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I. US SUPREME COURT

A. SUMMARY OF DEVELOPMENTS IN 2008

During 2008 the US Supreme Court handed down one important decision dealing with plaintiffs' claims in securities litigation cases. In *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, the Court reexamined the role of secondary actors, here third-party suppliers of the issuer, facing allegations of securities fraud and held that the issuer's investors could not state claims against the suppliers because the investors did not rely upon any deceptive statements or conduct of the suppliers. The Court also reaffirmed that Section 10(b) liability does not extend to aiders and abettors.

B. NOTEWORTHY CASES IN 2008

1. Scienter

a. *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761 (2008).

This class action suit against a cable company involved allegations that the company overpaid two of its suppliers for digital cable converters, and in return, the suppliers refunded the overpayment by purchasing advertising from the company. The Court began its analysis by reaffirming the importance of *Central Bank*, in which it held that private Section 10(b) liability does not extend to aiders and abettors because, among other things, plaintiffs do not rely upon those who merely provide assistance to the "primary" violator. Reliance, the Court opined, "is an essential element of the Section 10(b) private cause of action. It ensures that, for liability to arise, the requisite causal connection between a defendant's misrepresentation and a plaintiff's injury exists as a predicate for liability." Moreover, because the suppliers were under no duty to disclose, and their acts were not communicated to the public, plaintiff could not show any reliance on their actions except in an indirect chain which the Court found too "remote." Accounting firms, banks, and other secondary actors long have argued that *Central Bank* precluded liability where they neither issued the alleged misstatements nor undertook a duty to speak.

The Court also turned to plaintiff's theory of "scheme liability," *i.e.*, that investors rely "not only upon the public statements relating to a security but also upon the transactions those statements reflect." The Court did not accept this theory as there was no authority for this and it would create an implied cause of action that would "reach the entire marketplace in which the company did business." In so reasoning, the Court emphasized that restraint was appropriate in light of the Private Securities Litigation Reform Act (PSLRA), which requires private plaintiffs to meet "heightened pleading requirements" and demonstrate loss causation in any action arising under the Securities Exchange Act of 1934 (Exchange Act). In enacting the PSLRA, "Congress accepted the [Section] 10(b) private of cause as then defined but chose to extend it no further." Thus, the Court refused plaintiff's proposed construction of Section 10(b), because "it would revive in substance the implied cause of action against all aiders and abettors except those who committed no deceptive act in the process of facilitating the fraud; and . . . undermine Congress' determination that this class of defendants should be pursued by the [the Commission] and not by private litigants."

II. FIRST CIRCUIT

A. SUMMARY OF DEVELOPMENTS IN 2008

The 1st Circuit issued two important decisions in 2008, both regarding scienter. In *ACA Fin. Guar. Corp. v. Advest, Inc.*, the Circuit altered its threshold for establishing scienter in light of the US Supreme Court's decision in *Tellabs* by explaining that where there are "equally strong inferences for and against scienter, *Tellabs* now awards the draw to the plaintiff." Thus, in order to establish scienter in the 1st Circuit, a plaintiff must show that any inferences of scienter are "cogent and at least as compelling as available competing inferences of non-fraudulent conduct." In *New Jersey Carpenters' Pension & Annuity Funds v. Biogen Idec*, the 1st Circuit again ruled that plaintiffs must allege a strong inference of scienter in order to survive the pleadings stage. Because the plaintiffs failed to allege that defendant had specific, material, nonpublic information during the time period in question, their claim was dismissed.

B. NOTEWORTHY CASES IN 2008

1. Scienter

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

Defendant pharmaceutical company withdrew its drug from the market after learning that two patients taking the drug in clinical trails had developed progressive multifocal leukoencephalopathy and that one of these patients had died. Plaintiffs filed suit, alleging that during the class period defendant corporation, as well as various officers and directors of the company, made material misstatements and omissions of fact concerning the safety and marketability of the drug. The 1st Circuit affirmed the dismissal of plaintiffs' complaint based upon the fact that plaintiffs failed to allege a strong inference of scienter adequately. Plaintiffs failed to allege that the company or any individual defendant was aware of specific risks associated with the drug prior to the withdrawal of the drug from the market. Further, the individual defendants' class period trading activity was not indicative of scienter because plaintiffs failed to show that any defendant possessed material nonpublic information at the time of trading.

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

In affirming the district court's dismissal of the plaintiffs' claims under Section 10(b), the court explained that where there are "equally strong inferences for and against scienter, *Tellabs* now awards the draw to the plaintiff." However, the court still held that plaintiffs' allegations did not lead to an inference of scienter that was "cogent and at least as compelling as available competing inferences of non-fraudulent conduct" because plaintiffs did not adequately allege that defendants had sufficient information before them demonstrating that the statements were indeed false. The court took into consideration that the individual defendants worked for a non-profit corporation and would not be enriched personally by the proceeds of the bond sales at issue. With no underlying violation of the federal securities laws, the court also affirmed the district court's dismissal of the plaintiffs' claims under Section 20(a). Finally, the court held that the plaintiffs' claims against an underwriter were insufficiently pled because, "[w]here section 12(a)(2) claims are grounded in fraud, Rule 9(b) applies."

III. SECOND CIRCUIT

A. SUMMARY OF DEVELOPMENTS IN 2008

In 2008, the 2d Circuit issued two notable opinions regarding an issuer's liability vis-à-vis its officers and directors. In the first case, *Teamsters Local 445 Freight Division Pension Fund v. Dynex Capital Inc.*, the 2d Circuit noted that, in theory, a plaintiff may plead scienter adequately against a corporate defendant without alleging scienter against the individuals who participated in the fraud. However, plaintiffs nonetheless must raise a "strong inference" of scienter against the corporate defendant demonstrating that its statements to investors were misleading. In its opinion, the court provided only indirect guidance on the theory of "collective scienter." In *In re CBI Holding Co., Inc.*, the 2d Circuit once again drew a clear line between issuer and officer/director wrongdoing. There, the 2d Circuit held that the "adverse interest" exception to the general rule of imputation was nonetheless applicable, even after the company benefited from management's fraud, so long as management did not intend to do so.

The 2d Circuit also examined issues regarding class certification in 2008. In *In re Salomon Analyst Metromedia Litigation*, the court held that, for the purpose of showing class commonality on the issue of reliance, the fraud-on-the-market presumption applies to statements made by third-party market analysts as well as to statements made by securities issuers. The court also held that when relying on a fraud-on-the-market presumption to establish class commonality, defendants must be allowed an opportunity to rebut the presumption before class certification. In *Teamsters Local 445 Freight Div. Pension Fund v. Bombardier Inc.*, the 2d Circuit held that the appropriate standard of proof applicable to a Fed. R. Civ. P. 23 determination of predominance is a preponderance of the evidence standard.

In another important decision, the 2d Circuit visited the issue of constitutional standing on the part of investment advisors in securities actions. In *W.R. Huff Asset Management Co., LLC v. Deloitte & Touche LLP*, the 2d Circuit held that an investment advisor who held a power-of-attorney but not an assignment of a claim does not have constitutional standing to bring a claim on behalf of its clients. The court held that the minimum requirement for injury-in-fact is that the plaintiff have legal title to, or a property interest in, a claim. The court further noted that the investment advisor plaintiff did not qualify for one of the "prudential exceptions" to the injury-in-fact requirement.

The 2d Circuit also decided a noteworthy case involving foreign parties in 2008. In *Morrison v. National Australia Bank Ltd.*, the 2d Circuit held that it did not have subject matter jurisdiction where a foreign parent company was responsible for verification of financial information and communications to investors. Although a US subsidiary of the foreign company had conceived of and executed an allegedly fraudulent valuation model, the relevant conduct, that of the foreign parent company, had occurred outside the US, and no effect on US investors or capital markets had been alleged.

In 2008, the Southern District of New York decided noteworthy cases involving a few threshold issues. In *Pirelli Armstrong Tire Corp. Retiree Medical Benefits Trust v. Lundgren*, the district court, applying Delaware law, held that the plaintiff in a shareholder derivative suit failed to plead with particularity why the plaintiff had not made a pre-suit demand. The district court also held the plaintiff's claim that the board of directors would not act independently due to "prejudicial entanglements" did not excuse the plaintiff's failure to bring a pre-suit demand, as any such entanglements were minor in nature. In *New Jersey Carpenters Vacation Fund v. Harborview Mortg. Loan Trust*, the district court held that the removal provisions of the Class Action Fairness Act (CAFA) supersede the anti-removal provisions of Section 22(a) of the Securities Act of 1933 (Securities Act).

The Southern District of New York also provided some cautionary practice pointers in 2008 concerning the attorney work product doctrine and proper certification of pleadings in a securities case. The defendant in *In re Initial Pub. Offering Sec. Litig.* had disclosed attorney work product in the form of investigative memoranda to the US Attorney's Office and the Securities and Exchange Commission (Commission or SEC) pursuant to a confidentiality agreement. Despite the confidentiality agreement, the district court concluded that the defendant waived attorney work product protection by voluntarily providing its investigative memoranda and all of the information contained within them to the government. It further held that the doctrine of selective waiver did not apply under the circumstances in the case. In the other case, the district court granted the defendant's motion for Fed. R. Civ. P. 11 sanctions based on the plaintiff's counsel's inclusion of frivolous claims in the complaint. In *ATSI Comm'cns, Inc. v. Shaar Fund, Ltd.,* the court imposed sanctions on the attorneys who signed the offending complaint, but not the plaintiff itself, because the defendant had made no effort in its motion to suggest that the plaintiff was responsible for violating Rule 11 in alleging the claims.

B. NOTEWORTHY CASES IN 2008

1. Pleading Standards for Securities Fraud

a. *Hoffman v. UBS-AG*, No. 05-6817, 2008 WL 4684168 (S.D.N.Y. Oct. 22, 2008).

Defendants moved to dismiss a class action alleging violations of Section 12(a)(1) of the Securities Act and Section 10(b) of the Exchange Act, as well as Rule 10b-5. Defendant financial services company classified certain mutual fund families as Tier I. Plaintiff fund holders alleged the company failed to disclose: i) that classification as a Tier I fund was predicated on revenue sharing arrangements with the fund families (called "buying shelf space"); and ii) that the company's internal incentive structure rewarded the sale of Tier I funds. The Southern District of New York found that a duty to disclose could be imposed only by an express statutory requirement or when omission was material and would cause a reasonable investor to view the information as significantly altering the "total mix." Here, where total commissions were about 1% and plaintiffs didn't allege any amounts paid to individual brokers for selling Tier I funds, "nominal incentives to brokers and financial advisors to sell a particular group of funds are immaterial." The court further noted that SEC registration Form N-I, required for mutual funds, imposes no additional requirements, and that prospectuses require only disclosure of the fact that shelf-space agreements may be entered into, not the specifics of any such agreements. The court granted the motion to dismiss.

b. *In re Refco Capital Markets, Ltd. Brokerage Customer Securities Litigation*, No. 06-643, 2008 WL 4056159 (S.D.N.Y. Aug. 28, 2008).

Plaintiffs opened non-discretionary trading funds with defendant's brokerage firm, which required plaintiffs' advance approval of all transactions. Plaintiffs alleged that defendant sold their securities without authorization and improperly used the proceeds to make loans and fund the business of defendant's other affiliates. Plaintiffs alleged violations of Sections 10(b) and 20(a) of the Exchange Act. Defendant moved to dismiss the complaint for lack of standing and failure to prove deceptive conduct. The court held that plaintiffs' own allegations of the facts precluded them from having standing. Because plaintiffs claimed defendant appropriated their securities and then sold them, plaintiffs could no longer claim to be actual sellers of securities, as they had become too far removed from the transaction that could have given rise to a Section 10(b) claim. As such, the court held that plaintiffs lacked standing to sue under Section 10(b), and, likewise, under Section 20(a). The court nevertheless considered the question of whether defendant had engaged in deceptive conduct, and held it had not. Plaintiffs argued that the customer agreements it signed with defendant implied that defendant could use plaintiffs' securities only as collateral against a loan balance when plaintiffs engaged in margin or other financing. According to plaintiffs, defendant acted deceptively and without authorization by using plaintiffs' securities in excess of the value of plaintiffs' respective margin balances. However, the court held that the customer agreements that gave defendant a security interest in "all" of a margin customer's securities and authorized defendant to "loan, pledge, hypothecate or otherwise use or dispose of" those securities explicitly meant that defendant had not engaged in deceptive conduct by using plaintiffs' securities in excess of the margin balances. In addition, the court held that, because the customer accounts in question were non-discretionary, defendant owed no "general fiduciary duty" to plaintiffs and the complaints did not allege any specific instances of defendant's failure to execute customer-directed transaction.

c. *Teamsters Local 445 Freight Division Pension Fund v. Dynex Capital Inc.*, No. 06-2902, 2008 WL 2521676 (2d Cir. June 26, 2008).

