society, and had been named in products liability lawsuits alleging damaged sense of smell.

3. Plaintiffs asserted that Defendants' projections of revenue in the face of information received were false and misleading, and that the failure to disclose the reports about the adverse effects of Zicam constituted actionable omissions. Defendants argued that Plaintiffs failed to adequately plead materiality or scienter because the complaint did not allege that the reports received reflected statistically significant evidence that Zicam caused anosmia, or loss of the sense of smell. The Supreme Court disagreed, concluding that Plaintiffs had adequately pleaded both scienter and materiality.

4. As to scienter, the Supreme Court assumed without deciding that scienter can be satisfied by showing deliberate recklessness. Defendants had not challenged this part of the Ninth Circuit's holding. The Supreme Court concluded that, in light of the facts alleged, "[t]he inference that Matrixx acted recklessly (or intentionally, for that matter) is at least as compelling, if not more compelling, than the inference that it simply thought the reports did not indicate anything meaningful about adverse reactions." 131 S. Ct. at 1324. In particular, Plaintiffs alleged that, in response to the information Matrixx had received, it hired a consultant to review the product, asked one of the parties who brought

information to the attention of Matrixx to participate in animal studies, convened a panel of physicians and scientists, took steps to prevent a scientist presenting on the subject from using Zicam's name in the presentation, and issued a press release suggesting that studies confirmed that Zicam does not cause anosmia, when it had not conducted any such studies and that the scientific evidence, according to the panel of scientists, was uncertain.

First Circuit

B. *City of Dearborn Heights Act 345 Police & Fire Ret. Sys. v. Waters Corp.*, 632 F.3d 751 (1st Cir. Jan. 20, 2011).

1. Appeal from an order of the district court (D. Mass.) dismissing Plaintiff pension fund's class action lawsuit alleging violations of §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5 against a Defendant technology corporation and two of its senior officers. The First Circuit affirmed, holding that Defendant Waters Corporation's failure to disclose new regulations enacted in Japan, one of its markets, did not give rise to a strong inference of scienter.

2. Waters designs, manufactures, sells, and services scientific equipment. During 2006, sales to Japan accounted for 10% of its global sales, due in part to stringent Japanese water testing regulations. In March 2007, the Japanese government amended the regulations, which reduced the demand for Waters' equipment. Plaintiffs alleged that company officials were aware of but failed to disclose this development.

3. In January 2008, Waters released its fourth quarter results. While sales were higher than expected, earnings were lower. In an investor conference call, the company identified a number of factors including weaker than anticipated sales in Japan due to a combination of the "sluggish" economic condition and the regulatory change. *Id.* at 756.

4. The First Circuit found that, while company officers knew of the new Japanese regulation in March 2007, Plaintiffs failed to establish that Defendants knew the change would have a material impact on the company's overall sales. The court observed that overall sales for the third and fourth quarters exceeded projections, despite the decline of sales in Japan. In addition, one of the defendant officers had made reference during the class period to "softness in demand" in Japan and noted "drinking water regulations . . . spurred a great deal of investment . . . up through 2006," but that this trend had "beg[un] to tail itself off." *Id.* at 759-60. These statements weakened the inference of scienter. "It would have been easy enough for management to have disclosed the change in regulations. It was not unreasonable for [P]laintiff to have been suspicious of why that was not done. But mere suspicion is not enough." *Id.* at 760.

5. Plaintiff also attempted to establish scienter based on sales of shares by

company insiders. The First Circuit rejected this argument. Although Defendant officers did sell company stock during the class period, Plaintiff failed to allege facts showing that those sales were not within the Defendants' normal pattern of trading.

C. *Mississippi Pub. Emps. Ret. Sys. v. Bos. Scientific Corp.*, 649 F.3d 5 (1st Cir. Aug. 4, 2011).

1. Appeal from an order of the district court (D. Mass.) granting summary judgment in favor of Defendant, Boston Scientific Corporation and individual defendants. The First Circuit affirmed, holding that Plaintiff failed to produce evidence that would permit a reasonable inference of scienter.

2. Boston Scientific developed and manufacturers the TAXUS coronary stent systems. After two recalls of stents due to a problem referred to as "no-deflate," the company's stock price fell and Plaintiff commenced a class action alleging that Defendants withheld material information and made misleading statements in violation of §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The district court initially granted a motion to dismiss, which was reversed by the First Circuit. After discovery, the district court granted summary judgment to Defendants, and the First Circuit affirmed.

3. Plaintiff alleged that Defendant misled investors about the "no-deflate" problems with TAXUS, and pointed to the following in support of its allegation of scienter: (1) the facts and circumstances surrounding changes in the manufacturing process; (2) the statements to the market concerning problems associated with physician unfamiliarity with the product, as opposed to the "no deflate" issue; and (3) the statements concerning the risk of additional recalls after the first recall was announced. The First Circuit reviewed in detail the facts and timing of the statements surrounding the manufacturing changes and problems with the stents and rejected Plaintiff's claims. "The investing public was not only aware of the no-deflate complaints, but also of the risk of recall, which defendants openly discussed." *Id.* at 29.

4. The First Circuit further held that Plaintiff's claim of insider trading did not affect its reasoning. "Insider trading cannot establish scienter on its own, but rather can only do so in combination with other evidence. . . . No such evidence exists here." *Id.* (internal citation omitted).

Sixth Circuit

D. *Frank v. Dana Corp.*, 646 F.3d 954 (6th Cir. May 25, 2011). *reh'g and reh'g en banc denied*, July 1, 2011.

1. Appeal from an order of the district court (N.D. Ohio) dismissing claims against Michael Burns and Robert Richter, the chief executive officer and chief financial officer of Dana Corporation, respectively, a now bankrupt auto-parts

manufacturer. Plaintiff brought a securities fraud class action against Dana and the individuals, alleging violations of §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The district court initially dismissed the action on scienter grounds applying the pre-*Tellabs* standards. The Sixth Circuit reversed and remanded in light of *Tellabs*. The district court again dismissed concluding that Plaintiff had not adequately pled scienter. The Sixth Circuit reversed.

2. Plaintiff alleged that Defendant officers made materially false statements touting the company's financial health, profitability, and continued growth, and falsely assured investors that the company employed sound accounting controls. Subsequently, Defendant officers made a series of announcements that the company would revise its earnings projections and restate its financial statements, and that they had discovered material weaknesses in the company's accounting systems. The stock price fell, and the company filed for bankruptcy.

3. Applying *Tellabs*, the Sixth Circuit employed a holistic review of all of Plaintiff's allegations and concluded that they raised a sufficiently strong inference that Defendants acted with scienter. Specifically, Plaintiff alleged that Defendants repeatedly made positive statements about the company's earnings even while one of its key product lines was operating at 50%, several departments had failed to meet their budgets, and the price of steel, one of the company's biggest supply costs, had risen significantly. The Sixth Circuit further found that these facts gave rise to an inference of scienter that was at least as compelling as the opposing inference offered by Defendants—that they failed to recognize the problem earlier because of faulty accounting systems. The Sixth Circuit observed that Defendants "were the two top executives of an auto parts manufacturer, and they reported gangbuster earnings during a period of time when the entire auto industry was spiraling toward bankruptcy." *Id.* at 961.

4. As to the claims under § 20(a), the court determined that "good faith" is a defense, but that plaintiffs are not required to plead an absence of good faith to pursue a claim. *Id.* at 963.

E. *Ashland, Inc. v. Oppenheimer & Co., Inc.*, 648 F.3d 461 (6th Cir. July 28, 2011).

1. Appeal from an order of the district court (E.D. Ky.) dismissing Plaintiff's complaint alleging violations of § 10(b) of the Exchange Act and Rule 10b-5 for failure to adequately plead materiality and scienter. The Sixth Circuit affirmed.

2. Plaintiff purchased auction rate securities (ARS) from Defendant and, when the ARS market seized, sold the securities at a discount. Plaintiff raised claims of securities fraud, as well as a number of state law claims alleging, *inter alia*, that "Oppenheimer actually knew about the ARS meltdown months in advance." *Id.* at 466. The district court dismissed on the grounds that the Plaintiff failed to adequately allege scienter.

3. In affirming the district court's dismissal, the Sixth Circuit focused on Plaintiff's central allegation: "Oppenheimer peddled ARS to Ashland as liquid, short-term investments, all while withholding a crucial factor about the market – that its continued wealth depended upon the intervention of underwriters, many of whom were abandoning ARS auctions." *Id.*at 468-69. The Sixth Circuit found that "the more compelling explanation is that the near-spontaneous collapse of the ARS market caught Oppenheimer and its employees off guard." The court also affirmed dismissal of the ancillary claims.

Eighth Circuit.

F. *Minneapolis Firefighters' Relief Ass'n. v. MEMC Elec. Materials, Inc.*, 641 F.3d 1023 (8th Cir. June 17, 2011).

1. Appeal from an order of the district court (E.D. Mo.) dismissing Plaintiff's complaint alleging violations of §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The Eighth Circuit affirmed, concluding that Plaintiff did not adequately plead scienter.

2. Plaintiff brought a putative class action against MEMC, a silicon wafer manufacturer, and its CEO, alleging that Defendants issued materially misleading statements and omissions in connection with production delays at two of the company's manufacturing facilities, including one in Pasadena.

3. The company disclosed, in a 10-K, risks associated with interruption of operations at the Pasadena facility and other facilities could have a materially adverse effect on results. At various points before the class period, the company disclosed production and maintenance problems at the Pasadena plant. In June 2008, a fire halted production at the Pasadena plant, and a second facility also suffered a production interruption. These facts were not disclosed until a July 23, 2008 8-K addressing financial results. Thereafter, the stock price declined. The district court dismissed the complaint on the grounds that Plaintiff had not sufficiently alleged scienter or an actionable omission.

4. As to scienter, Plaintiff argued, *inter alia*, that Defendants had disclosed production problems before and after the class period, and knew that such problems were material. The Eighth Circuit rejected this argument, observing that there is no legal precedent supporting Plaintiff's "pattern" theory. According to the court, the simpler inference was that the defendants did not believe that they had a continuing duty to disclose or that the estimated

anticipated loss was material.

Ninth Circuit

G. *New Mexico State Investment Council v. Ernst & Young LLP*, 641 F.3d 1089 (9th Cir. Apr. 14, 2011).

1. Appeal from an order of the district court (C.D. Cal.) dismissing claims that Ernst & Young LLP violated § 10(b) of the Exchange Act. The Ninth Circuit reversed, finding that Plaintiffs' complaint pleads particularized facts giving rise to a strong inference that the auditor acted with scienter when it certified the financial statements of its client, Broadcom Corporation.

2. Plaintiffs alleged that Broadcom engaged in an improper stock option "backdating" scheme that required the company to restate its financial statements, and that Ernst & Young knew, or was deliberately reckless in not knowing, that its audit opinion was materially false and misleading.

3. Upon dismissing Plaintiffs' § 10(b) claim against Ernst & Young for failing to plead scienter, the district court stated: "I think the allegations are deficient on actual knowledge of the defendant . . . , and I think there's a little bit of a heavier burden of allegations on accountants on the question of scienter." *Id.* at 1093. The Ninth Circuit disagreed: "Contrary to the district court's comment . . . this Court has previously advised against developing "separate[] rules of thumb for each type of scienter allegation." *Id*. at 1095 *quoting South Ferry LP, No. 2 v. Killinger*, 542 F.3d 776, 784 (9th Cir. Sept. 9, 2008).

4. Plaintiffs attempted to establish scienter based upon the alleged fact of a large grant of options for which Ernst & Young was given no documentation, the facts that options were granted during a period when there was no quorum of the compensation committee, and Ernst & Young's involvement in prior corrective reforms to Broadcom's options practices. The Ninth Circuit held that these allegations were each sufficient to support an inference of scienter, and that while a holistic review was not necessary, these primary allegations supported an inference of scienter when viewed collectively with other claims.

5. The court rejected Ernst and Young's argument that Plaintiffs failed to show scienter because employees who authored the most recent audit opinion were not aware of the earlier alleged backdating. The Ninth Circuit found that because the Defendant served as auditor from 1998 through 2008, it could not "now disclaim those prior opinions simply because the same individuals were not involved." *Id.* at 1100.

H. *WPP Luxembourg Gamma Three Sarl v. Spot Runner, Inc.*, 655 F.3d 1039 (9th Cir. Aug. 23, 2011).

1. Appeal from an order by the district court (C.D. Cal.) granting Defendants' motion to dismiss without prejudice. The Ninth Circuit affirmed in part and reversed and remanded in part. Plaintiff shareholder brought claims against a corporation, its founders, and its general counsel, asserting violations of § 10(b) of the Exchange Act and Rule 10b-5(a)-(c). Plaintiff alleged that amidst large operating losses unknown to investors, Defendants solicited Plaintiff to purchase additional shares in the company at the same time that executives of the company were selling personally owned shares. Moreover, Defendants did so despite both contractual obligations to disclose those insider sales and the Plaintiff's specifically asking whether the executives were selling.

