Portfolio Media, Inc. | 860 Broadway, 6th Floor | New York, NY 10003 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@portfoliomedia.com

Securities Litigation Developments In 2009

Law360, New York (February 23, 2010) -- In 2009, the United States Courts of Appeal issued more than 60 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.

These decisions — covering a wide array of issues that are often dispositive in high-stakes private securities litigation — point to the following trends.

First, as in 2008, the Circuit Courts continue to focus heavily on the pleading requirements for scienter. At least 20 appellate decisions addressed scienter, including nine decisions by the Second Circuit.

Under Tellabs Inc. v. Makor Issues & Rights Ltd., 551 U.S. 308, 127 S. Ct. 2499, 168 L. Ed. 2d 179 (June 21, 2007), the Circuit Courts are applying a “dual inquiry,” first examining whether, standing alone, any of the allegations are sufficient to create a strong influence of scienter.

If no one individual allegation is sufficient, the courts are then reviewing all of the allegations holistically to determine whether the allegations combine to create a strong inference. See Zucco Partners LLC v. Digimarc Corp., 552 F.3d 981 (9th Cir. Feb. 10, 2009); see also Avon Pension Fund v. GlaxoSmithKline PLC, No. 08-4363, 2009 WL 2591173 (2d Cir. Aug. 24, 2009).

The Circuit Court decisions largely favored defendants, with a number of appellate decisions holding that the scienter requirement was not met through application of the second-level, holistic inquiry.

As the Second Circuit put it in the unpublished decision Malin v. XL Capital Ltd., 312 Fed. Appx. 400, 402 (2d Cir. Feb. 26, 2009):

"[H]aving concluded that none of plaintiffs’ allegations showed even a weak inference of scienter, there is no logical way that the District Court could have determined that the combined effect of the allegations would have a strong inference of scienter."

See also ECA and Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co., 553 F.3d 187 (2d Cir. Jan. 21, 2009); Avon Pension Fund, 2009 WL 2591173 at *2 (“[P]laintiffs’ circumstantial pleadings, even when considered in the aggregate, do not permit an inference of defendants’ ‘conscious misbehavior or recklessness.’”); Zucco Partners, 552 F.3d at 1007 (“Although the allegations in this case are legion, even together they are not as cogent or compelling as a plausible alternative inference.”).

After Tellabs, the Second Circuit continues to hold that scienter may be established either by allegations of facts demonstrating that defendants had the motive and opportunity to commit fraud or by alleging strong

All Content Copyright 2003-2010, Portfolio Media, Inc.

circumstantial evidence of conscious misbehavior or recklessness. See ECA, 553 F.3d at 198-99; Condra v. Pxre Grp. Ltd., No. 09-1370, 2009 WL 4893719 (2d Cir. Dec. 21, 2009).

By contrast, the Third Circuit has concluded that, after Tellabs, "'motive and opportunity' may no longer serve as an independent route to scienter." Inst'l Investors Group v. Avaya Inc., 564 F.3d 242, 277 (3d Cir. Apr. 30, 2009).

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

The Circuit Courts appear reluctant to accept the claims that alleged insider stock transactions are evidence of scienter. Insider trading "is suspicious only when it is dramatically out of line with prior trading practices at times calculated to maximize the personal benefit from undisclosed insider information." Konkol, 2009 WL 4909110, at *6 (quoting Zucco Partners, 552 F.3d at 1005).

In addition, plaintiffs "must provide a 'meaningful trading history' for purposes of comparison to the stock sales within the class period." Id.

The Circuit Courts also remain cautious of the use of confidential witnesses to establish scienter.

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

Importantly, only four scienter decisions had aspects that were favorable to plaintiffs.[1]

On loss causation, the most defense-friendly decision was Fener v. Operating Engineers Construction Industry and Miscellaneous Pension Fund (Local 66), 579 F.3d 401 (5th Cir. Aug. 12, 2009), where the Fifth Circuit affirmed a denial of a motion for class certification, based on a failure adequately to establish loss causation.

The press release where the "truth" emerged was coupled with other negative news unrelated to the alleged fraud. The Fifth Circuit held that in such circumstances, "plaintiffs must prove that the fraudulent disclosure caused a significant amount of the decline." Id. at 409.