Plaintiffs brought claims under Sections 10(b) and 20(a) of the Exchange Act against defendant company and its executives alleging that defendants had misrepresented certain facts relating to the performance of a bond collateral. The Southern District of New York had held that the plaintiffs failed to allege scienter as to the individual executive defendants, but had pleaded scienter adequately as to the corporate defendant. The 2^{d} Circuit noted that, in theory, a plaintiff may adequately plead scienter against a corporate defendant without alleging scienter against the individuals who participated in the fraud. In its ruling, the court provided some guidance suggesting that claims against a corporation may not be based on a theory of "collective scienter" – that is, the theory that corporate agents' knowledge, or one agent's knowledge and another's act, may be combined to allege a securities fraud claim against the corporation even where the knowledge or act of any single employee was insufficient in and of itself to support a claim. Ultimately, the 2^{d} Circuit reversed the Southern District of New York and found that in this case the plaintiffs did not raise a "strong inference" of scienter against the corporate defendant because plaintiff failed to allege the existence of specific information available to the corporate defendant that would demonstrate that any of its statements to investors were misleading.

2. Reliance

a. *In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474 (2d Cir. 2008).

Defendant financial companies and market analyst appealed an order certifying a class for claims under Section 10(b) of the Exchange Act and Rule 10b-5. Plaintiffs alleged that defendant market analyst issued fraudulently optimistic market reports on a company in order to obtain that company's business for his related investment banking division. The 2d Circuit found that for the purposes of showing class commonality on the issue of reliance, *Basic*'s fraud-on-the-market presumption could apply to misrepresentations by third-party market analysts as well as securities issuers. The legal standard for establishing the presumption remains the same in those cases. In addition, the court held that when relying on a fraud-on-the-market presumption in order to establish class commonality defendants must be given the opportunity to rebut the presumption before class certification. The 2d Circuit vacated and remanded in order to give defendant an opportunity to rebut the presumption.

3. Subject Matter Jurisdiction

a. *Morrison v. National Australia Bank Ltd.*, No. 07-0583, 2008 WL 4660742 (2d Cir. Oct. 23, 2008).

Plaintiffs appealed an order to dismiss their claims under Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 for lack of subject matter jurisdiction. Foreign plaintiffs brought the claim against a foreign securities issuer for issuing materially false statements about earnings which originated from a wholly-owned US subsidiary that allegedly had knowingly over-reported profits. The transactions in question also occurred outside of the US. On appeal the 2d Circuit explicitly chose to not categorically exclude such "foreign cubed" and similar cases from US jurisdiction. Instead the court reaffirmed its commitment to the current fact-specific analysis which asks "(1) whether the wrongful conduct occurred in the United States, and (2) whether the wrongful conduct had a substantial effect in the United States or upon United States citizens." The court determined that while the US subsidiary had conceived and executed the allegedly fraudulent valuation model, the foreign parent company was responsible for vetting its financial information and bore responsibility for communications to investors. Since the alleged violation was for making materially false statements, the "conduct" in question had occurred outside of the US, and no "effect" on US investors or capital markets had been alleged. The 2d Circuit therefore affirmed the order to dismiss for lack of jurisdiction.

4. Class Certification

a. *Teamsters Local 445 Freight Div. Pension Fund v. Bombardier Inc.*, No. 06-3794, 2008 WL 4554156 (2d Cir. Oct. 14, 2008).

Plaintiffs brought a securities class action against defendant corporation for failing to disclose its reckless underwriting practices in relation to certain debt instruments. The district court denied plaintiffs' motion for class certification. The plaintiffs appealed, claiming that the district court erred in applying a preponderance of the evidence standard to evidence proffered to establish predominance under Rule 23. In addition, the plaintiffs claimed that the district court made erroneous factual findings when applying the *Cammer* factors and in concluding that the fraud-on-the-market presumption did not apply. The 2d Circuit held that the appropriate standard of proof applicable to Rule 23 is the preponderance of the evidence standard. The 2d Circuit also found that the district court's factual findings were not clearly erroneous. Notably, the 2d Circuit concluded that, in this case, the district court did not err in applying the *Cammer* factors to determine whether the debt instruments traded in an efficient market. However, the court noted that other cases involving debt instruments may require an adjusted set of the *Cammer* factors or an entirely different analytical approach to determine the applicability of the fraud-on-the-market presumption.

5. Standing

a. *W.R. Huff Asset Management Co., LLC v. Deloitte & Touche LLP.*, No. 06-1664, 2008 WL 5076825 (2d Cir. Dec. 3, 2008).

Plaintiff, an investment advisor, filed suit against defendants, claiming that defendants had prepared, facilitated, or certified inaccurate or misleading disclosures of a company that subsequently filed for bankruptcy, leading to financial losses for plaintiff's clients. Plaintiff alleged that defendants violated Sections 11 and 12(a)(2) of the Securities Act and Sections 10(b) and 18 of the Exchange Act. The district court for the Southern District of New York denied defendants' motion to dismiss for lack of constitutional standing and defendants appealed. The 2d Circuit reversed and remanded, holding that a party who possesses a power-of attorney but not an assignment of a claim does not have constitutional standing to bring a claim on behalf of its clients. The court held that the minimum requirement for injury-in-fact is that the plaintiff have legal title to, or a property interest in, the claim. The court also held that the plaintiff did not qualify for one of the "prudential exceptions" to the injury-in-fact requirement for constitutional standing.

6. Other Issues

a. *Staehr v. Hartford Fin. Servs.*, No. 06-3877, 2008 WL 4899445 (2d Cir. Nov. 17, 2008).

Plaintiff appealed a Southern District of New York order to dismiss a class action, alleging violations of Sections 10(b) and 20(a) of the Exchange Act, as well as Rule 10b-5, because it was barred by the statute of limitations. Defendant insurance company claimed that the fraud alleged against it had been revealed to the market, and the statute of limitations had begun running, when lawsuits were brought against competing insurance companies for similar fraud and the mainstream media and industry publications revealed that such fraud was widespread in the industry. On appeal, the 2d Circuit held that, absent any specific information or allegations against defendant insurance company, general information of fraud in the industry did not constitute "storm warnings" adequate to put plaintiffs on constructive notice (*i.e.*, inquiry notice) and start the statute of limitations running. The 2d Circuit held that plaintiffs were not on inquiry notice prior to the statute of limitations and vacated and remanded the decision.

b. *Heller v. Goldin Restructuring Fund, LP*, No. 07-3704, 2008 WL 5328430 (S.D.N.Y. Dec. 22, 2008).

Plaintiff brought a common law claim for breach of fiduciary duty and a claim for violation of Section 10(b) of the Exchange Act against defendants, an investment fund and its principals. Plaintiff made a $1 million investment in the fund as part of defendants' stated goal of a $200 million capital commitment that would go towards a diversified portfolio. Plaintiff alleged that the fund was in fact undercapitalized and not truly diversified. Defendants moved to dismiss the claims. The court held that plaintiff's claim for breach of fiduciary duty was preempted by New York's Martin Act, which prohibits various fraudulent practices in the sale of securities. The New York Attorney General has the sole authority to enforce the Martin Act's provisions and thus litigants do not have a private right of action for these claims. Plaintiff argued that the breach of fiduciary claim was not preempted by the Martin Act because it related to events after plaintiff had already invested in the fund and thus was not "in connection with" the sale of securities. The court rejected this distinction and held that the breach of fiduciary duty claim arose generally from the alleged securities fraud, which sufficed to preempt the claim under the Martin Act. The court therefore granted defendants' motion to dismiss the claim for breach of fiduciary duty but after a separate analysis rejected the motion to dismiss the Section 10(b) claim.

c. *Plymouth County Retirement Ass'n v. Schroede*r, 576 F. Supp. 2d 360 (E.D.N.Y. 2008).

Plaintiff brought a shareholder derivative action against defendants, alleging involvement in a scheme to backdate stock options issued to certain directors and executives. The defendant corporation moved to dismiss the complaint for lack of standing but this motion ultimately was denied. The court held that plaintiff had standing because it alleged sufficiently that bringing a demand would have been futile by alleging that a majority of the board personally benefited from the alleged backdating and providing dates of specific grants and stock prices to support its claims. The individual defendants named in the action also moved to dismiss for failure to state a claim, and this motion was granted with ability for plaintiffs to replead. The court held that plaintiff failed to adequately plead reliance. The court explained that claims relating to the backdating itself were time-barred (and could not be the basis of reliance) because the alleged backdating took place more than five years before the complaint was filed. Plaintiff also alleged reliance on false and misleading statements made by defendants, but the court held those claims were too speculative as pled.

d. *Pirelli Armstrong Tire Corp. Retiree Medical Benefits Trust v. Lundgren*, No. 07-5862, 2008 WL 4414687 (S.D.N.Y. Sept. 30, 2008).

Plaintiff brought a shareholder derivative action on behalf of company, asserting violations of Section 10(b) of the Exchange Act and Rule 10b-5. Plaintiff alleged that defendants, members of company's board of directors and audit committee, made misleading statements regarding the success of a recent company merger and that the alleged misstatements artificially inflated the value of the company's stock. Plaintiff also alleged that the board damaged the company by approving a $4 billion stock buyback during a period of alleged share price inflation. Plaintiff failed to bring a pre-suit demand to the board, alleging that such a demand would be futile, as the various defendants would refuse a demand due to lack of independent judgment and personal self-interest. In applying Delaware law, the court rejected plaintiff's argument that the directors would not act independently due to "prejudicial entanglements," holding that any such entanglements were minor in nature and no reason to excuse a demand. The court also held plaintiff failed to provide evidence that any defendants had adverse non-public knowledge that they either failed to disclose to investors or acted upon to sell their own personal shares, which would have given rise to liability in the event of a suit. Finally, the court held plaintiff failed to allege that the stock buyback was anything other than the result of an exercise of business judgment and plaintiff therefore was not reasonable in its failure to bring a demand on this point. Because the court did not excuse plaintiff's failure to make a pre-suit demand, the court granted the motion to dismiss the complaint without prejudice. The court granted plaintiff leave to amend its complaint in order to allege with particularity why pre-suit demand was not made.

e. *New Jersey Carpenters Vacation Fund v. Harborview Mortg. Loan Trust 2006-4*, No. 08-5093, 2008 WL 4369840 (S.D.N.Y. Sept. 24, 2008).

Plaintiffs filed a class action lawsuit in New York State Supreme Court for violations of the Securities Act in connection with issuance of bonds, alleging misrepresentations in the prospectuses and registration statements of these bonds. Defendants, the issuer of the bonds, removed the case to federal court in the Southern District of New York, relying on the removal provisions of CAFA. Plaintiffs moved to remand the case back to state court, relying on the anti-removal provision of Section 22(a) of the Securities Act. The court held that CAFA overrides Section 22(a), noting that the legislative intent of CAFA was to include within its reach all securities class actions, subject to certain exceptions found with CAFA. The court noted that the legislative history reflects that CAFA's exceptions are to be interpreted narrowly. The court analyzed the CAFA exception exempting from removal a case that "relates to the rights, duties . . . obligations relating to or created by or pursuant to any security," and explained that this exception does not broadly include any security, but rather disputes over the meaning of the terms of a security. Because the claims in this case did not implicate the terms or meaning of the bonds, the case did not fall within a CAFA exception. Therefore, the court held that removal was proper and denied plaintiffs' motion to remand.

f. *In re Salomon Analyst Metromedia Litigation*, No. 06-3225, 2008 WL 4426412 (2d Cir. Sept. 30, 2008).