2. The Ninth Circuit found that the Defendant founder's share sale coupled with their alleged "machinations to avoid giving notice of [the company's] poor performance and to avoid giving notice of the [f]ounders [sic] share sales bespeaks a guilty knowledge." *Id.* at 1053. However, scienter had not been adequately alleged as to the company's counsel. Plaintiffs claimed that this attorney purposely misled them in an email conversation, but the court found that an intent to defraud was not the only reasonable explanation for the attorney's email.

Tenth Circuit

I. *Dronsejko v. Thornton*, 632 F.3d 658 (10th Cir. Jan. 20, 2011).

1. Appeal from an order by the district court (D. Utah) dismissing the complaint for failure to adequately plead violations of § 10(b) of the Exchange Act and Rule 10b-5. Plaintiff investors brought a putative class action against an e-services company and its independent auditor after the company reissued its financial statements and the auditor withdrew its prior audit opinions in the face of SEC questioning of the company's revenue recognition policy. Specifically, Plaintiffs alleged that Defendants deliberately or recklessly overestimated the collection rate on the company's license sales from extended payment term arrangements. The company settled after the complaint was filed, and the auditor filed a motion to dismiss, which was granted by the district court. The Tenth Circuit affirmed, holding that the Plaintiff failed to plead facts giving rise to a strong inference of scienter.

2. The Tenth Circuit observed that other circuits have developed a heightened or "especially stringent" recklessness standard specifically for Section 10(b) claims against outside auditors. The Tenth Circuit declined to reach the question of whether to adopt an auditor-specific standard, concluding that that the allegations did not give rise to a strong inference of scienter against the auditor and were more consistent with the plausible nonculpable inference that the auditor had mistakenly or negligently interpreted the ambiguous accounting

standard for probable collectability. The Tenth Circuit also rejected Plaintiffs' argument that the auditor's alleged motive "to please the client and continue receiving auditing fees," *id.* at 669, was sufficient to support an inference of scienter because this motive is present in every relationship between an independent auditor and its company.

Eleventh Circuit

J. *FindWhat Investor Group v. FindWhat.com*, 658 F.3d 1282 (11th Cir. Sept. 30, 2011).

1. Appeal from an order of the district court (M.D. Fla.) dismissing two of Plaintiffs' claims and granting summary judgment to Defendants on the remaining claims. Plaintiff investors brought a putative class action against Defendant company and three of its officers, alleging violations of § 10(b) of the Exchange Act and Rule 10b-5.

2. Defendant company, an Internet commerce company, provided "pay-per-click" advertising services to other companies. Plaintiffs alleged that Defendant officers made a series of misleading statements about the company's attempts to identify and cease to do business with distribution partners who used "click fraud" (clicking on an Internet advertisement solely for the purpose of forcing the advertiser to pay for the click) and spyware to generate more advertising revenue. In fact, Defendants continued to do business with the company's two largest distribution partners, both of whom allegedly employed these questionable practices. Later, when Defendants revealed that some revenue resulted from click fraud, the value of the company's stock fell. The district court dismissed Plaintiffs' claims based on two alleged misstatements because it held that those statements were not false or misleading. The district court awarded summary judgment to Defendants' remaining claims. The Eleventh Circuit affirmed the dismissal, vacated the award of summary judgment, and remanded.

3. The first statement that Plaintiffs challenged was an SEC filing, in which the Defendants stated that they enforce strict guidelines to ensure that none of the company's distribution partners engage in click fraud or use spyware. The district court found that the statement was not false or misleading and granted Defendants' motion to dismiss this claim. The Eleventh Circuit disagreed with the district court's assessment, but affirmed the dismissal because Plaintiffs had failed to raise a strong inference of scienter. The Eleventh Circuit concluded that, based on Plaintiffs' allegations, the earliest date that Defendants could have known about the distribution partners' use of click fraud was three months after the SEC filing. Plaintiffs' arguments that the Defendants must have previously known about the problems were speculative, conclusory, and insufficient.

Supreme Court

A. *Erica P. John Fund, Inc. v. Halliburton Co., 563* U.S. —, 131 S. Ct. 2179, 180 L. Ed. 2d 24 (June 6, 2011).

1. Appeal from a decision of the Fifth Circuit affirming an order of the district court (N.D. Tex.) denying class certification. Plaintiff investors brought a putative class action alleging that Halliburton made misrepresentations regarding the scope of potential liability in asbestos litigation, expected revenue from construction contracts, and the benefits of a merger with another company in violation of § 10(b) of the Exchange Act and Rule 10b-5. The company later made corrective disclosures, allegedly causing the price of the stock to fall and Plaintiffs to lose money. The district court concluded that Plaintiffs could not proceed as a class because of their failure to prove loss causation. This failure prevented Plaintiffs from establishing reliance based on a fraud-on-the-market theory. The Fifth Circuit affirmed, holding that Plaintiffs' failure to prove loss causation precluded class certification. The Supreme Court vacated and remanded, concluding that Plaintiffs need not prove loss causation in order to proceed on a fraud-on-the-market theory and obtain class certification.

2. The Fifth Circuit held that Plaintiffs had to establish loss causation to trigger the rebuttable presumption of reliance of the fraud-on-the-market theory. The Supreme Court found that this extra requirement undermines the assumption that "an investor presumptively relies on a defendant's misrepresentation if that information is reflected in [the] market price of the stock at the time of the relevant transaction." *Id.* at 2186, *quoting Basic Inc. v. Levinson*, 485 U.S. 224 (1988) (quotations omitted). If the price of a stock is inflated due to a defendant's misrepresentations, an investor who purchases the stock at the inflated price does not necessarily suffer a loss if the price of the stock later declines because that decline can sometimes be caused by factors other than the alleged misrepresentations. Investors cannot prove loss causation to the extent that the decline can be attributed to factors other than the misrepresentation. However, "[t]he fact that a subsequent loss may have been caused by factors other than the revelation of a misrepresentation has nothing to do with whether an investor relied on the misrepresentation in the first place, either directly or presumptively through the fraud-on-the-market theory." *Id.* at 2186. Thus, loss causation need not be established as a condition for obtaining class certification.

Second Circuit

B. *Ashland Inc. v. Morgan Stanley & Co., Inc.*, 652 F.3d 333 (2d Cir. July 28, 2011).

1. Appeal from an order by the district court (S.D.N.Y.) dismissing Plaintiff's claims for violations of § 10(b) of the Exchange Act, common law fraud, promissory estoppel, breach of fiduciary duty, negligence, negligent

misrepresentation and unjust enrichment. Plaintiff alleged that Morgan Stanley & Co., Inc. and its broker "materially misrepresented the liquidity of certain auction rate securities (ARS) and thereby fraudulently induced Ashland to purchase and hold these securities at a time when Morgan Stanley knew that the market for ARS was collapsing." *Id.* at 335. In particular, Plaintiff alleged that starting in May 2007 its Morgan Stanley broker made repeated representations that the market for ARS was safe and liquid, and that in the event that there was instability in the market, Morgan Stanley would intervene and place sufficient bids to prevent auction failure. *Id.* The district court dismissed all claims, concluding that (i) "hold" and "hold-at-rate" orders for ARS "did not constitute a purchase or sale of securities" under *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 95 S. Ct. 1917, 44 L. Ed. 2d 539 (1975), (ii) Plaintiff's first amended complaint "did not allege facts to support a strong inference of scienter as to any misrepresentations or omissions," and (iii) Plaintiff's reliance on the alleged representations by its broker were not reasonable because Morgan Stanley had sufficiently disclosed its bidding policies on its website. *Id.* at 337. The Second Circuit affirmed.

2. Plaintiff argued that its reliance on its broker's misrepresentations was reasonable due to (i) its longstanding relationship with the broker,,(ii) the broker's repeated assurances that the ARS were safe and liquid, and (iii) information concerning ARS was not publicly available. *Id.* at 338. In affirming the district court's dismissal, the Second Circuit observed that the risk disclosure posted on Morgan Stanley's website specifically advised investors about liquidity risks in ARS. *Id.* at 338. Plaintiff admitted that it was a "sophisticated investor," and as such, the Second Circuit underscored that "it was not justified in relying on [its broker's] statements that [the ARS] 'had no liquidity issues,' or that 'in the event of instability or weakness,' Morgan Stanley would 'come in and make a market,' as it had always done in the past." *Id.*

3. As to the state law claims, under New York law, reliance is a required element of common law fraud, promissory estoppel, breach of fiduciary duty, and negligent misrepresentation. Because Plaintiff could not establish such reliance, the Second Circuit also upheld dismissal of those claims. *Id.* at 339.

C. *Wilson v. Merrill Lynch & Co., Inc.*, No. 10-1528, 2011 WL 5515958 (2d Cir. Nov. 14, 2011).

1. Appeal of an order of the district court (S.D.N.Y.) dismissing Plaintiff's amended complaint alleging violation of § 10(b) of the Exchange Act and Rule 10b-5(a) and (c). Plaintiff brought a class action lawsuit on behalf of himself and all purchasers of auction rate securities for which Defendant, Merrill Lynch & Co., Inc., served as sole, lead, co-lead, or joint lead auction dealer between March 25, 2003 and February 13, 2008. Plaintiff alleged that Defendant had engaged in manipulation of the ARS market. *Id*. at *2. The district court granted Defendant's motion to dismiss the complaint on the grounds that "[Defendant's] disclosures of its auction practices preclude[d] [Plaintiff's] claim that these

practices were manipulative." *Id.* at *1. The Second Circuit affirmed.

2. Plaintiff alleged that Defendant manipulated the ARS market by following a "'uniform policy of placing support bids if needed to prevent auction failures in every auction for which it served as sole or lead dealer.'" *Id.* at *2 (internal citations omitted). Plaintiff also alleged that Defendant "masked the liquidity risks inherent in [Defendant] ARS and created the false impression that the lack of auction failures reflected investor demand" and that investors could easily liquidate Defendant ARS. *Id.* at *2, *10 (internal citations omitted). Plaintiff further alleged that Defendant's research department received material non-public information from its trading desk and that its reports on ARS contained misleading information about the liquidity of these securities. *Id.* at *3.

3. Defendant maintained that the disclosures it made pursuant to a 2006 settlement with the SEC precluded Plaintiff's claims. *Id.* These disclosures discussed auction bidding practices, including that Defendant may routinely make bids, but also that "the fact that an auction clears successfully does not that mean an investment in [ARS] involves no significant liquidity or credit risk;" and that Defendant "is not obligated to submit a bid to keep an auction from failing, and [t]herefore, auction failures were possible." *Id.* at *4. In dismissing Plaintiff's complaint in its entirety, the district court held that the market manipulation claim was deficient because Plaintiff did not allege with sufficient specificity that the conduct was manipulative or that there was "direct reliance or reliance on an assumption of a market free of manipulation." *Id. at *5*

4. On appeal, Plaintiff argued "that [Defendant's] disclosures were incomplete or misleading." The Second Circuit held that to bring a claim of market manipulation under Rule 10b-5(a) and (c), a plaintiff must allege "(1) manipulative acts; (2) damage (3) caused by reliance on an assumption of an efficient market free of manipulation; (4) scienter; (5) in connection with the purchase or sale of securities; (6) furthered by the defendant's use of the mails or any facility of a national securities exchange." *Id.* at *7. The Second Circuit further noted that "[i]n order for market activity to be manipulative, that conduct must involve misrepresentation or non-disclosure." *Id.* at *8.

5. The Second Circuit observed that while Plaintiff faulted Defendant for *not* disclosing that it would place support bids in "*every* single auction in which it was the sole or lead auction dealer," Defendant's disclosure that it "may routinely" bid in auctions provided notice that it was possible that Defendant would place such bids in every Defendant ARS auction. *Id.* at *9, 10-11. The complaint failed to allege that Defendant "knew with certainty" that the ARS auctions would fail without Defendant intervention. *Id.* at *11. The Second Circuit further held that Plaintiff could not show that allegedly misleading research reports sent a false signal to the market when Plaintiff purchased ARS, because the reports "pertain[ed] to matters taking place in August 2007," after Plaintiff had purchased the ARS. *Id.* at *11, 12. The Second Circuit

therefore concluded that Defendant's disclosures were sufficient "to prevent Defendant's alleged policy of support bidding from sending a false signal to the ARS market" and thus were not manipulative. *Id.*

6. The Second Circuit noted that, in an amicus brief, the SEC had asserted Defendant's disclosures about its support bidding were misleading. While acknowledging some deference to the SEC, the Second Circuit nonetheless disagreed with its conclusions.