SLUSA continues to be a useful tool for defendants to attack state law claims. In Segal v. Fifth Third Bank NA, 581 F.3d 305 (6th Cir. Sept. 17, 2009), the Sixth Circuit made clear that SLUSA is triggered where the complaint alleges a misrepresentation or omission, and does not require that the misrepresentation be an element of plaintiff's state law cause of action:

"The Act does not ask whether the complaint makes 'material' or 'dependent' allegations of misrepresentation in connection with buying or selling securities. It asks whether the complaint includes these types of allegations, pure and simple." Id. at 311.

However, SLUSA is not unlimited in its preclusive scope. In In re Lord Abbett Mut. Funds Fee Litig., 553 F.3d 248 (3d Cir. Jan. 20, 2009), the Third Circuit rejected the district court's conclusion that SLUSA precludes an entire action, notwithstanding the fact that a part of the claim may not fall within SLUSA's scope.

All Content Copyright 2003-2010, Portfolio Media, Inc.

“Allowing those claims that do not fall within SLUSA’s preemptive scope to proceed, while dismissing those that do, is consistent with the goals of preventing abusive securities litigation while promoting national legal standards for nationally traded securities.” Id. at 257.

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

The 2008 decision in Morrison v. Nat'l Australia Bank Ltd., 547 F.3d 167 (2d Cir. Oct. 23, 2008), was one of several recent “Foreign Cubed” cases analyzing whether U.S. courts have jurisdiction over securities actions involving foreign plaintiffs suing foreign issuers concerning securities transactions in foreign countries.

The Second Circuit applied a “conduct test” and determined that the district court lacked subject matter jurisdiction. On Nov. 30, 2009, the Supreme Court granted certiorari, and oral argument is scheduled for March 29, 2010.

The biggest winners this year may have been accounting firms. The Circuit Courts rejected attempts to bring actions against accountants/auditors for the following reasons:

- the complaints failed to adequately plead scienter (see W. Va. Inv. Mgmt. Bd. v. Doral Fin. Corp., No. 08-3867, 2009 WL 2779119 (2d Cir. Sept. 3, 2009); Public Employees’ Retirement Assoc. of Colo. v. Deloitte & Touche LLP, 551 F.3d 305 (4th Cir. Jan. 5, 2009));

- the claims failed under Stoneridge (see In re Peregrine Systems Inc. Securities Litigation, 310 Fed. Appx. 149 (9th Cir. Nov. 6, 2009)); the plaintiffs failed adequately to allege loss causation (see McAdams v. McCord, 584 F.3d 1111 (8th Cir. Oct. 20, 2009)[2]);

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

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

In the coming year, cases arising out of the Madoff scandal and the financial crisis will likely begin to percolate through the Circuit Courts. They are bound to include vigorous arguments over loss causation and scienter.

Additional analysis on all of these developments is available in the Morgan Lewis 2009 Year in Review: Selected Federal Securities Litigation Developments.[3]

--By Brian A. Herman and Karen Pieslak Pohlmann, Morgan Lewis & Bockius LLP.

Brian Herman is a partner in the securities litigation and enforcement practice at Morgan Lewis & Bockius and Karen Pieslak Pohlmann is of counsel, based in the firm's New York and Philadelphia offices, respectively.

The opinions expressed are those of the authors and do not necessarily reflect the views of Portfolio Media, publisher of Law360.

All Content Copyright 2003-2010, Portfolio Media, Inc.

[1] See Inst'l Investors Group v. Avaya Inc., 564 F.3d 242 (3d Cir. Apr. 30, 2009); Brunig v. Clark, 560 F.3d 292 (5th Cir. Feb. 17, 2009); Huberman v. Tag-It Pacific Inc., 314 Fed. Appx. 59 (9th Cir. Feb. 11, 2009); Siracusano v. Matrixx Initiatives Inc., 585 F.3d 1167 (9th Cir. Oct. 28, 2009).

[2] Morgan Lewis served as counsel in the action McAdams v. McCord, with partner Christian Bartholomew representing Moore Stevens Frost.

[3] The Year in Review on which this summary is based was written by a team that also included Morgan Lewis partners John M. Vassos and Elizabeth Frohlich, as well as associates Gayle Gowen and Ruby Marenco, Michelle Ferreri, Mark Hitchcock, Sheila Jambekar, Kate McMahon and Robert Scannell and senior paralegal Jan McGovern. It is available at www.morganlewis.com/pubs/LIT_2009SECLITDvlpmntsWP_Jan2010.pdf

All Content Copyright 2003-2010, Portfolio Media, Inc.