Plaintiffs brought a class action alleging securities fraud against defendant research analysts for making materially misleading statements. The district court certified a class of plaintiffs who were allegedly harmed by these statements. In so doing the district court presumed predominance under the fraud-on-the-market doctrine, in which reliance is presumed once material statements become public. Defendants argued that this presumption does not apply to statements by research analysts, and alternatively that in such cases plaintiffs must make a heightened showing that the statements had an actual causal effect on the price of the shares. Defendants filed an interlocutory appeal of the grant of class certification, arguing that predominance had not yet been shown. The court held that the fraud-on-the-market presumption applies to statements made by analysts as well as issuers themselves, ruling that the *Basic* test requires only that a defendant make a public material misrepresentation about stock, and who the defendant is does not matter. The court also held that plaintiffs did not need to make a heightened showing that the alleged misrepresentations actually had an effect on the stock price. The court explained that there was no basis to conclude that a different standard should apply when a misrepresentation is made by a third party analyst compared to when it is made by an issuer. Finally, the court vacated the grant of class certification and remanded to the district court, holding that the district court was mistaken in not allowing defendants to present their full rebuttal arguments at class certification to the fraud-on-the-market presumption.

g. *In re Alstom SA Securities Litigation*, No. 03-6595, 2008 WL 4053361 (S.D.N.Y. Aug. 26, 2008).

Following a discussion of how plaintiffs satisfied the elements of Fed. R. Civ. P. 23 to merit typical class certification in this securities litigation, the court faced an unusual decision about how to treat certain foreign putative class members. In particular, the court had to decide whether to certify foreign plaintiffs from France, England, the Netherlands, and Canada as part of the class. The defendants maintained that all foreign plaintiffs should be excluded because courts in those countries would not find the judgment of a US court preclusive, and a class action therefore would not be superior to other available methods of adjudication, as required under Rule 23(b)(3). But the court determined that certification would be appropriate if the plaintiffs could demonstrate that the foreign courts would probably recognize as preclusive any judgment rendered in the United States (the Probability Standard). The court applied this Probability Standard in lieu of plaintiffs' requested, more lenient "Possibility Standard." In applying the Probability Standard analysis, the court took at detailed look at the jurisprudence of the four foreign countries and determined that the French courts would not recognize a United States judgment in this class action as preclusive, and that the French plaintiffs should therefore not be certified as part of the class. The court determined that the courts in England, the Netherlands, and Canada would recognize the United States judgment and held that the plaintiffs from those countries should be certified.

h. *In re CBI Holding Co., Inc.*, No. 04-5972, 2008 WL 2405702 (2d Cir. June 16, 2008).

The 2d Circuit reversed the holding of the Southern District of New York, and found that the "adverse interest" exception to the general rule of imputation was applicable even when evidence existed that the company "actually benefited" from management's fraud. In particular, the panel held that such evidence was not sufficient to trump the fact that management did not "intend" to benefit the company.

i. *CSX Corp. v. Children's Investment Fund Mgmt. (UK) LLP*, No. 08-2764 (S.D.N.Y. June 11, 2008).

Plaintiff alleged that defendant hedge funds violated Section 13(d) of the Exchange Act by failing to timely file a Schedule 13D and that the Schedule 13D was false and misleading. The two defendant hedge funds intended to run a proxy contest to capture seats on plaintiff's board. One defendant increased its economic position primarily through Total Return Swaps

(TRS). Because it never acquired more than 5% of plaintiff's outstanding shares, it did not file a Schedule 13D, even though the TRSs gave it economic exposure in excess of that threshold. The other defendant hedge fund directly acquired stock, in an amount less than 5% of the outstanding shares. Together, the defendants held more than 5% of plaintiff's stock, but did not initially file a Schedule 13D, maintaining they were not a group until the time of their filing. The court made two major rulings in this case. First, the court held that the TRSs, while not ownership of actual voting shares, constituted beneficial ownership, and thus, the first defendant hedge fund violated Section 13(d) by not filing a Schedule 13D when its TRS positions first exceeded 5% of plaintiff's outstanding shares. The court found evidence showing that the defendant intended to avoid the reporting requirements of Section 13(d) by amassing TRS positions as opposed to traditional acquisition of voting shares. Second, the court considered the concerted action between the defendants and held that the two defendants were acting as a group long before they filed their Schedule 13D and thus had failed to file it timely. However, the court held that while the defendants violated the timing requirement, the Schedule 13D itself was not false and misleading, as "the existence of the group, not the date of its formation," was the material information disclosed in the Schedule 13D, and that fact was accurate.

j. *In re Initial Pub. Offering Sec. Litig.*, 249 F.R.D. 457 (S.D.N.Y. 2008).

Defendant underwriter disclosed attorney work product in the form of internal investigative memoranda to the United States Attorney's Office for the Southern District of New York and to the Commission pursuant to a confidentiality agreement. Plaintiffs moved to compel, arguing that the documents were not attorney work product and that defendants had waived the doctrine. The court held that the documents in question were attorney work product because drafting investigative memoranda in preparation for reporting back to a government agency even with respect to a potential litigation can be considered "in preparation of litigation" and thus falls under the definition of attorney work product. However, the court also found that the doctrine of selective waiver did not apply in this instance, and granted the plaintiffs' motion to compel. The court noted that the attorney work product privilege had been waived when the investigative memoranda were voluntarily disclosed and that the confidentiality agreements signed between the parties did not preserve the privilege. Although there are special circumstances where selective waiver could apply, the court did not find those circumstances in the instant matter.

k. *ATSI Comm'cns, Inc. v. Shaar Fund, Ltd.*, No. 02-8726, 2008 WL 850473 (S.D.N.Y. Mar. 27, 2008).

Defendant moved for an order for sanctions on plaintiff for asserting frivolous claims, pursuant to the PSLRA and Fed. R. Civ. P. 11. Plaintiff had brought a claim for market manipulation based on alleged misrepresentations at the time of a transaction and subsequent short selling. The claim stated that because most trades in plaintiff's stock were made through defendant, a market maker, defendant knew or should have known about the sellers' manipulation and was therefore complicit. Plaintiff presented no evidence that defendant had actual knowledge. The court granted the motion for sanctions, holding that defendant had no reason to know that sellers were engaged in a scheme to depress the price of common shares to improve the conversion ratio of convertible preferred shares they held. Even if defendant had known, executing the transactions would not have made it complicit. The court imposed sanctions on the attorneys who signed the offending complaint, but not the client, because defendant had made no effort in its motion to suggest that plaintiff itself was responsible for violating Rule 11.

IV. THIRD CIRCUIT

A. SUMMARY OF DEVELOPMENTS IN 2008

Courts in the 3d Circuit handed down several noteworthy decisions in 2008. Many of the 3d Circuit's important decisions came from the Eastern District of Pennsylvania, and were focused on pleading requirements for securities fraud and insider trading. For instance, in *Hialeah Employees' Retirement System & Laborers Pension Trust Funds for N. Cal. v. Toll Bros., Inc.*, the Eastern District of Pennsylvania ruled that "mixed character" statements that touch upon both future projects and existing conditions do not fall under the safe harbor for forward looking statements. In *Clark v. Comcast Corp.*, the court found that plaintiffs alleging a Rule 10b-5 violation had failed to adequately support their allegations regarding undisclosed material facts, and therefore granted the defendants' motion to dismiss for failure to plead fraud with particularity. The Eastern District of Pennsylvania also ruled that scienter and loss causation were insufficiently alleged in *Majer v. Sonex Research, Inc.*, a Section 10(b) case in which the court found that the defendants' alleged misstatements were speculative in nature and that the company had already disclosed to investors that it was having financial problems. Similarly, in *Pennmont Sec. v. Wallace*, the court granted summary judgment to defendants because plaintiffs could not show reliance where plaintiffs' stock was sold before the alleged misstatements and where plaintiff failed to present evidence of causation and scienter.

Two other areas of focus for the 3d Circuit in 2008 were loss causation and the statute of limitations. In *Roll v. Singh*, the District of New Jersey dismissed plaintiff's Section 10(b) claim for failure to plead loss causation, finding the fact that plaintiff would not have entered into the transaction but for defendant's misrepresentations to be insufficient. Rather, the court ruled that plaintiffs must additionally show an economic loss caused by the misrepresentations. In *Joyce v. Bobcat Oil & Gas, Inc.*, the Middle District of Pennsylvania found the plaintiffs insufficiently alleged loss causation and scienter, and also dismissed their Section 12 claims on statute of limitation grounds. The 3d Circuit, in *In re Merck*, found that plaintiffs' complaint against defendant pharmaceutical company was not time-barred because the public warning letter issued to defendant by the FDA and articles questioning the safety of the drug were not sufficient to put plaintiffs on inquiry notice of their potential claim. In *Pathfinder Management, Inc. v. Mayne Pharma PTY*, the District of New Jersey found that defendant failed to show that plaintiff was on inquiry notice of its claim, while in *Travis v. Vanguard Group, Inc.* the Eastern District of Pennsylvania held that plaintiff was on inquiry notice due to declines in the account balance at levels which a reasonable investor would notice.

In *LaSala v. Bordier et Cie*, the 3d Circuit reversed the dismissal of a complaint because it found that the Securities Litigation Uniform Standards Act of 1998 (SLUSA) did not preempt an action brought on behalf of the company based on violations of the statutory or common law of other nations. Instead, the court noted that SLUSA was more limited and would have preempted class actions brought pursuant to the laws of other "states," as defined by the states circumscribed within the US.

B. NOTEWORTHY CASES IN 2008

1. SLUSA

a. *LaSala v. Bordier et Cie,* 2008 WL 638266 (3d. Cir. Mar. 11, 2008).

Directors and officers of a Delaware company allegedly executed a "pump-and-dump" scheme prior to the company's filing for bankruptcy. Bankruptcy trustees filed a suit on behalf of the company against two Swiss banks alleging (1) the banks violated Delaware law by aiding and abetting a breach of a fiduciary duty and (2) the banks violated Swiss money laundering laws. The banks filed a motion to dismiss, arguing that the trustees' lawsuit was preempted by SLUSA. The district court granted the motion to dismiss, but the 3^d Circuit reversed. First, the 3^d Circuit held that the trust was not bringing its claims on behalf of the 6,000 purchasers of the company stock; rather, it was bringing the claims on behalf of the company, a single entity. Accordingly, the lawsuit was not a "class action" and was not prohibited by SLUSA. Second, the 3^d Circuit held SLUSA did not preempt Swiss money laundering laws because SLUSA only preempted class actions based upon the statutory or common law of any "State," and Switzerland was not a "State." In reinstating the plaintiffs' complaint, the 3^d Circuit rejected the banks' argument that permitting these claims to go forward would create a loophole for abusive securities litigation.

2. Pleading Requirements for Securities Fraud

a. *Hialeah Employees' Retirement System & Laborers Pension Trust Funds for N. Cal. v. Toll Bros., Inc.*, No. 07-1513, 2008 WL 4058690 (E.D. Pa. Aug. 29, 2008).

Plaintiffs brought a securities fraud class action against a corporation-builder of luxury homes and nine individual defendants. Plaintiffs alleged that defendants made material misrepresentations and omissions in public statements about the company's present financial conditions, the demand for existing luxury homes, and the company's difficulty in opening new home communities. Defendants filed a motion to dismiss for failure to state a claim, arguing that the statements cited by plaintiffs were accompanied by sufficient cautionary statements and were therefore immaterial as a matter of law. The district court denied defendants' motion to dismiss. The court found that plaintiffs had pled specific facts about defendants' failure to disclose materially adverse facts concerning existing conditions at the company and in future projections about luxury home sales. The court also found that plaintiffs had pled specific facts in support of their argument that any cautionary statements made by defendants were insufficient to render the misrepresentation immaterial as a matter of law. Finally, the court determined that the forward-looking statements were ineligible for protection under the "bespeaks caution" doctrine or the safe harbor provision of the PSLRA because the "mixed character" statements related both to future projections and to existing conditions of the company.

b. *Clark v. Comcast Corp.*, No. 08-52, 2008 WL 3930560 (E.D. Pa. Aug. 25, 2008).

Plaintiffs filed a Rule 10b-5 claim against defendant cable corporation and its officers, alleging that defendants had defrauded investors by artificially inflating the value of common stock by making false and misleading statements regarding the company's financial outlook. The court found that plaintiffs had failed to support any of their allegations regarding undisclosed material facts, and therefore granted the defendants' motion to dismiss for failure to plead fraud with particularity.

c. *Majer v. Sonex Research, Inc.* 2008 WL 282257 (E.D. Pa. Jan. 31, 2008).

Plaintiffs' amended complaint was dismissed by the Eastern District of Pennsylvania for failure to state a claim upon which relief could be granted. Plaintiffs' complaint had alleged that the company had made materially false and misleading statements in violation of Section 10(b) of the Exchange Act. The court held the statements about which the plaintiffs complained were speculative in nature and thus immaterial. Additionally, the court held that plaintiffs had failed to prove with sufficient fact or detail that the defendants had acted with scienter with regard to any portion of the transaction. Finally, due to defendants' specific warning regarding the financial difficulties that the company was having, the court held that plaintiffs did not plead facts sufficient to establish that plaintiffs' loss was caused by statements made by the defendants.