7. Because Plaintiff could not satisfy the "manipulative acts" element of the § 10(b) claim, the Second Circuit did not address Plaintiff's arguments on appeal regarding other elements of the claim. It also affirmed dismissal of the control liability claims and the district court's denial of leave to amend. *Id.*

Third Circuit

D. *In re DVI, Inc. Sec. Litig.*, 639 F.3d 623 (3d Cir. Mar. 29, 2011).

1. Appeal from an order of the district court (E.D. Pa.) granting Plaintiff investors' motion for class certification as to claims against Defendant accounting firm, but dismissing the motion as to Defendant attorney. The Third Circuit affirmed.

2. Plaintiffs, investors in Diagnostic Ventures, Inc, (DVI), a publicly traded healthcare finance company that filed for Chapter 11 bankruptcy protection in 2003, brought a putative class action against multiple Defendants, including DVI's independent auditor, Deloitte & Touche LLP, and outside counsel, Clifford Chance, under § 10(b) of the Exchange Act and Rule 10b-5. Plaintiffs alleged that the Defendants engaged in a scheme to artificially inflate the price of DVI securities by refusing to write down millions of dollars of impaired assets, double pledging collateral and/or pledging ineligible collateral, refusing to implement and comply with internal controls and concealing cash shortages by overstating revenue, assets and earnings and understating liabilities and expenses. Plaintiffs alleged that Deloitte committed securities fraud by issuing unqualified audit reports, and that Clifford Chance assisted DVI by drafting fraudulent financial reports, conspiring with other defendants to hide material information, and "deflecting" SEC inquiries. The district court granted Plaintiffs' motion for class certification with respect to all Defendants but Clifford Chance, and parties appealed under Rule 23(f).

3. The Third Circuit reiterated that to invoke a fraud-on-the-market presumption of reliance, plaintiffs must show that they traded shares in an efficient market, and a defendant may rebut a presumption of reliance by a showing that severs the link between the misrepresentation and the price received or the decision to trade.

4. On appeal, Deloitte challenged the application of a fraud-on-the-market presumption and argued that loss causation must be established as a

prerequisite before invoking the presumption of reliance. The Third Circuit rejected these arguments, finding that Plaintiffs successfully established a presumption of reliance through the fraud-on-the-market theory where the shares were traded in an efficient market and where the misrepresentation at issue became public, and holding that Plaintiffs need not establish loss causation as a prerequisite to invoking the presumption of reliance.

5. As for Deloitte's attempt to rebut the presumption of reliance, the Third Circuit agreed that rebuttal at class certification stage was appropriate. However, the various rebuttal arguments put forth by Deloitte fell short.

Fourth Circuit

E. *Katyle v. Penn Nat'l Gaming, Inc.*, 637 F.3d 462 (4th Cir. Mar. 14, 2011).

1. The Fourth Circuit affirmed the judgment of the district court (D. Md.), refusing to allow Plaintiff investors to file their proposed Third Amended Complaint (TAC) because their claim failed to adequately allege loss causation.

2. Penn National Gaming Inc. is a public company that operates gaming and off-track betting facilities. Prior to the class period, Penn announced that it had entered into a leveraged buyout agreement with private equity buyers. The stock price subsequently increased and Penn's shareholders approved the leveraged buyout. In light of turmoil in the credit market, shareholder confidence that the buyout would be completed proved unsustainable, and the share price began to decline. After Lehman Brothers issued an analyst report noting that it could not predict whether the transaction would close, Penn issued a series of press releases concerning state regulatory approvals and an extension of the closing date to secure additional approvals. At the same time, Penn was involved in private discussions with the buyers and financing institutions related to renegotiation or termination of the buyout.

3. Plaintiff brought a putative class action against Defendant corporation, alleging violations of § 10(b) of the Exchange Act and Rule 10b-5. According to the Second Amended Complaint, Plaintiff alleged that the truth was revealed on July 3, 2008, when Penn announced the termination of the buyout. The district court observed that the stock price increased on that date, which was fatal to establishing loss causation.

4. Plaintiff then sought to file the TAC, which alleged a series of corrective disclosures from June 16, 2008 through July 2, 2008. The district court concluded that allowing Plaintiffs to replead would be futile. To establish loss causation on the basis of a series of partial disclosures, a plaintiff must plead facts to show that: "(1) those disclosures gradually revealed to the market the undisclosed truth . . ., and (2) such disclosures resulted in the decline of [the] share price." *Id.* at 472-73. The court walked through each of the alleged partially corrective disclosures, and concluded that they did not, gradually or

otherwise, reveal to the market any undisclosed truth. Thus, any subsequent decline in the corporation's share price could not have been attributed to those omissions.

Seventh Circuit

F. *AnchorBank, FSB v. Hofer,* 649 F.3d 610 (7th Cir. 2011).

1. Appeal from an order of the district court (W.D. Wisc.) dismissing Plaintiff investment fund's complaint for failure to adequately plead loss causation. The Seventh Circuit reversed.

2. Plaintiff sued Defendant, a former employee, for allegedly conducting a collusive trading scheme in violation of § 9(a) of the Exchange Act and making a material misrepresentation or omission in connection with the purchase or sale of a security in violation of §10(b) of the Exchange Act, as well as violations of state law. Specifically, Plaintiff alleged that Defendant and co-conspirators made coordinated sales and purchases of the Defendant's shares, which resulted in gains for Defendant and co-conspirators and losses for Plaintiff and the other participants in Plaintiff's fund.

3. A plaintiff can adequately establish loss causation by pleading that the defendant's conduct is at least one cause of the economic loss. Here, Defendant's allegedly collusive trading scheme resulted in his co-conspirators and him amassing 72% of the fund's shares and increasing the value of their holdings by well over 200%. At the same time, the overall value of the fund, and the value of the fund's other holders, decreased. Defendant argued that Plaintiff's loss was at least partly caused by the recent economic downturn. The Seventh Circuit held, "we do not require that a plaintiff plead that *all* of its loss is necessarily attributed to the actions of the defendant, only that it plead that the defendant is at least one plausible cause of the economic loss." *Id.*at 618 (emphasis in original).

Ninth Circuit

G. *WPP Luxembourg Gamma Three Sarl v. Spot Runner, Inc.*, 655 F.3d 1039 (9th Cir. Aug. 23, 2011).

1. Appeal from an order of the district court (C.D. Cal.) granting Defendant's motion to dismiss. The Ninth Circuit affirmed in part and reversed in part. Plaintiff shareholder brought claims against corporation and corporation's founders and general counsel, asserting violations of §10(b) of the Exchange Act and Rules 10b-5(a)-(c). Plaintiff alleged that amidst large operating losses unknown to investors, Defendants solicited Plaintiff to purchase additional shares in the company at the same time that executives of the company were selling personally owned shares. Defendants allegedly did so despite contractual obligations to disclose those insider sales and despite Plaintiff

specifically asking whether the executives were selling.

2. Plaintiff claimed that when Defendant revealed that its executives had been secretly selling their own shares (while encouraging outside investment), the shares that Plaintiffs owned immediately became worthless as no investor would be willing to purchase them once the founders' alleged scheme was public. The Ninth Circuit noted that it is unclear in the Ninth Circuit whether pleading Rule 9(b) or Rule 8(a)(2) applies to allegations of loss causation. Nonetheless, the court concluded that Plaintiff adequately alleged that Defendant's alleged concealment of its executives' stock sales caused Plaintiff's loss.

Eleventh Circuit

H. *FindWhat Investor Group v. FindWhat.com,* 658 F.3d 1282 (11th Cir. Sept. 30, 2011).

1. Appeal of an order of the district court (M.D. Fla.) dismissing two of Plaintiffs' claims and granting summary judgment to Defendants on the remaining claims. Plaintiff investors brought a putative class action against Defendant company and its officers, alleging violations of § 10(b) of the Exchange Act and Rule 10b-5. Defendant company, an Internet commerce company, provided "pay-per-click" advertising services to other companies. Plaintiffs alleged that Defendant officers made a series of misleading statements about the company's attempts to identify and cease to do business with distribution partners who used "click fraud" (clicking on an Internet advertisement solely for the purpose of forcing the advertiser to pay for the click) and spyware to generate more advertising revenue. In fact, Defendants continued to do business with its two largest distribution partners, both of whom employed these questionable practices. Later, when Defendants did reveal that some revenue resulted from click fraud, the value of the company's stock fell. The district court dismissed Plaintiffs' claims based on two alleged misstatements because it held that those statements were not false or misleading. The district court awarded summary judgment to Defendants on the remaining claims. The Eleventh Circuit affirmed the dismissal, vacated the award of summary judgment, and remanded.

2. Two of the several statements challenged by Plaintiffs were made during a conference call with investors and in an SEC filing, respectively. Both of these statements contained claims that Defendants had removed certain distribution partners because those partners were engaged in click fraud and used spyware. In fact, Defendants had not removed those partners. The district court granted summary judgment to Defendants on these claims, holding that, as a matter of law, Plaintiffs could not establish loss causation and damages because the stock was inflated (due to the distribution partners' use of spyware) before the first alleged actionable misstatement, and it remained inflated after the alleged actionable misstatements. The Eleventh Circuit

rejected this conclusion, holding "that confirmatory information that wrongfully *prolongs* a period of inflation—even without increasing the *level* of inflation—may be actionable under the securities laws." *Id.* at 1314 (emphasis in original). Companies may not prolong the inflation of stock prices by repeating falsehoods that materially mislead the market. The Eleventh Circuit vacated the award of summary judgment and remanded the case to the district court to determine, in the first instance, whether Plaintiffs had demonstrated triable issues of fact regarding loss causation and damages.

I. *Ledford v. Peeples*, 657 F.3d 1222 (11th Cir. Sept. 23, 2011).

1. After vacating their prior decision granting rehearing en banc to consider the district court's (D. Ga.) denial of Defendants motion for sanctions, 630 F.3d 1345 (11th Cir. Jan. 19, 2011), the Eleventh Circuit again concluded that the district court did not abuse its discretion in denying sanctions, 657 F.3d 1263 (11th Cir. Sept. 23, 2011) and reissued its opinion affirming the district court's grant of summary judgment to Defendants because the evidence showed that Plaintiffs did not rely on the misrepresentation at issue. 657 F.3d 1222 (11th Cir. Sept. 23 2011). This opinion was previously reported as 605 F.3d 871 (11th Cir. May 6, 2010), and was discussed in our 2010 Securities Litigation Year in Review at 16-17.

Supreme Court

A. *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. —, 131 S. Ct. 1309, 179 L. Ed. 2d 398 (Mar. 22, 2011).

1. The Supreme Court affirmed the decision of the Ninth Circuit reversing and remanding the district court's (D. Ariz.) order granting Defendants' motion to dismiss. Plaintiff investors alleged that Matrixx Initiatives, makers of Zicam cold remedy products, made material misstatements and omissions in violation of § 10(b) of the Exchange Act and Rule 10b-5. The district court dismissed the complaint, concluding that Plaintiffs had not adequately pleaded materiality and scienter. The Ninth Circuit reversed and remanded, holding that the district court erred in requiring Plaintiffs to allege statistical significance to establish materiality. The Supreme Court affirmed, holding that there is no bright-line rule requiring Plaintiffs to allege a statistically significant number of adverse events to establish materiality, and that Plaintiffs had adequately alleged scienter.

2. Matrixx develops, manufactures, and markets over-the-counter pharmaceutical products including its core brand, Zicam cold remedies. The complaint alleged that Defendants were aware of but failed to disclose information that a Zicam product allegedly caused a loss of sense of smell, or asnosmia, in patients. Specifically, Matrixx allegedly received communications from physicians (including the neurological director at the Smell & Taste Treatment and Research Foundation, Ltd.) concerning asnosmia, was alerted to studies linking an ingredient in Zicam asnosmia, was aware of a presentation on the issue by the American Rhinologic Society, and had been named in products liability lawsuits alleging damaged sense of smell.

3. Plaintiffs asserted that Defendants' projections of revenue in the face of information received were false and misleading, and that the failure to disclose the reports about the adverse effects of Zicam constituted actionable omissions. Defendants argued that Plaintiffs failed to adequately plead materiality or scienter because the complaint did not allege that the reports received reflected statistically significant evidence that Zicam caused anosmia. The Supreme Court disagreed, concluding that Plaintiffs had adequately pleaded both scienter and materiality.