3. Pleading Requirements for Insider Trading Allegations

a. *Pennmont Sec. v. Wallace*, No. 06-1646, 2008 WL 834379 (E.D. Pa. Mar. 26, 2008).

Plaintiff alleged it sold shares to an insider, who knew of the corporation's strategic business discussions. Plaintiff conceded that the alleged tippee did not receive material nonpublic information from the alleged tipper. Plaintiff's Rule 10b-5 claim failed because the alleged misstatements occurred after plaintiff sold its shares, negating reliance, and plaintiff also presented no evidence of causation and scienter. As a result, the court granted defendants' motion for summary judgment on all counts.

4. Loss Causation

a. *Roll v. Singh*, No. 07-04136, 2008 WL 3413863 (D.N.J. June 26, 2008).

Plaintiff filed a Rule 10b-5 claim against defendant alleging that defendant had fraudulently induced plaintiff into selling plaintiff's 20% interest in defendant's company back to the company. Defendant moved to dismiss the claim, and the court granted defendants' motion with regard to all federal securities law claims. First, although the court found that most portions of the complaint had been pled with sufficient particularly, plaintiff had failed to plead loss causation adequately. The court noted that a demonstration that plaintiff would not have entered into the transaction but for defendant's misrepresentations is not sufficient; plaintiff must additionally show an economic loss caused by the misrepresentations. Second, the court found that the claim was barred by the two-year statute of limitations because facts alleged in the complaint showed that plaintiff was aware of a general fraudulent scheme more than two years prior to filing suit.

b. *Joyce v. Bobcat Oil & Gas, Inc.*, No. 07-1421, 2008 WL 919724 (M.D. Pa. Apr. 3, 2008).

Plaintiff alleged that he purchased oil and gas securities from defendants that were fraudulently represented, thereby violating Rule 10b-5, and Sections 12(a)(1), 12(a)(2), and 17 of the Securities Act. The court held that plaintiff did not sufficiently allege loss causation. Plaintiff alleged that he entered into the agreements because of defendants' misrepresentations and omissions, which constituted an allegation of transaction causation (reliance), not loss causation. Plaintiff's allegations that the purchased interests were worth less than the money paid at the time of the purchase were merely another way to assert that the purchase price was artificially inflated, a concept held to be insufficient to allege loss causation under *Dura*. Furthermore, plaintiff failed to plead specific facts to support an allegation of scienter. Plaintiff's Section 12(a)(1) claim was time barred because the securities were purchased more than one year before the suit began, and the court found that the discovery rule and equitable tolling did not apply to such a claim. Plaintiff's Section 12(a)(2) claim was time barred, in part, because the limitations period barred actions on securities sold three years or more before the suit began. However, the court did not require the plaintiff to affirmatively plead in his complaint that his action complied with the applicable statute of limitations (this was an affirmative defense to be raised by defendants), and thus, the court did not dismiss all of plaintiff's Section 12(a)(2) claims. Finally, the court dismissed plaintiff's Section 17 claim, finding there was no private right of action.

5. Statute of Limitations

a. *In re Merck*, Nos. 07-2431, 07-2432, 2008 WL 4138476 (3d Cir. Sept. 9, 2008).

Plaintiffs brought a class action against defendant pharmaceutical company for securities violations in connection with defendant's alleged concealment of safety information regarding a pharmaceutical drug. The district court granted defendants' motion to dismiss on statute of limitations grounds, and plaintiffs appealed to the 3^{d} Circuit. The 3^{d} Circuit first held that the standard for inquiry notice of a securities claim was whether the plaintiffs had sufficient information of "possible"—as opposed to "probable"—wrongdoing to excite storm warnings of culpable activity. Next, the court found that an FDA's public warning letter issued to defendant, coupled with several published articles questioning the safety of the drug, did not put plaintiffs on inquiry notice. Accordingly, the 3^{d} Circuit found plaintiffs' claims were not barred by the statute of limitations and reversed the district court's order dismissing the complaint.

b. *Pathfinder Management, Inc. v. Mayne Pharma PTY*, No. 06-2204, 2008 WL 3192563 (D.N.J. Aug. 5, 2008).

Plaintiff filed a Rule 10b-5 claim against defendants alleging that defendants had fraudulently misstated the value of two subsidiary companies in connection with plaintiff's purchase of the subsidiaries from defendants. Defendants moved to dismiss the claim, and the court granted defendants' motion in part and denied in part. First, the court found that the claim was not barred by the two-year statute of limitations because defendants had failed to show evidence of storm warnings that would put plaintiff on inquiry notice prior to the statute of limitations period. Second, the court found that portions of the complaint had not been pled with sufficient particularity. The court found that plaintiff had not adequately pled all misstatements or omissions; more specifically, the court found that plaintiff had not explained why certain statements were false or misleading. Furthermore, the court found that plaintiff had not adequately pled scienter with regard to all misrepresentations. The court noted that establishing a motive and opportunity to commit fraud is not sufficient to demonstrate scienter. Finally, the court held that plaintiff had adequately pled reasonable reliance, because as a matter of law the court could not conclude that an integrated non-reliance clause in the purchase agreement rendered plaintiff's reliance unreasonable. The court granted plaintiff leave to amend its complaint to cure the pleading deficiencies.

c. *Travis v. Vanguard Group, Inc.*, No. 07-3484, 2008 WL 2073372 (E.D. Pa. May 15, 2008).

Plaintiff filed a complaint against defendant investment firm in August 2007 alleging, among other claims, violations of Section 10(b) of the Exchange Act. The court held that plaintiff's action was time-barred, and dismissed the complaint. Plaintiff argued that she did not have notice of the purported fraudulent activity until December 2005, when, for the first time, she reviewed one of the monthly account statements that she had been receiving since opening her account. Rejecting plaintiff's contention that her prior reliance on her then-husband to oversee all family financial matters indicated that she could not have discovered the purported violation at an earlier time, the court applied a reasonable-investor standard and imputed to plaintiff knowledge that she would have gleaned had she routinely reviewed her account statements. Thus, plaintiff was on inquiry notice of the possible fraudulent activity in early 2004, when precipitous declines in plaintiff's account balance were first reflected in her account statements. The two-year limitations period expired in early 2006, rendering plaintiff's August 2007 complaint time-barred.

6. Other Issues

a. *Levy v. Sterling Holding Co.*, No. 07-1849, 2008 WL 4415135 (3d Cir. Oct. 1, 2008).

Defendant corporations held significant amounts of preferred stock in a semiconductor company. The company undertook a reclassification that converted all preferred stock into common stock to pave the way for a successful IPO. Less than six months later, defendants sold their common stock at a profit during the company's secondary offering. Plaintiff filed a shareholder derivative action claiming that the sale of stock by defendants violated Section 16(b) of the Exchange Act, requiring defendants to disgorge profits from the stock sale. The district court initially granted defendants' motion to dismiss, but that ruling was reversed by the 3d Circuit, which held that neither Rule 16b-3 nor Rule 16b-7 exempted defendants from Section 16(b) liability. In direct response to that holding, the Commission amended Rules 16b-3 and 16b-7. Thereafter, applying the amended rules, the district court granted defendants' motion for summary judgment. Plaintiff appealed, claiming that (1) the court was bound to the earlier judicial decision; (2) the amendments exceeded the Commission's authority; and (3) the amendments had an impermissible retroactive effect. The 3d Circuit, reaching only the applicability of new Rule 16b-3, affirmed the grant of summary judgment to defendants. The court held that its earlier decision was not based on the rules' unambiguous language, so the prior decision was not binding. Moreover, the amendments, which were intended to explain an ambiguity in the existing rules, were supported by reasonable explanations by the Commission, and therefore constituted a permissible exercise of agency authority. Finally, the amendment to Rule 16b-3 was merely a clarification of the existing rule; it neither created rights or obligations nor altered existing rights or obligations. Thus, the new Rule 16b-3 did not generate retroactivity concerns and, as such, did not have an impermissible retroactive effect.

b. *Urban v. Comcast Corp.*, No. 08-773, 2008 WL 4739519 (E.D. Pa. Oct. 28, 2008).

The plaintiff filed a class action lawsuit alleging violations of numerous fiduciary duties by the defendant corporation and other individual defendants in conjunction with the defendants' control and monitoring of a retirement-investment plan that was subject to ERISA. During the relevant period, the investment plan, which qualified as an eligible individual account plan, allowed the individual defendants to determine whether to offer to plan participants an option to invest in stock of the defendant corporation. The lawsuit by participants in the plan who had chosen to invest in company stock, as well as plan beneficiaries, followed on the heels of a negative revision of earlier, more positive corporate growth projections made by executives of the defendant corporation. The revision allegedly caused the defendant corporation's stock to fall. After the complaint was filed, the defendants moved to dismiss. The court held that because certain individuals had complete discretion to determine whether to offer an investment option to plan participants that included company stock, the defendants were not entitled to the "presumption of prudence" normally enjoyed by fiduciaries. Further, while the court dismissed the plaintiff's claim alleging violations of the duty to disclose, the court did not extend the reasoning underlying that holding to dismiss other claims for breach of fiduciary duties. The plaintiff sufficiently pleaded loss causation with respect to those additional claims.

c. *In re FleetBoston Fin. Corp. Sec. Litig.*, 253 F.R.D. 315 (D.N.J. 2008).

Pursuant to a merger between Banks A and B, shareholders of Bank A acquired 1.02 shares of Bank B's stock for each share of Bank A they owned. When a deepening recession in Argentina caused Bank B to incur significant losses in its Argentine investments, a class action was instituted in 2002 on behalf of former shareholders of Bank A, alleging that the Merger Registration Statement was false and misleading. Following the death of the class representative, plaintiffs moved for substitution of the class representative. Defendants opposed the motion and moved for class decertification on the ground that the class' counsel failed to demonstrate numerosity of the class. The district court dismissed both motions. First, the court found that the class counsel's proposal for new class representative was unsuitable due to his criminal conviction and pattern of exercising poor judgment. The court granted the class' counsel leave to propose a group of candidates, from whom the court would choose the new class representative. Second, the court found that the class' counsel had failed to demonstrate numerosity because the expert declaration it relied on was unfounded and based on "pure conjecture." The court also concluded that putative class members were required, pursuant to Section 11, to trace the stocks of Bank B they sold during the class period to the specific shares that were exchanged as a result of the merger. However, the court did not decertify the class, instead giving the class' counsel six months to demonstrate that the class was sufficiently numerous. Finally, the court severed the claim of the lead plaintiff from the class action.

V. FOURTH CIRCUIT

A. SUMMARY OF DEVELOPMENTS IN 2008

There were three notable securities decisions in the 4th Circuit in 2008. In *Victor Stanley Pipe, Inc v. Creative Pipe, Inc.*, the District of Maryland ruled that production of attorney-client privileged documents irreparably waives the privilege where no privilege search protocol was in place, and the court was not asked to approve a "clawback" agreement. In *Cozzarelli v. Inspire Pharms. Inc.*, the Middle District of North Carolina dismissed plaintiff's securities fraud complaint when it failed to create an inference of scienter more compelling than the countervailing inference that defendant's actions had been non-fraudulent. Finally, in *City of Ann Arbor Employees' Ret. Sys. v. ICG, Inc.*, the Southern District of West Virginia dismissed plaintiff's complaint under the statute of limitations, holding that since the allegedly fraudulent information contained in defendant's filings had been exposed, and the resultant decrease in share value had occurred, more than a year prior to the filing of the claim, the plaintiff's complaint was time-barred.

B. NOTEWORTHY CASES IN 2008

1. Waiver of Privilege

a. *Victor Stanley Pipe, Inc v. Creative Pipe, Inc.*, No. 06-2662, 2008 WL 2221841 (D. Md. May 28, 2008).

The court held that the defendants' production of attorney-client privileged documents waived the privilege where the defendants did not agree on a privilege search protocol with the plaintiff, failed to seek the court's approval of a "clawback" agreement, and was unable to prove that the search protocol used to identify privileged documents was reasonable.

2. Pleading Requirements for Securities Fraud

a. *Cozzarelli v. Inspire Pharms., Inc.*, No. 07-1851, 2008 WL 5194311 (4th Cir. Dec. 12, 2008).

Plaintiffs alleged that the defendants made false statements during the clinical trial of the defendant company's drug. The district court for the Middle District of North Carolina dismissed the plaintiffs' complaint with prejudice for failure to plead facts giving rise to a strong inference of scienter and failure to allege falsity with the particularity required by Fed. R. Civ. P. 9(b), and the plaintiffs appealed. The 4th Circuit affirmed, holding that (1) no strong inference of scienter existed because the inference that the defendants acted with a non-fraudulent intent to protect their competitive advantage was more powerful and compelling than the inference that the defendants acted with an intent to deceive; and (2) the plaintiffs failed to allege falsity with the particularity required by Rule 9(b).

3. Statute of Limitations

a. *City of Ann Arbor Employees' Ret. Sys. v. ICG, Inc.*, No. 07-0226, 2008 WL 4509356 (S.D. W. Va. Sept. 30, 2008).

On April 5, 2007, plaintiffs filed an action against the defendant corporation alleging violations of Sections 11, 12(a)(2), and 15 of the Securities Act. Plaintiffs alleged that, despite the company's glowing statements in its registration statements and prospectuses regarding its commitment to mine safety, the company was not operating its mines in a safe manner. On the defendants' motions to dismiss, the court held that the plaintiffs' claims were barred by the one-year statute of limitations because (1) a highly publicized explosion occurred at the company's mine in Sago on January 2, 2006; (2) an avalanche of media reports detailing the company's poor safety were published between January 3 and 24, 2006; (3) the company disclosed on February 1, 2006 that all of its mines and shipping facilities would begin each shift with a special in-depth safety review, which suggested that its safety record was not as good as previously disclosed; and (4) the company's declining stock prices were evident by March 1, 2006 when the price of its stock had fallen by 23%. The court rejected the plaintiffs' argument that the company's reassuring press releases, which were designed to counteract the company's negative publicity, offset the avalanche of media accounts regarding its poor safety record, stating that equitable estoppel applies only where the defendant misrepresented to the plaintiff his legal rights or used settlement negotiations to induce delay. Accordingly, the court granted the defendants' motions to dismiss.

VI. FIFTH CIRCUIT

A. SUMMARY OF DEVELOPMENTS IN 2008

Courts in the 5th Circuit handed down several significant securities decisions in 2008, most notably touching upon pleading requirements. In *Indiana Elec. Workers' Pension Trust Fund IBEW v. Shaw Group*, the 5th Circuit ruled that allegations based on (a) defendants' failure to use generally accepted accounting principles (GAAP) in preparing financial statements, (b) the argument that defendants must have known of misstatements because of their positions, (c) vague statements made by defendants which were susceptible to various interpretations, or (d) uncorroborated statements from unidentified confidential sources are all insufficient bases to establish scienter. The court also held that insider stock sales are insufficient evidence of scienter where there are plausible explanations for the sales other than fraud. In *Lone Star Fund V (U.S.), L.P. v. Barclays Bank PLC*, the Northern District of Texas held that a prospectus stating that loans granted "were or would be made to be" not delinquent could not support a pleading of material misrepresentation unless the loans were delinquent and the grantor refused to rectify them. In addition, several district courts dismissed claims brought under Section 14(a) for pleading deficiencies. Claims alleged based merely on the officers' and directors' positions with a company and day-to-day roles were rejected by the Eastern District of Texas in *Pedroli ex rel. Microtune, Inc. v. Bartek*, and, in *Hulliung v. Bolen*, the Northern District of Texas dismissed claims based on allegations of stock option backdating that occurred years prior to the issuance of the challenged proxy statements.

Courts within the 5th Circuit also rendered two decisions regarding the element of loss causation. In *Catogas v. Cyberonics, Inc.*, the 5th Circuit noted that although a sharp decline in share price resulted from a press release mentioning defendant's internal investigation into alleged backdating and warning of possible delistment from NASDAQ, loss causation was not demonstrated because this information had been revealed in previous releases without market reaction. In *In re Dell Inc. Securities Litigation*, the Western District of Texas determined that plaintiffs need only plead sufficient loss causation to satisfy the "short and plain statement" test of Fed. R. Civ. P. 8(a)(2), rather than the more stringent requirements of Fed. R. Civ. P. 9(b).

In considering jurisdictional issues, the 5th Circuit affirmed in *In re Enron Corp. Securities, Derivative & ERISA Litigation* that state securities claims removed to federal district court along with federal bankruptcy claims based on "related to" jurisdiction still could be decided by that federal court even after the Chapter 11 plan was confirmed. Further, in *Allen v. Byrne*, the Northern District of Texas relied on the fact that the Exchange Act provides for nationwide service of process to conclude that the court has personal jurisdiction over a defendant with regard to plaintiff's federal claims and deny defendant's motion to dismiss.

Touching upon rules of discovery, in *In re Stone Energy Corp.*, the Western District of Texas ruled that selective waiver does not apply to the work product doctrine and therefore documents previously given to the Commission cannot be withheld during discovery. Finally, the 5th Circuit affirmed in *Motient Corp. v. Dondero*, that there is no private right of action for money damages under Section 13(d), and, in *Mark Newby, et al. v. Enron Corporation, et al.*, the Southern District of Texas held that lead plaintiffs in a class action may be reimbursed only for actual expenses and cannot be given incentive awards, and non-class counsel may be reimbursed by the court only for non-duplicative services provided prior to appointment of a lead plaintiff.

B. NOTEWORTHY CASES IN 2008

1. Pleading Requirements

a. *Indiana Elec. Workers' Pension Trust Fund IBEW v. Shaw Group, Inc.*, 537 F.3d 527 (5th Cir. 2008).

Plaintiffs filed a securities fraud class action against the defendant corporation and several of its executive officers alleging violations of Section 10(b), Section 20(a) of the Exchange Act and Rule 10b-5. Defendants filed a motion to dismiss these claims for failure to satisfy the heightened pleading requirements for fraud cases under PSLRA, and the Eastern District of Louisiana denied the motion. On interlocutory appeal, the 5th Circuit considered whether plaintiffs' claims satisfied the heightened standard for scienter, as outlined by the US Supreme Court in *Tellabs*. The 5th Circuit reversed the district court's decision, remanding the case with instructions to dismiss plaintiffs' complaint, based on its determination that plaintiffs failed to adequately support the inference of scienter. The court ruled that allegations based on (a) the fact that defendants failed to use GAAP in preparing financial statements, (b) the argument that defendants must have known of alleged misstatements because of their positions within the company, (c) vague statements made by the defendants which were susceptible to various interpretations, or (d) uncorroborated statements from unidentified confidential sources are all insufficient bases to establish scienter. Further, the court held that insider stock sales are insufficient to satisfy the scienter requirement where the defendant officers made the sales in question just days after the expiration of a "lock up agreement" which previously had prevented them from trading the stock. Given this context, there is a plausible explanation for the sale other than fraud. Finally, the court rejected plaintiffs' argument that scienter should be attributed to officers who sign the certifications required by the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley) whenever those certifications are found to include inaccuracies.

b. *Lone Star Fund V(U.S.), L.P. v. Barclays Bank PLC*, No. 08-0261, 2008 WL 4449508 (N.D. Tex. Sept. 30, 2008).

Plaintiff asserted a negligent misrepresentation claim based on the fact that several of the mortgage loans underlying the securities it purchased from defendant were delinquent as of the initial offering date. The court, after denying plaintiff's motion to remand, considered whether plaintiff appropriately pleaded a material misrepresentation. The prospectus filed by defendant had in fact represented that the loans were or would be made to be not delinquent. The court found this representation to be sufficiently limited in scope such that no misrepresentation was present so long as the loans either were not delinquent, or any discovered delinquency was cured by the defendant. Since plaintiff did not claim that defendant failed to cure the delinquent loans at issue, no misrepresentation existed. Plaintiff argued further that the language in the prospectus granting defendant an ability to cure delinquent loans violated federal securities laws which prevent an investor from waiving fraud claims. The court rejected this argument, however, finding no such waiver; rather plaintiff was being held to the terms as stated in the prospectus.

c. *Pedroli ex rel. Microtune, Inc. v. Bartek*, No. 07-43, 2008 WL 901203 (E.D. Tex. Mar. 31, 2008).

The court dismissed claims under Section 14(a) of the Exchange Act based on insufficiency of pleading where plaintiffs only alleged claims based on the directors' positions and their access to meetings and documents and other employees as this is "nothing more than an example of group pleadings disfavored in this Circuit." Similarly, the court dismissed the Section 10(b) claims with and without prejudice, depending on the specific defendant, as plaintiffs' scienter allegations were limited to listing the various officers' and directors' positions and roles. Plaintiffs failed to plead demand futility, and the court also held that Section 304 of Sarbanes-Oxley does not create a private right of action and dismissed those claims in accordance with the position Congress adopted in drafting Sarbanes-Oxley.

d. *Hulliung v. Bolen*, 548 F. Supp. 2d 336 (N.D. Tex. 2008).

Plaintiffs failed to state a claim under Section 14(a) as allegations, as best characterized, that the proxy statements misled defendant shareholders into electing directors who took allegedly improper actions are insufficient to state a proxy fraud claim. In particular, the proxies cannot be an essential link to any harm caused by stock option backdating that occurred years prior to the proxies' issuance.

2. Jurisdiction

a. *In re Enron Corp. Securities, Derivative & ERISA Litigation*, 535 F.3d 325 (5th Cir. 2008).

The 5th Circuit affirmed a dismissal of securities fraud after it held that the removal of state securities claims based on their relation to a federal bankruptcy case continued past the resolution of the bankruptcy and the claims were subject to SLUSA preemption as "covered class actions." Plaintiffs had challenged whether the district court had bankruptcy jurisdiction over their cases at the time it dismissed the plaintiffs' claims and argued their claims were not subject to SLUSA. But the 5th Circuit agreed that state securities actions removed on basis of the federal district court's "related to" jurisdiction in a Chapter 11 case commenced by a bankrupt entity did not cease to be proceedings over which court could exercise "related to" jurisdiction simply because the Chapter 11 plan was confirmed post-removal and bankruptcy estate ceased to exist. In addition, the 5th Circuit, under the analysis in *WorldCom*, agreed that plaintiffs could not avoid SLUSA preemption by filing several state court actions across the state each with forty-nine or fewer plaintiffs to avoid being considered "covered class actions."

b. *Allen v. Byrne*, No. 07-0601, 2008 WL 763066 (N.D. Tex. Mar. 24, 2008).

In a decision bringing the Texas courts in line with the majority of other courts to have decided this issue, the court denied defendant's motion to dismiss after concluding that the court has personal jurisdiction over the defendant with regard to plaintiff's federal claims by virtue of the Exchange Act's nationwide service of process provision. Similarly, this court has pendant personal jurisdiction over the defendant with respect to plaintiff's state claims because they arise out of a common nucleus of operative fact as the federal claims.

3. Private Right of Action Under Section 13(d)

a. *Motient Corp. v. Dondero*, 529 F.3d 532 (5th Cir. 2008).

In an issue of first impression for the 5th Circuit, the court affirmed the district court's decision that there is no private right of action for money damages under Section 13(d). The remainder of this case involved a claim for injunctive relief, but the court held dismissal of the claims for injunctive relief was proper because they became moot during the appeal through the unilateral action of the party that prevailed in the lower court, particularly, the divestiture by a defendant of its holdings in the plaintiff.

4. Loss Causation

a. *In re Dell Inc. Securities Litigation*, No. 06-726, 2008 WL 5068856 (W.D. Tex. Oct. 7, 2008).

Plaintiffs filed a securities fraud class action against defendants, alleging that the corporation, certain named officers, and the corporation's outside auditor made false and misleading statements amounting to violations of Sections 10(b) and 20(a) of the Exchange Act, as well as Rule 10b-5. The court granted defendants' motions to dismiss, finding that plaintiffs' complaint failed to plead scienter and loss causation with the requisite particularity. In considering plaintiffs' burden to plead loss causation, the court noted that district courts are divided over whether to apply the "short and plain statement" test of Fed. R. Civ. P. 8(a)(2) or the more stringent requirements of Fed. R. Civ. P. 9(b). Finding that the 5th Circuit has considered this issue only in the dicta of a single case (*Plotkin v. IP Axess Inc.*, 407 F.3d 690, 696 (5th Cir. 2005)), the court determined that only the less stringent Rule 8(a)(2) test need be satisfied. Despite this ruling, plaintiffs were unable to satisfy the burden and the motion to dismiss was granted.

b. *Catogas v. Cyberonics, Inc.*, No. 07-20787, 2008 WL 4158923 (5th Cir. Sept. 8, 2008).