4. As to materiality, Matrixx asked for a bright-line rule that reports of adverse events associated with a pharmaceutical company's products cannot be material "absent a sufficient number of such reports to establish a statistically significant risk that the product is causing the events," and argued that "reasonable investors would not consider such reports relevant unless they are statistically significant." *Id.* at 1312, 1318-19. The Supreme Court rejected this, observing that statistical evidence may not always be available, that an absence of such data "does not mean that medical experts have no reliable

basis for inferring a causal link between the drug and adverse events," and that the FDA does not limit the evidence it considers in assessing causation or taking regulatory action to statistically significant data. *Id.* The Supreme Court recognized that "the mere existence of reports of adverse events" does not satisfy the "total mix" of information standard: "Something more is needed, but that something more is not limited to statistical significance and can come from the source, content, and context of the reports.'" *Id.* at 1312, 1321 (internal citation omitted).

First Circuit

B. *Hill v. Gozani*, 638 F.3d 40 (1st Cir. Mar. 18, 2011).

1. Appeal of an order of the district court (D. Mass.) dismissing Plaintiff investors' class action complaint alleging that Defendants, medical device manufacturer NeuroMetrix and three of its officers, violated §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The First Circuit affirmed.

2. Plaintiffs alleged that in marketing a medical device to doctors for use in their offices, NeuroMetrix represented that procedures could be billed to insurers using existing standardized codes historically used for invasive procedures performed by specialists. The use of these codes resulted in artificially high reimbursement rates to the physicians.

3. Plaintiffs further alleged that NeuroMetrix "knew that its scheme would be discovered shortly" and that thereafter "the market value of the device would plummet," causing a decrease in revenue and stock price. *Id.* at 46. Plaintiffs further alleged that NeuroMetrix misled investors about the risk of the fall in value while individual officers sold "significant amounts of stock at great personal profit." *Id.*

4. In their complaint, Plaintiffs reprinted more than 30 pages of allegedly misleading statements by Defendants, including SEC filings and transcripts of conference calls. The district court held that Plaintiffs did not identify any actionable material mistakes or omissions.

5. On appeal, the First Circuit examined each of the alleged misstatements and omissions, and concluded that the complaint contained sufficient allegations "to support the assertion that the company was aware of at least some level of risk of non-reimbursement and had been apprised by experts that continuing its then-current course of billing recommendations could have significant repercussions" and that such facts were material. *Id.* at 56. Nevertheless, the First Circuit concluded that in the circumstances described, there was no duty to disclose. Specifically, the First Circuit observed that although certain employees believed the strategy was "both losing and potentially dangerous, there is simply nothing in the complaint to suggest that the expert opinions demonstrated that the danger posed . . . was, at the time the statement was

made, a near certainty of ruin." *Id.* at 59. Further, the total mix of information available to investors was "not skewed to present a rosy picture." *Id.* at 61. The First Circuit further stated that Defendants did inform investors of the risks associated with insurance reimbursement. According to the First Circuit, when the level of risk is unknown but the existence of the risk is disclosed, the failure to characterize the risk as "serious" is not misleading.

Second Circuit

C. *Litwin v. Blackstone Group, L.P.*, 634 F.3d 706 (Feb. 10, 2011), *cert. denied*, *sub nom*. *Blackstone Group, L.P. v. Litwin*, 132 S. Ct. 242, 181 L. Ed. 2d 138 (Oct. 3, 2011).

1. The Second Circuit vacated and remanded for reconsideration the district court's (S.D.N.Y.) dismissal of Plaintiffs' putative securities class action complaint alleging violation of §11, 12(a)(2) and 15 of the Securities Act for failure to state a claim. The Defendant, Blackstone Group, L.P., is an asset manager and provider of financial advisory services. The Plaintiff class consisted of purchasers of Blackstone's stock at the time of its IPO. Plaintiffs allege that at the time of the IPO, the Defendants knew, and failed to disclose, that two of Blackstone's portfolio companies and one of its fund investments were experiencing problems that subjected Blackstone to claw-back of fees, thereby materially affecting Blackstone's future revenues. Plaintiffs also alleged that certain financial disclosures violated GAAP and were otherwise inadequate.

2. The district court dismissed Plaintiffs' claims based on its finding that the alleged omissions and misstatements were not material. The district court applied the Second Circuit's previously articulated presumption of "a 5% threshold as an appropriate 'starting place' for immateriality." *Id*. at 713

3. Recognizing that a quantitative analysis is not dispositive, the district court additionally performed a qualitative analysis based on factors identified in SEC Staff Accounting Bulletin No. 99. The district court considered whether the omissions alleged any concealed unlawful transaction or conduct, whether alleged omissions related to a significant aspect of Defendant's operations, caused a significant market reaction to the public disclosure, hid a failure to meet analysts' expectations, changed loss into income, or affected Defendant's compliance with contractual requirements. The district court found that only one qualitative factor applied to the instant case: the alleged misstatements and omissions effectively increased the compensation for Defendant's management. The district court held that this alone was not enough to render the omissions material.

4. In reversing and remanding, the Second Circuit observed that this case is not a fraud case, and therefore plaintiffs need only satisfy the requirements of Rule 8, and rejected the district court's approach to assessing materiality. The

quantitative approach used by the district court compared the alleged misstatement with the entire financial position of the Defendant. The Second Circuit, however, noted that a misstatement that appears "quantitatively small" compared with firm-wide financial results can still be material if it is significant to a "particularly important segment" of the firm's business. *Id*. at 720. The Second Circuit then identified a number of qualitative factors that collectively implicated materiality.

5. The United States Supreme Court denied *certiorari*. *Blackstone Group, L.P. v. Litwin*, 132 S. Ct. 242, 181 L. Ed. 2d 138 (Oct. 3, 2011).

D. *Hutchison v. Deutsche Bank Securities Inc*., 647 F.3d 479 (2d Cir. July 26, 2011).

1. Appeal of an order of the district court (D. Conn.) dismissing Plaintiffs' second amended complaint alleging securities fraud by Defendants CBRE Realty Finance Inc. and certain of its officers, under §§ 11, 12 and 15 of the Securities Act and denial of Plaintiffs' motion for leave to amend. The Second Circuit affirmed on alternate grounds.

2. Plaintiffs alleged that CBRE's registration contained misrepresentations and omissions by failing to disclose impairments of two outstanding mezzanine loans worth approximately $51.5 million that it had provided to a real estate developer. CBRE's total investment portfolio was more than $1.1 billion, but these two loans made up approximately 25% of CBRE's mezzanine loan portfolio. Five months after the IPO, CBRE issued a press release "announc[ing] its financial results for the fourth quarter [of 2006]." *Id.* at 482. In the two days following the press release, CBRE's stock price dropped more than 18%. *Id*. at 483. The district court found that because the loans were adequately collateralized at the time of the IPO, the failure to reference concerns with two mezzanine loans was not material.

3. The Second Circuit rejected the test applied by the district court and applied instead both a "quantitative" and a "qualitative" evaluation of the materiality of the alleged omission. The court first reconciled two recent decisions concerning quantitatively evaluating the materiality of a misstatement, *ECA and Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co.*, 553 F.3d 187 (2d Cir. 2009) and *Litwin v. Blackstone Group L.P.*, 634 F.3d 706 (2d Cir. 2011). The Second Circuit determined: "If a particular product or product line, or division or segment of a company's business, has independent significance for investors, then even a matter material to less than all of the company's business may be material for the purposes of the securities laws." *Hutchison,* 647 F.3d at 488. The Second Circuit then observed that while the two loans in question represented a fraction of a percent of CBRE's total investments, they were a significant portion of CBRE's outstanding mezzanine loans. However, Plaintiffs failed to allege that mezzanine loans constituted a segment of CBRE's business that was of significant interest to investors. Thus, the Second Circuit compared the value of the loans in question to CBRE's total

investment portfolio and found that the statements were not material.

4. Turning to the qualitative analysis of materiality, Plaintiffs relied on two factors contained in SEC Staff Accounting Bulletin (SAB) No. 99 which provided guidance concerning materiality: (1) CBRE's stock drop following the disclosure, and (2) the impact on a major portion of CBRE's business. The Second Circuit noted that under SAB 99 a stock drop is only indicia of materiality when it is shown that a company's management expects that a known misstatement may result in a significant positive or negative market reaction. The Second Circuit noted that the cited press release was "loaded with news (largely very bad), any item of which could have caused CBRE's stock price to drop." *Id*. at 490 . As to the second factor, the court had already concluded that mezzanine loans did not constitute a major portion of CBRE's business.

5. The Second Circuit also affirmed the district court's denial of Plaintiffs' motion to amend based on futility because, even with the additional facts contained in Plaintiffs' Proposed Third Amended Complaint, the allegations failed to satisfy the "quantitative or qualitative" materiality factors.

Eighth Circuit

E. *Minneapolis Firefighters' Relief Ass'n. v. MEMC Elec. Materials, Inc*., 641 F.3d 1023 (8th Cir. June 17, 2011).

1. Appeal from an order of the district court (E.D. Mo.) dismissing Plaintiff's complaint alleging violations of §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The Eighth Circuit affirmed, concluding that Plaintiff did not adequately plead scienter, but it also discussed the duty to disclose.

2. Plaintiff brought a putative class action against MEMC, a silicon wafer manufacturer, and its CEO, alleging that Defendants issued materially misleading statements and omissions in connection with production delays at two of the company's manufacturing facilities, including one in Pasadena, California.

3. The company disclosed in a 10-K risks associated with interruption of operations at the Pasadena and other facilities could have a materially adverse effect on results. At various points before the class period, the company disclosed production and maintenance problems at the Pasadena plant. In June 2008, a fire halted production at the Pasadena plant, and a second facility also suffered a production interruption. These facts were not disclosed until a July 23, 2008 8-K addressing financial results. Thereafter, the stock price declined. The district court dismissed the complaint on the grounds that Plaintiff had not sufficiently alleged scienter or an actionable omission.

4. As to whether Plaintiff alleged an actionable omission, Plaintiff alleged that the

defendants "had a 'pattern' of disclosing similar disruptions in production" both before and after the class period, and therefore the failure to disclose constituted an omission. *Id*. at 1028. The court was unable to find support the "pattern theory," and even if a pattern of disclosure could spawn a duty to disclose, the facts alleged did not give rise to such a duty where the company had warned investors that the business was vulnerable to disruption.

Ninth Circuit

F. *Conn. Ret. Plans and Trust Funds v. Amgen, Inc*., 660 F.3d 1170 (9th Cir. Nov. 8, 2011).

1. Appeal from an order of the district court (C.D. Cal.) granting class certification in a securities fraud case brought by Plaintiff investors against biotechnology company Amgen Inc. and several of its officers. The Ninth Circuit affirmed.

2. Plaintiffs alleged that, by misstating and failing to disclose safety information about two of Amgen's products used to treat anemia, Defendants violated §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The Ninth Circuit joined the Third and Seventh Circuits in holding that to invoke fraud-on-the-market presumption of reliance in aid of class certification, "the plaintiff must (1) show that the security in question was traded in an efficient market . . . and (2) show that the alleged misrepresentations were public . . . ." *Id.* at 1172. "As for the element of materiality, the plaintiff must plausibly allege—but need not *prove* at this juncture—that the claimed misrepresentations were material." *Id.* According to the Ninth Circuit, the question of a statement's materiality goes to the merits of the claim and is thus not reviewable at the class certification stage.

3. The Ninth Circuit observed that the presumption of reliance can be rebutted by showing, for example, that the market was already aware of the truth behind the alleged falsehoods, and therefore the falsehoods did not affect the market price i.e., the truth on the market defense. However, the court held that the district court correctly refused to consider the Defendants' truth-on-the-market defense at the class certification stage. Although this defense would affirmatively rebut the fraud-on-the-market presumption, it would do so by refuting the materiality of the alleged misrepresentation, and materiality is an issue to be reached at trial or on summary judgment.

Supreme Court

A. *Erica P. John Fund, Inc. v. Halliburton Co.*, 563 U.S. —, 131 S. Ct. 2179, 180 L. ed. 2d 24 (June 6, 2011).

1. Appeal from an order of the Fifth Circuit affirming the district court's (N.D. Tex.) denial of class certification. Plaintiff investors brought a putative class action alleging that Halliburton made misrepresentations regarding the scope of potential liability in asbestos litigation, expected revenue from construction contracts, and the benefits of a merger with another company, in violation of § 10(b) of the Exchange Act and Rule 10b-5. The company later made corrective disclosures, allegedly causing the price of the stock to fall and Plaintiffs to lose money. The district court concluded that Plaintiffs could not proceed as a class because of their failure to prove loss causation. This failure prevented Plaintiffs from establishing reliance based on a fraud-on-the-market theory. The Fifth Circuit affirmed, holding that Plaintiffs' failure to prove loss causation precluded class certification. The Supreme Court vacated and remanded, concluding that Plaintiffs need not prove loss causation in order to proceed on a fraud-on-the-market theory and obtain class certification.