Plaintiffs filed a securities fraud class action against defendant, alleging that its directors and officers engaged in backdating and re-pricing of executive stock options without reporting this compensation in the company's financial statements. The Southern District of Texas dismissed the complaint for failure to state a claim. In affirming this decision, the 5th Circuit noted that the plaintiffs' claim could not succeed unless the class successfully showed that the market reacted negatively to a corrective disclosure made by the defendant. The plaintiffs claimed that an August 1, 2006 press release that mentioned defendant's internal investigation into the alleged backdating and re-pricing and warned that the resultant delay in filing of the FY06 10-K could result in delisting from NASDAQ served as the corrective disclosure, and that this information was clearly the cause of the 25% decline in share price that occurred on that day. The court, however, noted that prior analyst reports and 8-Ks had already revealed information about the alleged backdating and re-pricing, and had also warned about the delay in filing of the FY06 10-K, and there was no negative market reaction to these corrective disclosures. Since the August 1, 2006 press release did not contain new information, it could not accurately be considered a corrective disclosure. Rather, it was the earlier reports that represented corrective disclosure, and since there was no market reaction to those reports the requisite causation could not be shown.

5. Other Issues

a. *In re Stone Energy Corp.*, No. 05-2088, 2008 WL 3836657 (W.D. La. Aug. 14, 2008).

Plaintiffs filed a securities fraud class action against defendant corporation, alleging violations of Section 10(b) and 20(a) of the Exchange Act. During discovery, a dispute arose as to whether attorney work product documents given to the Commission by defendant were entitled to privileged status. After establishing that the documents qualified as attorney work product, the court considered whether release of those documents to the Commission served as a waiver of the privilege. Although the Commission never engaged in formal proceedings against defendant, the court ruled that the relationship between defendant and the Commission was adversarial because the work product documents were provided in response to a Commission request and not as part of a routine regulatory matter. But defendant's confidentiality agreement with the Commission was insufficient to protect the privilege because it granted the Commission discretion to disclose the documents to third parties if required by law or discharge of commission duties. As a result, the court held that selective waiver does not apply to the work product doctrine and, therefore, the privilege was lost.

b. *Mark Newby, et al. v. Enron Corp., et al.*, No. 01-3624, 2008 WL 2714176 (S.D. Tex. July 10, 2008).

Plaintiffs filed a motion for approval of several reimbursement requests, specifically seeking the court's guidance regarding reimbursement of costs for lead plaintiffs in class actions and outside, non-class counsel. After considering the approaches of other district courts outside of the 5th Circuit, the court held that lead plaintiffs only may receive reimbursement of actual expenses incurred through class representation, and may not be granted "incentive awards" to encourage "high quality monitoring" of class actions. In addition, the court explored the interaction between the common fund doctrine and PSLRA as it relates to reimbursement for outside, non-class counsel. The court concluded that non-class counsel may be reimbursed by the court under the common fund doctrine only for non-duplicative services provided to the class before the lead plaintiff in the case was appointed. Once a lead plaintiff has been appointed, that lead plaintiff becomes solely responsible for determining which lawyers will represent the class, and how those lawyers will be paid.

VII. SIXTH CIRCUIT

A. SUMMARY OF DEVELOPMENTS IN 2008

In 2008, courts in the 6th Circuit issued several decisions relating to the pleading requirements for securities fraud allegations. Defendants were successful in defeating such allegations in *Zaluski v. United Am. Healthcare Corp.*, *Grillo v. Tempur-Pedic Int'l, Inc.*, and *In re Nat'l Century Fin. Enters., Inc. Fin. Inv. Litig,.* (*Nat'l Century I*). Additionally, in a separate opinion issued in *In re Nat'l Century Fin. Enters., Inc. Fin. Inv. Litig.* (*Nat'l Century II*), the Southern District of Ohio granted a motion to dismiss Section 10(b) claims against the defendant credit rating agencies, but refused to dismiss the plaintiffs' claim under Ohio's blue sky laws, which was held not to have been preempted by federal law.

At the summary judgment stage, the Northern District of Ohio, in *Nolfi v. Ohio Ky. Oil Corp.*, rejected plaintiffs' claims under Section 12(a)(1) of the Securities Act and held that they were time barred. In reaching this conclusion, the court determined that the statute of limitations for Section 12(a)(1) claims are not subject to equitable tolling.

Finally, in *Berlin Fin. Ltd. v. MPW Indus. Servs. Group, Inc.*, the Southern District of Ohio considered whether appraisal rights under Ohio state law affected the plaintiffs' ability to bring a Section 14(a) action. The court held that the plaintiffs could bring their Section 14(a) claim despite the existence of potential appraisal under state law, but further concluded that the plaintiffs had failed to plead Section 14(a)'s elements with the degree of particularly required by the PSLRA.

B. NOTEWORTHY CASES IN 2008

1. Pleading Standards for Securities Fraud

a. *Zaluski v. United American Healthcare Corp.*, 527 F.3d 564 (6th Cir. 2008).

The 6th Circuit affirmed a grant of dismissal of plaintiffs' Section 10(b) claims. The district court correctly concluded that plaintiffs failed to allege any material misstatements as none of the alleged press releases were found to be actionable, the failure to follow GAAP is insufficient to state a claim, and the statements made in its SEC filings were "loosely optimistic statements" that are not the type that are relied on by investors.

b. *Grillo v. Tempur-Pedic Intern., Inc.*, 553 F. Supp. 2d 809 (E.D. Ky. 2008).

The court granted defendants' motion to dismiss with prejudice. Plaintiffs brought Section 10(b) and 20(a) claims based on an alleged fraudulent scheme whereby defendants made false and misleading statements regarding the defendant company's earnings, growth, and retail business strength. The court held the allegations of scienter to be insufficient. The various allegations were based on anonymous claims of GAAP violations, trading by defendants that was not unusual or suspicious, and internal reports that plaintiffs did not provide or cite to for any of their specific details.

c. *In re National Century Financial Enterprises, Inc. Financial Investment Litig.*, 580 F. Supp. 2d 630 (S.D. Ohio 2008).

Investors brought actions under Section 10(b) of the Exchange Act, Rule 10b-5 and the state blue sky laws alleging that statements by two credit rating agencies induced them to invest in notes issued by defendant corporation, which went bankrupt amid allegations of financial fraud. The court granted in part and denied in part defendant rating agencies' motion to dismiss. The court granted the motion to dismiss as to the Section 10(b) claim, but denied it as to the negligent misrepresentation claim and the claim under Ohio's blue sky laws. The court held that (1) plaintiff did not rely on reports published by credit rating agency in deciding whether to purchase notes issued by defendant corporation and thus those reports could not form the basis of Section 10(b), fraud, or negligent misrepresentation claims; (2) plaintiff failed to plead scienter with sufficient particularity; (3) plaintiff did state a negligent misrepresentation claim; (4) the issuance of bond ratings brought the defendants within the ambit of Ohio's blue sky laws, which were not preempted by federal law; and (5) issues of fact remained as to whether the rating agency knew of the alleged fraud at the defendant corporation.

d. *In re National Century Financial Enterprises, Inc. Financial Investment Litigation*, 553 F. Supp. 2d 902 (S.D. Ohio 2008).

The court granted individual defendants' motions to dismiss for failure to state a Section 10(b) claim because plaintiffs do not attribute any of the alleged false statements to the moving defendants and do not allege that the moving defendants engaged in deceptive conduct on which plaintiffs relied in purchasing stock in one of the defendant companies. The complaints identify seventeen misleading press releases and six misleading SEC filings issued by one of the defendant companies, but none of the moving defendants are alleged to have authored, reviewed, approved, assisted with, or given direction to any of the releases or filings.

2. Statute of Limitations

a. *Nolfi v. Ohio Kentucky Oil Corp.*, No. 06-620, 2008 WL 2091146 (N.D. Ohio May 12, 2008).

The court granted summary judgment for defendants on a claim under Section 12(a)(1) of the Securities Act as plaintiffs could not show that the claim was brought within one year of the alleged violation. Section 13 provides the statute of limitations for Section 12(a)(1) claims as needing to be both within one year of the alleged violation and within three years of the time the security was first bona fide offered to the public. The court agreed that the plain language of Section 13 demonstrates Congress' intent that Section 12(a)(1) claims not be subject to equitable tolling. The court denied summary judgment as to the Section 10(b) claims because material issues of fact remained as to the scienter and reliance allegations.

3. Section 14(a)

a. *Berlin Financial Ltd. v. MPW Indus. Services Group, Inc.*, No. 07-442, 2008 WL 161309 (S.D. Ohio Jan. 15, 2008).

The court held that where a minority shareholder bases an action under Section 14(a) of the Exchange Act on an omission or misrepresentation of material fact in a proxy statement and does not seek only to attack the fairness of the offer price, a Section 14(a) cause of action exists despite the existence of potential appraisal under state law. Nevertheless, the court dismissed the Section 14(a) claim here as plaintiffs failed to plead the necessary elements with the particularity required under the PSLRA. Plaintiffs failed to support their allegation that the company was in possession of a higher valuation amount.

VIII. SEVENTH CIRCUIT

A. SUMMARY OF DEVELOPMENTS IN 2008

In 2008, 7th Circuit courts issued several decisions discussing the pleading requirements in securities fraud cases. The decisions clarified the impact of the Supreme Court's *Tellabs* opinion on the requisite standard for pleading scienter. In *Silverman v. Motorola, Inc.*, the Northern District of Illinois held allegations of scienter sufficient under *Tellabs*, reasoning that it was "inconceivable" that high-level executives were unaware of production problems in an important new product line in the division that accounted for the largest share of the company's sales. In *In re Northfield Labs., Inc. Sec. Litig.*, the court similarly inferred scienter because the two co-founders of a one-product company likely would know details about an important study on the one product. In *Lewis v. Straka*, the Eastern District of Wisconsin observed that scienter could not be assumed solely from a defendant's position in a company, but could be inferred from the access the defendant had to information regarding the financial health of the company and the volume of alleged misstatements and magnitude of the company's undisclosed financial problems. The Eastern District of Wisconsin again addressed the *Tellabs* scienter requirement in *Stark Trading v. Falconbridge Ltd.*, where the plaintiff alleged that defendants fraudulently misstated the valuation of a target company in a tender offer. The district court declined to infer scienter under *Tellabs* largely because the valuation that the company provided was made by an investment bank under the supervision of an independent Special Committee and because the defendants issued a press release reaffirming the challenged valuation even after the plaintiff questioned the valuation's validity. Finally, in *Makor Issues & Rights, Ltd. v. Tellabs Inc.*, the 7th Circuit applied on remand the Supreme Court's articulation of the scienter standard, and held that the standard was met because it was exceedingly unlikely that false statements about the company's flagship product and its successor were attributable to careless mistake.

Courts in the 7th Circuit also addressed loss causation in some detail in 2008. In *Calnin v. Hilliard*, the Eastern District of Wisconsin denied a defendant's summary judgment motion because he had not shown, as a matter of undisputed fact, that the plaintiff's economic loss did not result from the alleged fraudulent conduct. The court declined to require plaintiff to introduce expert testimony to establish loss causation because a reasonable fact finder could conclude from the evidence that its losses were caused by the subject of the fraud. In *Maxwell v. KPMG LLP*, the 7th Circuit held that a plaintiff's claims against an accounting firm failed where the firm's alleged negligence was not a "necessary condition" for the plaintiff's injury. The necessary conditions for the injury in the case, the court explained, were the company's ill-fated business decision to acquire another company and a collapsing market, both of which were unrelated to what the auditor was hired to do. Thus, while the claim may have alleged "but for" causation, that the injury would not have occurred but for the firm's negligence, it did not establish "legal causation" because the kind of loss that occurred was not the kind that the accounting firm's duties were intended to prevent.

B. NOTEWORTHY CASES IN 2008

1. Scienter

a. *Silverman v. Motorola, Inc.*, No. 07-4507, 2008 WL 4360648 (N.D. Ill. Sept. 23, 2008).

Plaintiffs alleged that defendants violated Section 10(b) of the Exchange Act through omissions and misstatements regarding the status of defendant corporation's phone technology The court held that repeated statements that the technology was "on track" and that there were no supply constraints were material. The court held that scienter was sufficiently alleged for all but two defendants as it was inconceivable to the court that high-level executives would not have known of production problems with a key new product in the most important business unit. According to the court defendants must have known of the production problems, which, unlike accounting deficiencies, could not have "flown under the radar." The court found loss causation adequately alleged as the market could infer from a poor earnings announcement for a specific business unit, that lack of sales from a highly anticipated product in that unit was the cause of all or some of resulting stock price decline.

b. *In re Northfield Labs., Inc. Sec. Litig.*, No. 06-1493, 2008 WL 4372743 (N.D. Ill. Sept. 23, 2008).