2. To invoke the rebuttable presumption of reliance based on a fraud-on-the-market theory, plaintiffs must demonstrate that the stock was traded in an efficient market, the misrepresentation was publicly disclosed, and the plaintiff purchased the stock after the misrepresentation and before the corrective action. If a misrepresentation is reflected in the market price of a stock at the time of the transaction, then the investor presumptively relied on the misrepresentation, regardless of whether other factors caused subsequent decreases in the stock's price. The Fifth Circuit held that plaintiffs also had to establish loss causation to trigger this rebuttable presumption of reliance.

3. The Supreme Court found that this extra requirement undermines the assumption that "an investor presumptively relies on a defendant's misrepresentation so long as that information is reflected in the market price of the stock at the time of the relevant transaction." *Id.* at 2186, *quoting Basic Inc. v. Levinson*, 485 U.S. 224 (1988) (quotations omitted). If the price of a stock is inflated due to a defendant's misrepresentations, an investor who purchases the stock at the inflated price does not necessarily suffer a loss if the price of the stock later declines because that decline can sometimes be caused by factors other than the alleged misrepresentations. Investors cannot prove loss causation to the extent that the decline can be attributed to factors other than the misrepresentation. However, "[t]he fact that a subsequent loss may have been caused by factors other than the revelation of a misrepresentation has nothing to do with whether an investor relied on the misrepresentation in the first place, either directly or presumptively through the fraud-on-the-market theory." *Id.* at 2186. Thus, loss causation need not be established as a condition for obtaining class certification.

Third Circuit

B. *In re DVI, Inc. Sec. Litig.*, 639 F.3d 623 (3d Cir. Mar. 29, 2011).

1. Appeal from an order of the district court (E.D. Pa.) granting Plaintiff investors' motion for class certification as to claims against Defendant accounting firm, but dismissing the motion as to Defendant attorney. The Third Circuit affirmed.

2. Plaintiffs, investors in Diagnostic Ventures, Inc, (DVI), a publicly traded healthcare finance company that filed for Chapter 11 bankruptcy protection in 2003, brought a putative class action against multiple Defendants, including DVI's independent auditor, Deloitte & Touche LLP, and outside counsel, Clifford Chance, under § 10(b) of the Exchange Act and Rule 10b-5. Plaintiffs alleged that the Defendants engaged in a scheme to artificially inflate the price of DVI securities by refusing to write down millions of dollars of impaired assets, double pledging collateral and/or pledging ineligible collateral, refusing to implement and comply with internal controls and concealing cash shortages by overstating revenue, assets and earnings and understating liabilities and expenses. Plaintiffs alleged that Deloitte committed securities fraud by issuing unqualified audit reports, and that Clifford Chance assisted DVI by drafting fraudulent financial reports, conspiring with other defendants to hide material information, and "deflecting" SEC inquiries. The district court granted Plaintiffs' motion for class certification with respect to all Defendants but Clifford Chance, and the parties appealed under Rule 23(f).

3. The Third Circuit reiterated that to invoke a fraud-on-the-market presumption of reliance, plaintiffs must show that they traded shares in an efficient market, and that a defendant may rebut a presumption of reliance by a showing that "severs the link" between the misrepresentation and the price received or the decision to trade.

4. On appeal, Deloitte challenged the application of a fraud-on-the-market presumption and argued that loss causation must be established as a prerequisite before invoking the presumption of reliance. The Third Circuit rejected these arguments, finding that Plaintiffs successfully established a presumption of reliance through the fraud-on-the-market theory where the shares were traded in an efficient market and where the misrepresentation at issue became public, and holding that Plaintiffs need not establish loss causation as a prerequisite to invoking the presumption of reliance.

5. As for Deloitte's attempt to rebut the presumption of reliance, the Third Circuit agreed that rebuttal at class certification stage was appropriate. However, the various rebuttal arguments put forth by Deloitte fell short.

Ninth Circuit

C. *Conn. Ret. Plans and Trust Funds v. Amgen, Inc.*, 660 F.3d 1170 (9th Cir. Nov. 8, 2011).

1. Appeal from an order of the district court (C.D. Cal.) granting class certification in a securities fraud case brought by Plaintiff investors against biotechnology company Amgen Inc. and several of its officers. The Ninth Circuit affirmed.

2. Plaintiffs alleged that by misstating and failing to disclose safety information about two of Amgen's products used to treat anemia, Defendants violated §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The Ninth Circuit joined the Third and Seventh Circuits in holding that to invoke fraud-on-the-market presumption of reliance in aid of class certification, "the plaintiff must (1) show that the security was traded in an efficient market . . . and (2) show that the alleged misrepresentations were public . . ." *Id.* at 1172. "As for the element of materiality, the plaintiff must plausibly allege—but need not *prove* at this juncture – that the claimed misrepresentations were material." *Id.* According to the Ninth Circuit, the question of a statement's materiality goes to the merits of the claim and is thus not reviewable at the class certification stage.

3. The Ninth Circuit observed that the presumption of reliance can be rebutted by showing, for example, that the market was already aware of the truth behind the alleged falsehoods, and therefore the falsehoods did not affect the market price i.e., the truth-on-the-market defense. However, the Ninth Circuit held that the district court correctly refused to consider the Defendants' truth-on-the-market defense at the class certification stage. Although this defense would affirmatively rebut the fraud-on-the-market presumption, it does so by refuting the materiality of the alleged misrepresentation, and materiality is an issue to be reached at trial or on summary judgment.

First Circuit

A. *Plumbers' Union Local No. 12 Pension Fund v. Nomura Asset Acceptance Corp*., 632 F.3d 762 (1st Cir. Jan. 20, 2011).

1. Three union pension and welfare funds appealed from a district court (D. Mass.) order dismissing their putative class action complaint against eight trusts, the "depositor" that organized the trusts, the trusts' underwriters and five officers of the depositor. Plaintiffs sought redress for losses allegedly suffered when they acquired trust certificates representing mortgage-backed securities and claimed that the trusts and their underwriters, the depositor of the trusts, and five officers of the depositor violated §§ 11, 12(a)(2), and 15 of the Securities Act when they issued statements in their trust registrations and prospectus supplements that were allegedly false or misleading. The district court dismissed in part for lack of standing and in part for failure to state a claim. The First Circuit affirmed in part, and remanded for further proceedings.

2. As to standing, the First Circuit analyzed whether plaintiffs can pursue claims based on offerings in which they did not participate and against trusts whose certificates they did not purchase. The First Circuit observed that the Supreme Court "has not been consistent" on such issues in the class action context, and that "several circuits have cut themselves loose from a strict requirement that, in a plaintiff class action, no defendant may be sued unless a named plaintiff has a counterparty claim against that defendant." *Id.* at 769-70. The First Circuit affirmed the district court's finding of lack of standing as to certain defendants, reserving the question of whether standing may exist where the named plaintiffs' claims give them "essentially the same incentive to litigate the counterpart claims of the class members because the establishment of the named plaintiffs' claims necessarily establishes those of other class members." *Id.* at 770*.*

3. Plaintiffs made allegations concerning Defendants' lending guidelines, appraisal standards, and credit ratings. The district court concluded that all of these claims were inadequate. As to Plaintiffs' claim that Defendants engaged in a "wholesale abandonment of underwriting standards," the First Circuit reversed, finding that the various risk warnings in the offering documents did not address claims of wholesale abandonment. In contrast, the First Circuit affirmed the dismissal of claims concerning appraisal standards, as the claims were too general, and related to ratings, which are considered to be opinions were not deemed false and misleading simply because the ratings agency should have used better methods and data.

Second Circuit

B. *Fait v. Regions Financial Corp.*, 655 F.3d 105 (2d Cir. Aug. 23, 2011).

1. Appeal of an order of the district court (S.D.N.Y.) dismissing Plaintiff's amended complaint, which alleged violations of §§ 11, 12, and 15 of the Securities Act. The Second Circuit affirmed.

2. Regions Financial Corp. (Regions) was a bank holding company that had acquired another bank holding company, AmSouth Bancorporation (AmSouth), and subsequently issued hybrid securities in 2008 which were acquired by Plaintiff. Plaintiff alleged that Regions had overstated goodwill and underestimated loan loss reserves in its 2007 Form 10-K, other SEC filings, and in its Registration Statement and Prospectus for the offering of the 2008 securities. As a result, Plaintiff alleged that the Registration Statement and Prospectus contained "false and misleading" statements. The district court reasoned that the goodwill was not objectively determinable and the loan loss reserves reflected statements of opinions. *Id.* at 108-09. It then held that the "statements in question were not actionable because the complaint failed to allege that [Defendants] did not honestly hold those opinions at the time they were expressed." *Id.* at 109.

3. The Second Circuit observed that "matters of belief and opinion are not beyond the purview of [§§ 11 and 12]." *Id.* at 110. However, to assert a claim under these sections based upon a defendant's statements of opinion and belief, the plaintiff must allege that a statement "was both objectively false and disbelieved by the defendant at the time it was expressed." *Id.*

4. As to goodwill, the court held that Plaintiff did not "allege [ ]actionable misstatements or omissions regarding goodwill" because "the company's [goodwill] projections were opinions rather than guarantees" and the complaint did not "plausibly allege that [D]efendants did not believe the statements regarding goodwill at the time they made them." *Id.* at 112.

5. As to "loan loss reserves," these "reflect management's opinion or judgment about what, if any, portion of amounts due on the loans ultimately might not be collectible." *Id.* at 112-13. "Such a determination is inherently subjective, and like goodwill, estimates will vary depending on a variety of predictable and unpredictable circumstances." *Id.*

6. The Second Circuit affirmed dismissal of the remaining allegations in the complaint (which included claims against Regions for violations of Sarbanes-Oxley and against its auditor for violations of generally accepted accounting principles and generally accepted accounting standards) as they were derivative of the claims regarding goodwill and loan loss reserves.

Ninth Circuit

C. *Reese v. BP Exploration (Alaska) Inc.*, 643 F.3d 681 (9th Cir. June 29, 2011).

1. Appeal of an order of the district court (W.D. Wa.) granting in part and denying in part Defendant oil company's motion to dismiss. The suit followed BP Exploration (Alaska) Inc.'s (BPXA's) temporary shut-down of its pipelines and oil production in Prudhoe Bay, Alaska upon its discovery of a pipeline leak. Plaintiff alleged that BPXA knew about corrosion in its pipelines and therefore statements made by BPXA in a contract filed with the SEC, were false and misleading in violation of §§ 10(b), 18, and 20(a) of the Exchange Act and Rule 10b-5. Both parties appealed in part from the district court's judgment. The Ninth Circuit held that BPXA's breach of a contractual promise of specific future conduct, even where the contract was filed in conjunction with SEC reporting requirements, did not establish an actionable misrepresentation for purposes of a private action for securities fraud. In light of this holding, the Ninth Circuit did not reach the question of scienter.

2. The district court observed the lack of adequate precedent and certified two questions for interlocutory appeal: (a) "Whether a contract to which a defendant is a party, filed in conjunction with SEC reporting requirements and promising specific future conduct by the defendants, can be used as the foundation for a securities fraud action by a nonparty to the contract"; and (b) "Whether the facts contained in a party's admission of criminal negligence as part of a misdemeanor guilty plea may be used as evidence of civil misconduct . . . which requires an allegation of reckless or intentional misconduct as proof of scienter." *Id.* at 687.

3. In addressing the first question, the Ninth Circuit noted that a breach of a contractual promise of future performance typically does not constitute a misrepresentation that will support an action for securities fraud. However, the Ninth Circuit recognized that a forward-looking promise could become an inaccurate assertion of existing fact if its repeated filing creates an impression of a state of affairs that differs in a material way from the one that actually exists. Under the facts alleged, the Ninth Circuit found that a reasonable investor would not view the repeated, periodic filing of the contract as a certification of current compliance by BPXA.

4. In light of its holding, the Ninth Circuit did not address the scienter question.

Tenth Circuit

D. *Katz v. Gerardi*, 655 F.3d 1212 (10th Cir. Aug. 25, 2011).

1. Appeal of an order of the district court (D. Colo.) dismissing Plaintiff's' action for splitting potential legal claims and for lack of standing to sue as a purchaser under the Securities Act. The Tenth Circuit affirmed.

2. Plaintiffs, Infinity and Katz, were minority shareholders in a Real Estate Investment Trust owned by a public company. When the public company was acquired by merger, the investors had the option of exchanging REIT shares for cash or stock in the new entity; Katz opted for cash and Infinity for stock. Each then brought state court class actions alleging that the merger documents contained false statements. After Infinity's action was dismissed, Katz joined Infinity and another as Plaintiffs and asserted federal securities claims. The district court dismissed Katz's claims under the Securities Act on the grounds that he was not a purchaser of securities and therefore lacked standing. The district court dismissed Infinity's claims on the grounds that it was asserting claims it could have brought in its previous lawsuit, i.e. "claim splitting." Infinity subsequently asserted the claims in its original action.

3. As to Infinity, the Tenth Circuit observed that it had filed two cases in the same district court, involving the same subject matter and seeking the same relief, and therefore the district court did not abuse its discretion in dismissing.

4. As to Katz, the Tenth Circuit concluded that the Securities Act only gives standing to purchasers of securities. Katz elected to receive cash, and was therefore not a purchaser. On appeal, Katz argued that the "fundamental change doctrine," also known as "the forced change doctrine," enables a shareholder whose investment has been fundamentally changed to meet standing requirements even where he has not purchased securities. The Tenth Circuit refused to apply the fundamental change doctrine, holding it only applies to claims brought under the Exchange Act. Further, even if the doctrine could apply, Katz was a seller of securities, not a purchaser.

Eleventh Circuit

E. *FindWhat Investor Group v. FindWhat.com*, 658 F.3d 1282 (11th Cir. Sept. 30, 2011).

1. Appeal of an order of the district court (M.D. Fla.) dismissing two of Plaintiffs' claims and granting summary judgment to Defendants on the remaining claims. Plaintiff investors brought a putative class action against Defendant company and its officers, alleging violations of § 10(b) of the Exchange Act and Rule 10b-5. Defendant company, an Internet commerce company, provided "pay per click" advertising services. Plaintiffs alleged that Defendant officers made misleading statements about the company's attempts to identify and cease to do business with distribution partners who used "click fraud" (clicking on an Internet advertisement solely for the purpose of forcing the advertiser to pay for the click) and spyware to generate more advertising revenue. In fact, Defendants continued to do business with distribution partners who employed these questionable practices. Later, when Defendants did reveal that some revenue resulted from click fraud, the value of the company's stock fell. The district court dismissed Plaintiffs' claims based on two alleged misstatements because it held that those statements were not false or misleading. The district

court awarded summary judgment to Defendants on the remaining claims. The Eleventh Circuit affirmed the dismissal, vacated the award of summary judgment, and remanded.

2. The first statement that Plaintiffs challenged was an SEC filing in which Defendants stated that they enforce strict guidelines to ensure that none of its distribution partners engage in click fraud or use spyware. The district court found that the statement was not false or misleading and granted Defendants' motion to dismiss this claim. The Eleventh Circuit disagreed with the district court's assessment, but affirmed the dismissal because Plaintiffs had failed to raise a strong inference of scienter. The Eleventh Circuit concluded that based on Plaintiffs' allegations, the earliest date that Defendants could have known about the distribution partners' use of click fraud was three months after the SEC filing. Plaintiffs' arguments that Defendants must have previously known about the problems were speculative, conclusory, and insufficient.

3. The second statement that Plaintiffs challenged was made during a public conference call with investors. Defendant officer stated that the company's revenue had been increasing and that he expected revenue to continue to increase. Plaintiffs conceded that the statement was accurate, but argued that it was misleading because Defendants did not inform investors that the revenue increase was due to click fraud. The district court found that the statement was not false or misleading and granted Defendants' motion to dismiss the claim. The Eleventh Circuit agreed. Defendant officer did not create a false impression about the company's relation to spyware; thus, he did not need to disclose facts in order to prevent investors from being misled.

4. The third and the fourth statements that Plaintiffs challenged were made during a conference call with investors and in an SEC filing. Both of these statements contained claims that Defendants had removed certain distribution partners because those partners were engaged in click fraud and used spyware. In fact, Defendants had not removed those partners. The district court granted summary judgment to Defendants on these claims, holding that, as a matter of law, Plaintiffs could not establish loss causation and damages because the stock was inflated (due to the distribution partners' use of spyware) before the first alleged actionable misstatement, and remained inflated after the alleged actionable misstatements. The Eleventh Circuit rejected this conclusion, holding "that confirmatory information that wrongfully *prolongs* a period of inflation—even without increasing the *level* of inflation—may be actionable under the securities laws." *Id.* at 1314 (emphasis in original). Companies may not prolong the inflation of stock prices by repeating falsehoods that materially mislead the market. The Eleventh Circuit vacated the award of summary judgment and remanded the case to the district court to determine, in the first instance, whether Plaintiffs had demonstrated triable issues of fact regarding loss causation and damages.

First Circuit

A. *FirstBank Puerto Rico, Inc. v. La Vida Merger Sub, Inc.*, 638 F.3d 37 (1st Cir. Mar. 16, 2011).

1. Appeal of an order of the district court (D.P.R.) dismissing Plaintiff's complaint for alleged violations of § 10b of the Exchange Act and Rule 10b-5 as barred by the statute of limitations. The First Circuit affirmed.

2. Plaintiff, a warrant holder, alleged that Defendants, a corporation and its acquiring entity, engaged in a fraudulent scheme to deprive Plaintiff of its right under the warrant to acquire 15% of the corporation's common voting stock by failing to provide Plaintiff with notice and details of the sale and merger, thereby depriving Plaintiff of the opportunity to participate and redeem its warrant. On appeal, the First Circuit rejected Plaintiff's argument that under subsequent Supreme Court authority in *Merck & Co., Inc. v. Reynolds*, 130 S. Ct. 1784 (2010), dismissal was inappropriate.

3. More than two years before filing the complaint, Plaintiff filed a motion in a Puerto Rico court seeking to compel IBC to produce a complete copy of the merger agreement. The First Circuit held that this fact establishes that Plaintiff had actual notice of the merger—i.e., it had actual notice of the facts constituting the Defendants' alleged § 10(b) and Rule 10b–5 violations—more than two years before filing the complaint. Therefore, the district court properly dismissed Plaintiff's claims as barred by the applicable two-year statute of limitations.

Second Circuit

B. *City of Pontiac v. MBIA, Inc.*, 637 F.3d 169 (2d Cir. February 28, 2011).

1. Appeal from an order of the district court (S.D.N.Y.) dismissing Plaintiffs' proposed class action for alleged violations of Rule 10b-5 as barred by the statute of limitations. The Second Circuit vacated and remanded for reconsideration in light of the Supreme Court's decision in *Merck & Co. v. Reynolds*, 130 S. Ct. 1784 (2010).

2. Defendant MBIA sells insurance policies guaranteeing principal and interest on certain bonds. Defendant initially recorded the transaction in question as income but restated the transaction as a loan after the SEC and New York Attorney General launched investigations into MBIA's accounting practices.

3. The district court dismissed Plaintiffs' claims, concluding that the proposed class was on inquiry notice of the alleged fraud more than two years before filing suit based on certain trade reports commenting on the transaction. According to the Second Circuit, prior to the Supreme Court's holding in *Merck*, "a plaintiff was on 'inquiry notice' when public information would lead a

reasonable investor to investigate the possibility of fraud." *Id*. at 173 (internal citation omitted). However, the Supreme Court overruled this analysis in *Merck*, holding that the statute of limitations begins to run not when a reasonable investor would have been on inquiry notice, but rather only after a reasonable investor would have discovered the facts constituting the violation.

4. The Second Circuit then observed that *Merck* leaves unresolved two questions: "A. What are the facts that together constitute a securities fraud violation for purpose of commencing the statute of limitations?" and "B. With regard to any particular one of these facts, how much information does the reasonable investor need to have about it before it is deemed 'discovered' for purpose of commencing the statute of limitations?" *Id*. at 174.

5. Interpreting *Merck*, the Second Circuit held "that a fact is not deemed 'discovered' until a reasonably diligent plaintiff would have sufficient information about that fact to adequately plead it in a complaint" with sufficient particularity "to survive a 12(b)(6) motion to dismiss." *Id*. at 175.

6. The Second Circuit remanded to the district court for additional analysis consistent with *Merck*.

Seventh Circuit

C. *McCann v. Hy-Vee, Inc*., 663 F.3d 926 (7th Cir. Nov. 22, 2011).

1. Appeal of an order of the district court (N.D. Ill.) dismissing Plaintiff's claim as barred by the statute of repose because Plaintiff had brought suit more than five years after the alleged violation occurred. The Seventh Circuit, addressing whether the statute of limitations on a federal securities claim begins to run with the fraud or when harm befalls the plaintiff, affirmed.

2. Plaintiff wife divorced her nondefendant husband, an executive at Defendant Hy-Vee, Inc., a closely held corporation, in 2002. The husband possessed shares of the company, and as part of the divorce decree, the wife was awarded almost one-third of the shares, until such time as the husband was allowed to sell the shares.

3. Plaintiff alleged that the company defrauded her when, during negotiations leading up to the 2002 divorce, Hy-Vee's CFO informed her that the shares could not be sold until her husband died or left the company. In fact, the shares could be sold with the company's permission. Plaintiff alleged that these false statements caused her to accept stock in lieu of cash and to agree to allow her alimony to terminate as soon after May 2007 as her husband could sell the stock. In June 2007, the husband agreed to repurchase the stock from Plaintiff, but tendered less than the parties had agreed.

4. After additional legal proceedings with her ex-husband in state court, the wife

brought suit against the company in 2009, alleging a violation of § 10(b) of the Exchange Act and Rule 10b-5 in connection with her receipt and sale of the stock. The district court dismissed on statute of limitations grounds, and the wife appealed.

5. A plaintiff bringing a claim under § 10(b) or Rule 10b-5 must do so within two years of discovering the facts underlying the allegation, or within five years of the violation, whichever is sooner. On appeal, the Seventh Circuit considered whether the five year statute of repose governed, and if so, when it was triggered. Plaintiff argued that there was no violation until 2007, when Defendant agreed to buy back the stock, thereby extinguishing Plaintiff's alimony rights and causing injury.

6. The Seventh Circuit disagreed, concluding that an injury is not required for the violation to occur; otherwise "a person who had bought a security could, having later discovered he'd been defrauded, wait indefinitely to determine whether his purchase had been a mistake (because of the fraud) or a windfall (because despite the fraud the price of the security had risen beyond expectations), since his two-year [statute of limitations period] . . . would not run until the fraud causes him harm. This would be a heads I win, tails you lose, proposition, which the law would be unlikely to countenance." *Id.* at 931. Here, the alleged violation—the alleged misrepresentation—occurred in 2002, and Plaintiff's suit, which she filed approximately seven years after the alleged violation, was time barred.

Ninth Circuit

D. *Strategic Diversity Inc. v. Alchemix Corp.*, — F.3d —, Nos. 10-15256, 10-16404, 2011 WL 6004607 (9th Cir. Dec. 2, 2011), *opinion withdrawn, reissued and reh'g denied*, — F.3d —, 2012 WL 164091 (9th Cir. Jan. 20, 2012).

1. Appeal of an order of the district court (D. Ariz.) granting summary judgment in favor of Defendants on Plaintiffs' claims for rescission under § 10(b) of the Exchange Act and various state law claims. The Ninth Circuit affirmed in part, reversed in part, vacated the attorneys' fee award, and remanded.

2. Plaintiff invested in Defendant Alchemix Corp. in 2001, in return for a convertible promissory note, security interests in Alchemix's intellectual property, and a warrant that included a provision that the company's capitalization would not exceed certain limits. In 2002, Alchemix negotiated a new investment with another investor. In connection with that investment, on July 8, 2002, Plaintiff made an additional investment and Plaintiff's principal resigned from the Alchemix Board. By the end of July 2002, the new investor declined to exercise its option to make additional investments, but Plaintiff allegedly did not learn of this until December 2005.

3. In 2007, Plaintiff brought a claim asserting causes of action for federal

securities fraud, and various state and common law claims. Prior to the Supreme Court decision in *Merck*, the district court found that Plaintiff was on "inquiry notice" in June 2002. The Ninth Circuit concluded that, under *Merck*, Defendant had not met its burden of showing that the claims were time-barred; even assuming Plaintiff was on inquiry notice in 2002, Defendant "[did] not demonstrate how a reasonably diligent plaintiff from that point forward would have discovered the violations. The limitations period does not begin to run until *discovery*, 'irrespective of whether the actual plaintiff undertook a reasonably diligent investigation.'" *Id.* at *6 *quoting Merck & Co. v. Reynolds, Inc.*, 130 S. Ct. 1784, 1798 (2010). The Ninth Circuit therefore vacated and remanded.

4. On January 20, 2012, the Ninth Circuit withdrew its December 2, 2011 slip opinion and issued an otherwise identical opinion except for the addition of footnotes and a denial of Defendants' petition for a panel rehearing.

Supreme Court

A. *Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. —, 131 S. Ct. 2296, 180 L. Ed. 166 (June 13, 2011).

1. The Supreme Court reversed the decision of the Fourth Circuit and affirmed the district court's (D. Md.) dismissal of Plaintiff's complaint.