The court denied defendants' motion to dismiss largely rejecting their arguments that plaintiffs had failed to plead material misrepresentations, loss causation, and scienter. Notably, the court found the requisite strong inference of scienter from plaintiffs' allegations regarding the individual defendants' positions in a one-product company and the motive to save the company's sole source of revenue.

c. *ABN AMRO, Inc. v. Capital Int'l Ltd.*, No. 04-3123, 2008 WL 4286984 (N.D. Ill. Sept. 16, 2008).

Plaintiff bank alleged that defendant banks and investment companies had committed securities fraud by failing to inform plaintiff of an absolute restriction on certain notes. The district court rejected defendants' dismissal arguments. The district court found that under *Tellabs*, plaintiff had shown a "strong inference" of scienter, noting that while the defendants' opposing inference (plaintiff's lack of due diligence) was plausible, it was no more plausible or perhaps even "a bit" less plausible than inferences that could be drawn in plaintiff's favor (*e.g.*, defendants had withheld or not created key document until after closing).

d. *Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 513 F.3d 702 (7th Cir. 2008).

On remand from the US Supreme Court, the 7th Circuit applied the "cogent and compelling" standard and held that plaintiffs had established a "strong inference" of scienter under the PSLRA. The 7th Circuit found that it was "highly unlikely" that the alleged false statements about the company's "flagship product" and that product's "heralded successor" were the result of merely careless mistakes. The court also found it "exceedingly unlikely" that the CEO was unaware of the problems that those two major products were experiencing.

Additionally, the court distinguished recent circuit precedent holding that confidential source allegations must be steeply discounted, stating that the absence of proper names did not invalidate the drawing of a strong inference from confidential informants' assertions.

e. *Lewis v. Straka*, 535 F. Supp. 2d 926 (E.D. Wis. 2008).

The court applied the *Tellabs* standard for scienter to claims under Section 10(b) and 20(a) of the Exchange Act. Plaintiffs alleged that the CEO of a company misrepresented the financial health of the company where he knew that his disclosures were inaccurate due to his professional position. The court held that although scienter cannot be assumed solely from the defendant's position in a company, considering the access to accurate information that the CEO had concerning the company's loan portfolio, along with the volume of the misstatements and the amount of undisclosed problem loans, the allegations showed a strong inference of scienter that was at least as compelling as any plausible opposing inference. As a result, the court denied defendants' motion to dismiss the Section 10(b) and 20(a) claims, holding that plaintiffs adequately plead scienter.

f. *Roth v. Aon Corp.*, No. 04-6835, 2008 WL 656069 (N.D. Ill. Mar. 7, 2008).

The court denied defendants' motion for reconsideration filed in light of the publication of the US Supreme Court's *Tellabs* decision. Among other reasons, the court found that the dismissal should stand as plaintiffs sufficiently met the threshold of alleging a strong inference of scienter under *Tellabs*.

g. *CP St. Louis Casino, LLC v. Casino Queen, Inc.*, No. 07-447, 2008 WL 450463 (S.D. Ill. Feb. 15, 2008).

Plaintiff's amended complaint created a cogent and compelling inference of scienter because, contrary to the original complaint, it specified the timing of defendant's allegedly false representations and the alleged motive to withhold the information in question. Further, the amended complaint adequately alleged loss causation by claiming that defendant's false statements had caused plaintiff to undervalue the risk involved in the merger transaction at issue, prompting plaintiff to seek a closing extension that it would not otherwise have sought had it known the true level of risk.

h. *Stark Trading v. Faclonbridge Ltd.*, No. 05-1167, 2008 WL 153542 (E.D. Wis. Jan. 14, 2008).

The court applied the *Tellabs*' "cogent and compelling" standard to claims asserted under Sections 10(b), 14(e), and 9(a) of the Exchange Act. Ultimately, it granted defendants' motion to dismiss these claims, holding that plaintiffs failed to sufficiently plead scienter. Plaintiffs alleged that defendants fraudulently misstated their valuation in a tender offer. Plaintiffs brought this error to the defendants' attention but the defendants responded by issuing a press release reaffirming their valuation. The court, applying the *Tellabs* standard, held that defendants' actions did not strongly infer scienter. The fact that the valuation was made by an investment bank under the supervision of an independent Special Committee weighed towards non-culpability for alleged errors in the valuation. Further, the fact that defendants reaffirmed the valuation in a press release after being informed of errors by plaintiff, where they were not required to issue such a press release, supports the inference that defendants actually believed the valuation to be accurate. The district court further held that plaintiffs failed to plead reliance where they believed a fraud might be occurring but ultimately chose to accept the proposed tender offer. The court also dismissed plaintiffs' claim under Section 11 of the Securities Act for failure to plead damages, as their share values increased between the date of purchase and the date the lawsuit was filed. Thus, there were no damages.

i. *Last Atlantis Capital LLC v. AGS Specialist Partners*, 533 F. Supp. 2d 828 (N.D. Ill. 2008).

Defendants filed a motion requesting reconsideration of a prior order allowing plaintiff companies to file an amended consolidated complaint. The court held that plaintiffs had established a strong showing of scienter with regard to eleven defendants that were previously sanctioned by AMEX. The court based its determination on the presence of certain specific regulatory findings and a Commission report. The claims brought against the remaining defendants were dismissed on the grounds that plaintiffs had not established a strong inference of scienter based upon an absence of specific regulatory findings and the lack of support for declarations from plaintiffs' confidential sources.

2. Standards for Compliance with PSLRA Pleadings Requirements

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

The 7th Circuit affirmed the dismissal of a securities fraud action, holding that fraudulent newspaper circulation figures at the company's subsidiary did not give rise to a strong inference that executives at the company acted with scienter. Further, the court ruled that plaintiffs failed to link the statements and actions of employees at the subsidiary to the misstatements at issue in the case. The court also addressed plaintiffs' claim regarding the alleged "mastermind" of the underlying scheme, noting that, based on *Stoneridge*'s recent rejection of scheme liability, his indirect actions were too remote to establish primary liability for securities fraud. Finally, the court rejected plaintiffs' *respondeat superior* and other allegations against the company and concluded that the district court did not abuse its discretion when discarding these claims without leave to amend.

b. *Lieblang v. Crown Media Holdings, Inc.*, No. 07 C 4250, 2008 WL 320470 (N.D. Ill. Jan. 31, 2008).

The court denied defendants' motion to dismiss claims under Section 10(b) of the Exchange Act as well as state law claims. This case involved an announced auction sale, during which a large investor purchased shares while repeatedly being reassured by the CFO of the company whose shares he was purchasing that the auction was proceeding and that specific companies were participating in the auction. The auction was eventually terminated and the CFO admitted to plaintiff that that there were no companies interested in the sale. The plaintiff brought claims under Section 10(b) and state law claims, alleging that defendants caused him to suffer loss as a result of purchasing stock in reliance on material false statements about prospective purchasers in the auction process. In denying defendants' motion to dismiss, the court held that plaintiff met the pleading requirements under Section 10(b). The plaintiff adequately alleged false statements of material fact where the CFO's statements were not mere puffery or optimistic rhetoric, but rather stated that a specific outcome would occur. Further, the plaintiff's reference to contradictory statements in an article and in an analyst report met the false statement requirement. The plaintiff established a strong inference of scienter where he provided information from two sources that directly contradicted defendants' claims, especially where one of the sources occurred on the same day as statements by the CFO. The plaintiff adequately pleaded reliance, because although there were written warnings from the company that a sale might not take place, the warnings did nothing to contradict reliance-inducing statements from the CFO about specific companies participating in the auction. Loss causation was properly pleaded, although plaintiff did concede that he had no standing for losses on stock purchased prior to the announced auction. Finally, the court used the same rationale as above when denying defendants' motion to dismiss state law claims under the Illinois Consumer Fraud Act and common-law fraud.

3. Loss Causation

a. *Maxwell v. KPMG LLP*, 520 F.3d 713 (7th Cir. 2008).

Plaintiff, a Chapter 7 bankruptcy trustee, brought suit against an accounting firm, claiming that the company he represented had been harmed due to the negligence of the accounting firm. The 7th Circuit held that the accounting firm's alleged breach of the duty of care was not the cause of plaintiff's financial losses. The court analogized to the securities law distinction between "transaction causation" and "loss causation." The court found that the necessary conditions of the company's financial losses were an ill-fated business decision and market events, not the accounting firm's allegedly negligent auditing services. As the accounting firm had not caused the necessary conditions of plaintiff's injury, its alleged breach of duty could not be considered the legal cause of the company's bankruptcy. The court further observed that district court judges must be vigilant in policing bankruptcy trustees' judgment in litigation matters, imposing sanctions for the filing of frivolous suits where necessary.

b. *Calnin v. Hilliard*, Nos. 05-C-694, 05-C-1092, 05-C-784, 05-C-1148, 05-C-958, 2008 WL 336892 (E.D. Wis. Feb. 5, 2008).

Plaintiff investors brought suit against defendant owner of a dissolved corporation that dealt in the acquisition and management of airline holdings. Plaintiffs alleged that defendant had made various misrepresentations when soliciting plaintiffs to purchase stock in defendant's company, thus violating Section 10(b), the common law, and various state securities laws. The court denied summary judgment on the Section 10(b) claims, ruling that plaintiffs were not required to produce expert testimony to support their claims, and that to prevail at summary judgment defendant would have needed to prove that, as a matter of undisputed fact, plaintiffs' economic loss could not have resulted from the alleged fraudulent conduct. The court also denied defendant's summary judgment motion on the common law claims, holding that a reasonable finder of fact could conclude that defendant withheld material facts from the plaintiffs when soliciting their investments and that the plaintiffs' losses were caused by these hidden facts.

IX. EIGHTH CIRCUIT

A. SUMMARY OF DEVELOPMENTS IN 2008

In several decisions, courts in the 8th Circuit evaluated securities fraud allegations under the PSLRA and the *Tellabs* decision. In *In re Ceridian Corp. Securities Litigation*, the 8th Circuit affirmed the district court's dismissal of plaintiffs' claims and explained that bare allegations of GAAP violations suggest negligent accounting mistakes more so than scienter. Allegations of managements' insider trading and year-end bonuses also did not support an inference of scienter where they were not shown to be unusual. The 8th Circuit again affirmed the lower court's dismissal in *Cornelia I. Crowell GST Trust v. Possis Medical, Inc.*, noting that rumors circulating among low level employees (as established by confidential informants) about the results of a clinical study did not establish scienter where the allegations did not tie those rumors to the defendants nor provide information on how those employees would have access to the results. In *In re 2007 Novastar Financial, Inc. Sec. Litig.*, the Western District of Missouri granted defendants' motion to dismiss in the subprime litigation context. The court held that the complaint did not sufficiently plead scienter or falsity and characterized the allegations as pleading "fraud by hindsight."

Courts within the 8th Circuit also addressed SLUSA preemption. In *Siepel v. Bank of America, N.A.*, the 8th Circuit held that SLUSA was applicable to state law claims alleging nondisclosures that "coincided" with the purchase of a security. In *Brehm v. Capital Growth Financial, Inc*., the District of Nebraska found SLUSA inapplicable and remanded plaintiffs' claims involving private placement debentures because it found no evidence of "the purchase or sale of covered securities" as required by the Act.

B. NOTEWORTHY CASES IN 2008

1. Pleading Standards for Securities Fraud

a. *In re Ceridian Corp. Securities Litigation*, 542 F.3d 240 (8th Cir. 2008).

Plaintiffs filed a securities fraud class action against defendant corporation and its former officers, alleging violations of Sections 10(b) and 20(a) of the Exchange Act, as well as Rule 10b-5. The allegations were based on accounting errors which defendant had discovered and rectified through amendments to published financial statements. Defendant's motion to dismiss was granted by the district court, and plaintiffs appealed. Applying the heightened pleading requirement for scienter as outlined by the US Supreme Court in *Tellabs*, the court held that to defeat a motion to dismiss, "[n]ot only must a plaintiff state with particularity facts giving rise to an inference of scienter that is strong . . . the inference must be more than merely plausible or reasonable—it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent." The court ruled that an amalgam of unrelated GAAP violations, without more, cannot satisfy this strong inference of scienter required by PSLRA. Further, insider stock sales that are not out of line with prior trading practices do not give rise to the required inference, nor do year-end bonuses that are given in the regular course of business, alleged responsibility for or approval of the accounting policies that led to the errors, or the simple act of signing Sarbanes-Oxley certifications. Dismissal of the complaint was affirmed.

b. *Cornelia I. Crowell GST Trust v. Possis Medical, Inc.*, 519 F.3d 778 (8th Cir. 2008).