2. Janus Capital Management LLC serves as the mutual fund investment adviser to the Janus mutual funds, which were created by Janus Capital Group, Inc., a publicly traded company. Plaintiffs, investors in Janus Capital Group, alleged that Defendants negotiated arrangements with certain traders to permit market timing in the mutual funds. Plaintiffs alleged that Defendants violated Rule 10b-5 and § 10(b) of the Exchange Act because the prospectuses for certain of the mutual funds represented that the funds were not suitable for market timing, and suggested that the investment adviser would take steps to prevent market timing.

3. The Supreme Court granted certiorari to address whether the investment adviser can be held civilly liable under Rule 10b-5 for statements in the prospectuses of the mutual funds. The Supreme Court concluded that to be liable, a defendant must have "made" the allegedly material misstatements in the prospectuses. Here, the adviser had not "made" the statements.

4. The Supreme Court found that a party making a statement must have ultimate control over the statement, or else the party is merely suggesting rather than making the statement. "One who prepares or publishes a statement on behalf of another is not its 'maker.'. . . Even when a speechwriter drafts a speech, the content is entirely within the control of the person who delivers it. And it is the speaker who takes credit—or blame for what is ultimately said." *Id.* at 2302. The Supreme Court held that this rule was consistent with *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994) and *Stoneridge*, which held that § 10(b) does not include a private cause of action against aiders and abettors.

5. Here, the mutual funds, and not the investment adviser, made the allegedly misleading statements. The mutual funds had the statutory obligation to file the prospectuses, and nothing in the prospectuses indicated that the investment adviser prepared them.

Second Circuit

B. *In re: Lehman Bros. Mortgage-Backed Secs. Litig.*, 650 F.3d 167 (2d Cir. May 11, 2011).

1. Appeal of orders of the district court (S.D.N.Y.) dismissing Plaintiffs' class action complaint seeking to hold Defendant rating agencies liable as

underwriters or control persons for alleged misstatements or omissions in securities offering documents in violation of §§ 11 and 15 of the Securities Act of 1933, and denying Plaintiffs' request for leave to amend. The Second Circuit affirmed.

2. Plaintiffs, investors in mortgage pass-through certificates, alleged that Defendants, who rated the certificates, exceeded their traditional roles of passive credit risk evaluators by actively aiding in the structuring and securitization process by engaging in negotiations with issuing banks as to the amount of credit enhancements and percentage of AAA certificates for each mortgage pool, and by allowing themselves to be influenced by issuing banks that ultimately gave their business to the rating agency that provided the highest ratings. The district court dismissed the action in its entirety and held that rating agencies are not liable under § 11 because they are not "underwriters" as defined by the statute; while they participated in creating the securities, they did not purchase them for resale. Furthermore, the district court held that rating agencies are not liable as control persons as they lack the power to influence or persuade the primary violators.

3. The Second Circuit held that to qualify as an "underwriter" under § 11, a defendant must have participated, directly or indirectly, in the purchase of securities with a view toward distribution, or in the sale or offer of securities in connection with a distribution. "Because [Defendants'] alleged structuring or creation of securities was insufficient to demonstrate their involvement in the requisite distributional activities, [P]laintiffs' § 11 claims against these Defendants were properly dismissed [by the district court]." *Id*. at 188. Although participation in distribution may be direct or indirect, the statute is not intended to reach persons who only provide facilitation services in the securities offering. The distinction between distributional and non-distributional activities is intended to exclude from strict liability under § 11 individuals such as lawyers, accountants and other professionals whose work is necessary to bring a security to the market.

4. With regard to Plaintiffs' control person claims, Plaintiffs alleged on appeal that Defendants influenced the alleged primary violators because they had direct input, guided and provided advice to the issuers on the types of loans to include and "thereby largely determin[ed] the amount and kind of credit enhancement that would result in specific ratings." *Id*. at 186-87. The Second Circuit rejected Plaintiffs' argument, holding that "providing advice that banks chose to follow does not suggest control." *Id*. at 187 (citing *In re Alstom SA Sec. Litig.*, 406 F. Supp. 2d 433, 487 (S.D.N.Y. 2005) (stating that the "exercise of influence, without power to direct…management and policies" is insufficient to establish control)). The Second Circuit observed that Plaintiffs' allegation that issuing entities shopped for best ratings undermined the argument that Defendants exerted any control over the issuing entities.

5. In dismissing Plaintiffs' claims, the district court did not address Plaintiffs' request for leave to amend the complaint made in Plaintiffs' opposition brief to Defendants' motion to dismiss. The Second Circuit held that "[i]t is within the [district] court's discretion to deny leave to amend implicitly by not addressing requests for amendment made informally in a brief filed in opposition to a motion to dismiss." *Id*. at 188 (internal quotations omitted). In addition, as the district court did not specify that dismissal of the claims was with prejudice, and Plaintiffs made no formal motions to amend, the Second Circuit held there was no abuse of discretion by the district court in implicitly denying Plaintiffs' request for leave to amend.

Ninth Circuit

C. *WPP Luxembourg Gamma Three Sarl v. Spot Runner, Inc.*, 655 F.3d 1039 (9th Cir. Aug. 23, 2011).

1. Appeal from an order of the district court (C.D. Cal.) granting Defendant's motion to dismiss. Plaintiff shareholder brought claims against corporation and corporation's founders and general counsel, asserting violations of §10(b) of the Exchange Act and Rule 10b-5(a)-(c). Plaintiff alleged that amidst large operating losses unknown to investors, Defendants solicited Plaintiff to purchase additional shares in the company at the same time that executives of the company were selling personally owned shares; moreover, Defendants allegedly did so despite contractual obligations to disclose those insider sales and despite Plaintiff specifically asking whether the executives were selling. The Ninth Circuit affirmed in part and reversed in part.

2. Plaintiff pleaded a Rule 10b-5(a) and (c) scheme liability claim against all Defendants. The Ninth Circuit held that a defendant may only be liable as part of a fraudulent scheme based on misrepresentations and omissions when the scheme also encompasses conduct beyond those misrepresentations or omissions; allegations underpinning a typical Rule 10b-5(b) claim may not be recast as a Rule 10b-5(a) or (c) scheme liability claim, without more. Here, the plaintiff did not allege any facts that were separate from the omission claim.

Second Circuit.

A. *MLSMK Inv. Co. v. JP Morgan Chase & Co.*, 651 F.3d 268 (2d Cir. July 7, 2011).

1. Appeal from an order by the district court (S.D.N.Y.) granting Defendants' motion to dismiss Plaintiff's RICO claim as barred by the PSLRA. Along with several state law claims, Plaintiff, an investor in Bernard L. Madoff Investor Securities, alleged that Defendants JPMorgan Chase & Co. and JP Morgan Chase Bank, N.A. conspired to violate RICO, 18 U.S.C. §§ 1962(a) and 1964(c), by knowingly and purposefully conspiring with Madoff and by providing Madoff with banking services that allegedly were integral to the functioning of his racketeering enterprise. In their motion to dismiss, Defendants argued that Plaintiffs failed to sufficiently plead the requisite degree of scienter and that the claim was barred by § 107 of the PSLRA, 18 U.S.C. § 1964(c). In granting Defendants' motion to dismiss, the district court relied exclusively on Plaintiff's failure to sufficiently plead scienter. The Second Circuit previously affirmed dismissal of the state law claims and upheld dismissal of the RICO claim as barred by § 107 of the PSLRA.

2. Plaintiff alleged that Defendants aided and abetted Madoff's securities fraud. As the securities laws do not provide a private right of action for aiding and abetting fraud, Plaintiff's only federal claim was for alleged RICO violations.

3. Section 107, commonly referred to as the "RICO Amendment," provides that "no person may rely upon any conduct that would have been actionable as fraud in the purchase or sale of securities to establish a violation of section 1962." *Id.* at 273. The Second Circuit noted that there was disagreement among district courts within the Circuit as to whether § 107 bars all civil RICO claims predicated upon any type of securities fraud, or whether there was a carveout to preemption for claims when the underlying conduct does not give rise to a separate actionable securities claim.

4. The Second Circuit canvassed relevant district court opinions and concluded that "Section 107 of the PSLRA bars civil RICO claims alleging predicate acts of securities fraud, even where a plaintiff cannot itself pursue a securities fraud action against the defendant." *Id.* at 277. The Second Circuit cited the plain language of the statute, which it held "does not require that the same plaintiff who sues under RICO must be the one who can sue under securities laws." *Id.* at 278 (internal quotations and citations omitted). The Second Circuit also reviewed the legislative history of the statute, finding that "the RICO Amendment's purpose was to remove as a predicate act of racketeering *any conduct* that would have been actionable as fraud in the purchase or sale of securities as racketeering activity under civil RICO." *Id.* at 278-79 (internal quotations, parentheticals, and citations omitted). The Second Circuit noted that Congress could have but "did not say that it was removing 'any *claim* that would have been actionable.' Its focus was on the behavior alleged to satisfy RICO's predicate-act requirement." *Id.* at 279.

Sixth Circuit.

B. *Atkinson v. Morgan Asset Mgmt*., 658 F.3d 549 (6th Cir. Sept. 8, 2011).

1. Appeal from an order by the district court (W.D. Tenn.) dismissing the class action as barred by SLUSA. The Sixth Circuit affirmed.

2. Plaintiffs' mutual fund shareholders sued Defendant investment company for various state law violations based on the theory that Defendant took unjustified risks in allocating the fund's assets and concealed the risks from Plaintiffs. Defendants removed the action to federal court, Plaintiffs moved to remand, and the district court dismissed the action.

3. On appeal, Plaintiffs argued that their claims fell outside the preclusive scope of SLUSA because they were within the purview of so-called "first Delaware carve-out" and because many of the claims lacked fraud-based allegations. They further argued that the district court erred in dismissing the class action with prejudice.

4. The Sixth Circuit rejected each of these arguments. The "first Delaware carve-out" preserves a class action if it involves "the purchase or sale of securities by the issuer or an affiliate of the issuer exclusively from or to holders of equity securities of the issuer." *Id*. at 553. Here, however, the Plaintiffs held their shares when the alleged misconduct began. The Supreme Court in *Dabit* broadly eliminated holder claims, and the Sixth Circuit refused to "shield from the PSLRA's federal protections nearly every class action involving shareholders in open-ended mutual funds." *Id.* at 554.

5. The Sixth Circuit also rejected Plaintiffs' argument that most of their claims did not contain fraud as a necessary element and thus those claims were beyond the scope of SLUSA. All of Plaintiffs' claims included allegations of misrepresentations and omissions. "SLUSA damns each one." *Id.* at 556. Plaintiffs' artful labeling of its claims did not place those claims beyond SLUSA.

Seventh Circuit.

C. *Brown v. Calamos*, 664 F.3d 123 (7th Cir. Nov. 10, 2011).

1. Appeal of an order of the district court (N.D. Ill.) dismissing with prejudice Plaintiff's complaint—originally brought in state court and removed to federal court—which centered on an alleged breach of fiduciary duty barred by SLUSA. The Seventh Circuit affirmed.

2. Plaintiff shareholders brought a putative class action in state court against Defendants, an investment advisor, a closed-end investment fund, and the parent's board of trustees, on the theory that the investment advisor enriched preferred shareholders at the expense of Plaintiffs. Plaintiffs argued that their

claims were not precluded by SLUSA because they did not allege securities fraud, and specifically included a disclaimer to this effect.

3. The Seventh Circuit explained the three approaches that the Sixth, Third, and Ninth Circuits have taken to determine whether a complaint can be interpreted as alleging a misrepresentation such that it is precluded by SLUSA. The Seventh Circuit explained that under the literalist approach of the Sixth Circuit, if the complaint can be interpreted as containing a misrepresentation and meets the other requirements of SLUSA, it must be dismissed. The Third Circuit, by contrast, has found that if a misrepresentation or material omission is "inessential" to the plaintiff's success, it will not bar the suit. The Ninth Circuit takes an intermediate approach that permits the complaint to be dismissed but without prejudice, thus permitting the plaintiff to file an amended complaint in state court without the misrepresentation.

4. The Seventh Circuit held that the Plaintiffs here, however, "must lose even under a looser approach than the Sixth Circuit's (not the Ninth Circuit's approach, however, but one close to the Third Circuit's), whereby suit is barred by SLUSA only if the allegations of the complaint make it likely that an issue of fraud will arise in the court of the litigation—as in this case. The allegation of fraud would be difficult and maybe impossible to disentangle from the charge of breach of the duty of loyalty that the defendants owed their investors." *Id.* at 128–129. Under these circumstances, and despite the disclaimer in the complaint, the Seventh Circuit found that the suit was barred by SLUSA.

Second Circuit

A. *Fishoff v. Coty Inc.*, 634 F.3d 647 (2d Cir. Mar. 4, 2011).

1. Appeal of an order of the district court (S.D.N.Y.) awarding damages to Plaintiff but denying sanctions. The Second Circuit affirmed.

2. Plaintiff, a former CFO, brought action against Coty Inc. (Coty), his former employer, alleging common law fraud, violation of § 10(b) of the Exchange Act and breach of contract claims. The claims were based on Defendant's decision to retroactively value the company's shares in a manner that reduced Plaintiff's options value by half. The district court granted Coty's motion to dismiss the § 10(b) and common law fraud claims, holding that the Long Term Incentive Plan (LTIP), which entitled Plaintiff to nonqualified stock options, was not a security as the term is defined in the Exchange Act. Ultimately, the district court awarded Plaintiff damages based on a breach of contract on the grounds that the LTIP was unambiguous and provided for no discretion to retroactively change value of the options.

3. As the initial complaint included securities claims, the district court considered and denied possible sanctions against Plaintiff as required by the PSLRA, 15 U.S.C. § 78u-4(c)(1), and stated that, while Plaintiff failed to adequately plead scienter, it did not imply that the claim had no chance of success. The Second Circuit agreed, holding that Plaintiff's claim was not frivolous even if it was unlikely to succeed. The Second Circuit stated that a "party's failure to plead with the requisite particularity does not necessarily warrant sanctions." *Id.* at 655.

Ninth Circuit

B. *The Facebook, Inc. v. Pac. Nw. Software, Inc.,* 640 F.3d 1034 (9th Cir. Apr. 11, 2011, amended May 16, 2011).

1. Appeal of an order of the district court (N.D. Cal.) enforcing a settlement agreement entered into by The Facebook, Inc. and individual litigants, Cameron and Tyler Winklevoss and Divya Narendra, who claimed that the idea for the popular social networking site had been stolen from them. The Ninth Circuit affirmed.

2. Before a mediation session ordered by the district court, the parties signed a Confidentiality Agreement stipulating that statements made during the mediation were privileged, non-discoverable, and inadmissible in court. The mediation resulted in the parties signing a short, handwritten Settlement Agreement whereby the individuals agreed to give up their competing site, ConnectU, in exchange for cash and an interest in Facebook. After the settlement fell apart in final negotiations, Facebook filed a motion with the district court seeking to enforce the Settlement Agreement.

3. After signing the Settlement Agreement, Facebook notified the individuals of an internal valuation of the common stock share price prepared under the tax code. The individuals argued, *inter alia*, that they were misled as to the value of the shares in violation of Rule 10b-5, and therefore sought rescission of the Settlement Agreement under Section 29(b) of the Exchange Act. The Ninth Circuit rejected the claim for rescission, observing that the individuals were sophisticated parties, were represented by six lawyers at the mediation, had access to discovery, and signed releases. Moreover, the proffered evidence of alleged misstatements was inadmissible in light of the Confidentiality Agreement.

C. *Strategic Diversity Inc. v. Alchemix Corp.*, — F.3d —, Nos. 10-15256, 10-16404 2011 WL 6004607 (9th Cir. Dec. 2, 2011) *opinion withdrawn, reissued and reh'g denied*, 2012 WL 164091 (9th Cir. Jan. 20, 2012).

1. Appeal of an order of the district court (D. Ariz.) granting summary judgment in favor of Defendants on Plaintiffs' claims for rescission under § 10(b) of the Exchange Act and various state law claims. The Ninth Circuit affirmed in part, reversed in part, vacated the attorneys' fee award, and remanded.

2. Plaintiff invested in Alchemix Corp. in 2001 in return for a convertible promissory note, security interests in Alchemix's intellectual property, and a warrant that included a provision that the company's capitalization would not exceed certain limits. In 2002, Alchemix negotiated a new investment with another investor. In connection with that investment, on July 8, 2002, Plaintiff made an additional investment and Plaintiff's principal resigned from the Alchemix Board. By the end of July 2002, the new investor declined to exercise its option to make additional investments, but Plaintiff allegedly did not learn of this until December 2005.

3. The district court's grant of summary judgment was based in part on its finding that Plaintiff failed to produce evidence of damages. On appeal, the Ninth Circuit, noting that the Supreme Court has not yet settled the question, held that a plaintiff suing under § 10(b) that is seeking rescission must still demonstrate economic loss (damages) and loss causation. However, prior to addressing such evidence, the Ninth Circuit concluded that because of the passage of time and intervening events, true rescission was not feasible. Thus, the district court had the discretion to consider a recessionary measure of damages, i.e., "what monetary equivalent is necessary to return [Plaintiff] to the *status quo ante.*" *Id.* at *8. Moreover, the court held that it is for the finder of fact to determine causation i.e., had the Plaintiff known the truth, it would not have taken the actions it did. The Ninth Circuit therefore remanded on the question of damages and causation.

4. On January 20, 2012, the Ninth Circuit withdrew its December 2, 2011 slip opinion and issued an otherwise identical opinion except for the addition of footnotes and a denial of Defendants' petition for a panel rehearing.

Eleventh Circuit

A. *Quail Cruise Ship Mgmt. Ltd. v. Agencia de Viagens CVC Tur Limitada*, 645 F.3d 1307 (11th Cir. July 8, 2011).

1. Appeal from an order of the district court (S.D. Fla.) dismissing the action for lack of subject matter jurisdiction. Plaintiff cruise ship operator sued Defendant tour operating company and the company's president, alleging violations of § 10(b) of the Exchange Act and Rule 10b-5, as well as maritime and common law torts. Plaintiff purchased the cruise ship from the company via a share transfer agreement. Plaintiff alleged that Defendants deferred repairs and concealed damage to the ship and influenced inspectors to provide favorable inspections to the ship. The district court applied *Morrison v. Nat'l Australia Bank Ltd.*, 130 S. Ct. 2869 (2010) and concluded that it lacked subject matter jurisdiction over the securities fraud claims because Plaintiffs failed to allege that the transaction occurred in the United States. The Eleventh Circuit vacated and remanded.

2. In *Morrison*, the Supreme Court concluded that § 10(b) applies only where the security at issue is listed on a domestic stock exchange or where its purchase or sale is made in the United States. *Id*. at 2886. Here, Plaintiff alleged that the transaction closed in the United States, and thus the transaction did occur in the United States for the purposes of the statute. Therefore, it was premature for the district court to dismiss the case.

Summary Chart of Certain Unreported Decisions

Citation	Claims	Resolution
Amoroso v. AOL Time Warner Inc., 409 F. App'x 412 (2d Cir. Feb. 2, 2011)	§ 11 of the Securities Act and § 10(b) and 14(a) of the Exchange Act	Affirmed dismissal of Exchange Act claims for failure to plead loss causation where Plaintiff did not allege any corrective disclosure; affirmed dismissal of Securities Act claim as time-barred and because Defendant would be able to establish affirmative loss causation defense.
In re Am. Int'l Group, Inc. Derivative Litig., 415 F. App'x 285 (2d Cir. Mar. 17, 2011)	Breach of fiduciary duty, waste of corporate assets, contribution, unjust enrichment, §§ 10(b) and 20(a) of the Exchange Act, and Rule 10b-5	Affirmed dismissal; Plaintiffs did not allege with sufficient particularity that demand on the board would have been futile, and therefore, the failure to make a pre-suit demand was not excused.
Beleson v. Schwartz, 419 F. App'x 38 (2d Cir. Apr. 5, 2011)	§§ 10(b) and 20(a) of the Exchange Act, Rule 10b-5	Affirmed grant of summary judgment for Defendant and remanded for mandatory findings required by PSLRA; held that CEO's failure to disclose issuer's lack of viability and impending bankruptcy was immaterial in light of totality of available information about issuer's financial troubles.
R.W. Grand Lodge of F. & A.M. of Pa. v. Salomon Bros. All Cap Value Fund, 425 F. App'x 25 (2d Cir. June 9, 2011)	§§ 11 and 12(a)(2) of the Securities Act, 10(b) of the Exchange Act, Rule 10b-5 and Section 36(b) of the Investment Company Act of 1940	Affirmed in part and vacated and remanded in part; investors failed to establish connection between material misrepresentations or omissions and their economic losses for their

		securities fraud claims; however, investors' allegations regarding a transfer agent fee arrangement were sufficient to state a claim under Investment Company Act.
Local No. 38 Int'l Bd. of Elec. Workers Pension Fund v. Am. Express Co., 430 F. App'x 63 (2d Cir. Aug. 30, 2011)	§§ 10(b) and 20(a) of the Exchange Act	Affirmed dismissal for failure to establish scienter where Plaintiff failed to allege what contradictory facts Defendants may have been aware of when they made allegedly false statements.
Inter-Local Pension Fund GCC/IBT v. Gen. Elec. Co., No. 10-3477, 2011 WL 4348049 (2d Cir. Sept. 19, 2011)	§§ 10(b) of the Exchange Act, Rule 10b-5, and 20(a) of the Exchange Act	Affirmed dismissal for failure to raise strong inference of scienter; alleged pressure to generate greater returns for shareholders is not legally sufficient motive for fraud; Plaintiffs failed to allege any facts to suggest Defendants "benefited in a concrete and personal way from the purported fraud…"
GE Investors v. Gen. Elec. Co., No. 10-4284, 2011 WL 5867052 (2d Cir. Nov. 18, 2011)	§§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5	Affirmed dismissal; Plaintiffs failed to adequately plead loss causation.
SRM Global Fund Ltd. P'ship v. Countrywide Fin. Corp., No. 10-2919, 2011 WL 5867052 (2d Cir. Nov. 23, 2011)	§§ 10(b), 18(a), and 20(a) of the Exchange Act and Rule 10b-5	Affirmed dismissal on all claims. Optimistic statements in SEC filings about profitability and future liquidity were "non-actionable forward-looking statements."
New Orleans Emps. Ret. Sys. v. Celestica, Inc., No. 10-4702, 2011 WL 6823204	§§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5	Reversed dismissal of Plaintiffs' claims and remanded. Plaintiffs

(2d Cir. Dec. 29, 2011)		established an inference of scienter at least as strong as competing inferences through strong circumstantial evidence provided by three confidential witnesses who were described with "sufficient particularity;" defendants could not rely on the PSLRA's "safe harbor" for forward-looking statements, because they allegedly "did more than offer rosy predictions" and recklessly disregarded inventory issues; and alleged misstatements were material because they were relevant to investors' investment decisions.
Michael S. Rulle Family Dynasty Trust v. AGL Life Assurance Co., — F. App'x —, No. 10-4034, slip op. 2011 WL 3510285 (3d Cir. Aug. 11, 2011)	§ 10(b) and Rule 10b-5	Affirmed dismissal for failure to plead scienter.
City of Roseville Employees' Ret. Sys. v. Horizon Lines, Inc., 442 F. App'x 672 (3d Cir. Aug. 24, 2011)	§ 10(b) and Rule 10b-5	Affirmed dismissal; court held that the allegations of the complaint, standing alone or considered together, did not create the strong inference of scienter required by the PSLRA.
Walzer v. Muriel Siebert & Co., No. 10-4526, slip op. 2011 WL 4625704 (3d Cir. Oct. 6, 2011)	§ 10(b) and Rule 10b-5	Affirmed dismissal for failure to plead reliance.
Barnard v. Verizon Communications, Inc., No. 11-1318, slip. op., 2011 WL 5517326 (3d Cir. Nov. 14,	§ 10(b) and Rule 10b-5	Affirmed dismissal; court held that the allegations of the complaint did not establish that Defendants

2011).		made any misrepresentations, and that the complaint did not adequately allege reliance or economic loss.
Gerstner v. Sebig, LLC, 426 F. App'x 470 (8th Cir. July 5, 2011).	§ 77e(a) of the Exchange Act	Affirmed dismissal; court held that the unregistered-securities claim was untimely.
N.Y. State Teachers' Ret. Sys. v. Fremont General Corp., No. 10-55635, 2011 WL 5930459 (9th Cir. Nov. 29, 2011)	§ 10(b) of the Exchange Act and Rule 10b-5	Affirmed dismissal with prejudice for failure to raise strong inference of scienter.
Stoody-Broser v. Bank of Am., N.A., 442 F. App'x 247 (9th Cir. June 6, 2011)	Common law breach of fiduciary duty claim.	Affirmed dismissal but reversed to the extent dismissal should have been without prejudice; complaint essentially alleged fraudulent self-dealing that was precluded under SLUSA; remanded so that plaintiff could be given the opportunity to re-plead.
Kadel v. Flood, 427 F. App'x 778 (11th Cir. May 24, 2011)	§§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5	Affirmed dismissal; court held that the facts alleged in the complaint did not give rise to the strong inference of scienter required by the PSLRA.
Durgin v. Mon, 415 F. App'x 161 (11th Cir. Feb. 18, 2011)	§ 10(b) and Rule 10b-5	Affirmed dismissal; court held that the facts alleged in the complaint did not give rise to the strong inference of scienter required by the PSLRA.

TABLE OF AUTHORITIES

Cases