Plaintiff, a trust, filed a securities class action fraud suit against defendants, a medical device manufacturer and two of its executives, claiming that defendants had issued misleading statements regarding a clinical study's anticipated favorable impact on the company's profits. The 8th Circuit found that plaintiff's complaint failed to meet the heightened pleading standards under the PSLRA and denied plaintiff leave to amend its complaint. The court found that plaintiff failed to establish that defendant had misrepresented a material fact or that defendant had acted with the required scienter. The court stated that "rote allegations that the defendants knowingly made false statements of material fact" were not sufficient and that plaintiffs must often plead the "who what, when, where, and how" of any misleading statements and omissions. Anonymous employee testimony provided by plaintiff was not sufficiently particular. The court also stated that the relevant inquiry for scienter is "whether all the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any allegation, scrutinized in isolation meets that standard." The mere facts that the clinical study was important to the company and that insider stock sales had taken place, without more, did not support an inference of scienter. The court also denied plaintiff leave to amend its complaint, finding that plaintiff had failed to demonstrate how its complaint could be amended.

c. *In re H&R Block Securities Litigation*, No. 06-0236, 2008 WL 482403 (W.D. Mo. Feb. 19, 2008).

The court granted defendant's motion to dismiss a securities fraud class action for failure to plead scienter. Plaintiff alleged that the defendant company failed to disclose that it had improperly accounted for its effective income tax rate, which subsequently required a financial restatement. The court held that statements by confidential informants suggesting that the company knew it had problems failed to establish scienter because the company had disclosed these problems to investors. Additionally, the company conducted an investigation regarding the possibility of a restatement, and on-going financial statements divulged the continuing nature of the investigation.

d. *In re 2007 Novastar Financial, Inc. Securities Litigation*, No. 07-0139, 2008 WL 2354367 (W.D. Mo. June 4, 2008).

Plaintiff filed a class action lawsuit against defendant, a real estate investment trust, alleging securities fraud violations. The court dismissed plaintiff's complaint on the ground that it failed to meet the heightened pleading standards under the PSLRA. Noting that the PSLRA was intended to put an end to the practice of pleading "fraud by hindsight," the court held that plaintiff had not pled falsity with the required specificity. Plaintiff's complaint failed to specify allegedly misleading statements and also failed to specify why any statements referred to in the complaint were misleading. The court found that plaintiff merely had pointed to what may have been poor business decisions and that "bad decisions do not constitute securities fraud." The court further held that plaintiff had failed to create an inference of scienter that was as strong as an inference that defendants lacked fraudulent intent. Scienter could not be inferred merely because management attended routine meetings where adverse financial changes were discussed.

2. SLUSA Preemption

a. *Siepel v. Bank of America, N.A.*, 526 F.3d 1122 (8th Cir. 2008).

Plaintiffs, trust beneficiaries, filed suit against defendants, a bank and investment companies, alleging violations of federal securities laws, unjust enrichment, and breach of fiduciary duty. The 8th Circuit held that the state law claims of breach of fiduciary duty and unjust enrichment were preempted by the SLUSA where plaintiffs had alleged nondisclosures on the part of defendants and the alleged nondisclosures coincided with defendants' purchase of securities. The court stated that for preemption under the SLUSA to apply, misrepresentations or omissions must be made "in connection with" the purchase or sale of securities, and that the "in connection with" requirement is met where the alleged fraud coincides with a securities transaction, whether by the plaintiff or by someone else.

b. *Brehm v. Capital Growth Financial, Inc.*, No. 07-315, 2008 WL 553238 (D. Neb. Feb. 25, 2008).

Plaintiffs filed a securities class action suit alleging that defendants had made materially false statements. The court held that removing the action to federal court was improper under the SLUSA because no evidence could be found that "covered securities" were involved in the case. The court found that plaintiffs knew they were purchasing private placements and debentures, and not covered securities. Therefore any alleged fraud or misrepresentation did not take place "in connection with" covered securities as required under SLUSA. The court further noted that mere statements by defendants that they intended to take their companies public did not convert the securities into covered securities where no public offering had taken place.

X. NINTH CIRCUIT

A. SUMMARY OF DEVELOPMENTS IN 2008

In 2008 the 9th Circuit had an active docket in the subprime mortgage realm. In *Atlas v. Accredited Home Lenders Holding Co.*, the Southern District of California applied the group-published doctrine in upholding Sections 10(b) and 14(a) claims against the company and its officers for understating loan loss reserves and overstating income in the financial statements. The court also upheld claims based on violations of Sections 20(a), 11, and 15. In *In re Countrywide Fin. Corp. Derivative Litig.*, the Central District of California refused to dismiss as to individuals on board committees who would have been in a position to notice "red flags" related to the company's internal underwriting standards. The court found that sufficient allegations of scienter were made against these individuals as established by a number of confidential witnesses.

Meanwhile, the Northern District of California continued to deal with option backdating cases. In *Segen v. Rickey*, the district court found that insiders could avoid liability under Section 16(b) so long as their option grants were approved by a properly-constituted committee of board directors before the insiders' receipt of the options. In *In re KLA-Tencor Corp. S'holder Derivative Litig.*, the court ordered a Special Litigation Committee to disclose additional evidence related to the Committee's findings given the Committee's failure to disclose all of the details of its investigation due to a pending class action suit. On the settlement front, the court rejected a settlement in *In re Zoran Corp. Derivative Litig.*, finding that the non-cash concessions did not adequately make up the value of the case.

The Northern District of California also addressed a split in authority within its own court as to whether a lead plaintiff in a securities class action must have suffered all or some of the injuries alleged on behalf of the class. The *In re Connetics Corp. Sec. Litig.* court held that the better view is that "once a lead plaintiff demonstrates individual standing on the basis of its own injury in fact, that is the end of the inquiry and the lead plaintiff has standing to assert other related injuries suffered by members of the class."

As expected, the 9th Circuit confronted a variety of cases governed by the PSLRA's heightened pleading standard. For instance, in *Metzler Inv. GMBH v. Corinthian Colleges, Inc.*, the 9th Circuit affirmed the district court's dismissal with prejudice after finding that the third amended complaint failed to satisfy the pleading requirements of loss causation, scienter, and falsity. However, much of the securities litigation surrounding the pleading standard centered on courts grappling with what constituted a strong inference of scienter under the Supreme Court's decision in *Tellabs*.

In *South Ferry LP v. Killinger*, the 9th Circuit described the circumstances in which the core operations inference could be relied upon to satisfy the scienter requirement. In reaching its decision, the court highlighted that the facts of *Berson v. Applied Signal Tech.*, decided earlier in 2008, presented the "exceedingly rare" situation where the core operations inference by itself sufficiently alleged scienter. In *Berson*, the 9th Circuit reversed the district court's dismissal and remanded the case after finding that plaintiffs had adequately pled scienter, finding it "absurd" to believe that the defendants there would not know about the disputed fact. *Glazer Capital Mgmt.,* *LP v. Magistri* presented the 9th Circuit with an opportunity to clarify its position on collective scienter, but the court only acknowledged the possibility of its use without actually endorsing the theory. In affirming the dismissal, the court held that evidence of a personal profit motive was insufficient to raise a strong inference of scienter, and described the circumstances under which a Sarbanes-Oxley certification would be probative of scienter. And in *In re Dura Pharms., Inc. Sec. Litig.*, the Southern District of California carved out the role of confidential witnesses and internal reports, holding that only confidential witnesses and internal reports deemed reliable could be considered in evaluating whether scienter had been sufficiently alleged against certain defendants.

The courts also dealt with issues surrounding demand futility. In *Potter v. Hughes*, the 9th Circuit held that a formal demand must identify the demanding shareholder, and that futility could not be demonstrated unless plaintiffs made detailed factual allegations that the board was interested in the transactions at issue. In *In re Extreme Networks, Inc. S'holder Derivative Litig.*, the Northern District of California found that plaintiffs were not excused from making a demand because they had failed to plead facts sufficient to establish scienter on the part of the board members who were allegedly not disinterested or independent.

In another notable case, *In re Digimarc Corp. Derivative Litig.*, the 9th Circuit dismissed plaintiffs' claim under Section 304 of Sarbanes-Oxley. In reaching its decision, the court found that Section 304 did not provide a private cause of action.

B. NOTEWORTHY CASES IN 2008

1. Pleading Standards for Securities Fraud

a. *Glazer Capital Mgmt., LP v. Magistri*, No. 06-16899, 2008 WL 5003306 (9th Cir. Nov. 26, 2008).

The 9th Circuit clarified its holding in *Nordstrom, Inc. v. Chubb & Son, Inc.*, 54 F.3d 1424 (9th Cir. 1995), in which it noted that "there is no case law supporting an independent 'collective scienter' theory" and that, based on the facts of that case, there was "no way that [the defendant] could show that the corporation, but not any individual [director or officer], had the requisite intend to defraud." The court explained that "*Nordstrom* does not foreclose the possibility that, in certain circumstances, some form of collective scienter pleading might be appropriate." It stopped short, however, of fully endorsing the theory of collective scienter, noting only that the theory was not foreclosed from use by any previous 9th Circuit precedent. The court avoided defining the content and limitations of collective scienter by concluding that it did not need to address this issue since the theory clearly did not apply based on the facts of this case. The court also addressed a handful of questions surrounding the more traditional pleading requirements of individual scienter. It adopted the 11th and 5th Circuits' rule that a "Sarbanes-Oxley certification is only probative of scienter if the person signing the certification was severely reckless in certifying the accuracy of the financial statements." Additionally, it followed several other circuits in holding that "evidence of a personal profit motive on the part of officers and directors contemplating a merger is insufficient to raise a strong inference of scienter" because, in almost every corporate transaction, the involved officers and directors usually will benefit financially from the completion of the transaction.

b. *South Ferry LP v. Killinger*, 542 F.3d 776 (9th Cir. 2008).

Plaintiff shareholders brought suit against company officers, alleging violations of Sections 10(b) and 20(a) of the Exchange Act, and Rule 10b-5. Plaintiffs claimed that defendants made materially false or misleading statements concerning the company's ability to manage MSR-related and pipeline risks. These allegations were based, in part, on defendants' assurances that the company had fully integrated its information systems to closely monitor hedges when it had, according to plaintiffs, actually failed to do so. The district court denied the dismissal of the key company officers, reasoning that the core operations inference (that facts critical to a business's core operations or important transactions are known to key officers), satisfied the PSLRA's heightened pleading standard. On appeal, the 9th Circuit concluded that the core operations inference could satisfy the PSLRA scienter standard in three circumstances. First, in light of *Tellabs*'s instruction to consider the totality of the circumstances, the core operations inference may meet the pleading standard if, when read together with other particularized supporting allegations, a strong inference of scienter is raised. Second, the core operations inference may independently satisfy the scienter standard where the allegations are particularized and joined with detailed and specific allegations about management's access to the disputed information. Finally, the court recognized that it was conceivable, but "exceedingly rare," that allegations based on the core operations inference, without more, could meet the standard if the nature of the disputed fact is of "such prominence that it would be 'absurd' to suggest that the management was without knowledge of the matter." The court placed one of its recent decisions, *Berson v. Applied Signal Tech., Inc.*, 527 F.3d 982 (9th Cir. 2008), in this last category based on the specific facts of that case. Although the court acknowledged that the district court had indicated that there might not exist an alternative ground to affirm the complaint, it declined to reach the merits of the entire complaint. Instead, the court vacated the district court's order and remanded it to be decided under the appropriate standard.

c. *Metzler Inv. GMBH v. Corinthian Colleges, Inc*., 534 F.3d 1068, as amended by 540 F.3d 1049 (9th Cir. 2008).

Plaintiff brought a federal securities fraud class action pursuant to Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 against defendant corporation and three of its officers. The Third Amended Complaint (TAC) alleged that defendants used false or deceptive schemes to maximize the amount of federal funding the defendant corporation's colleges received under Title IV. Moreover, the TAC alleged that the defendant corporation failed to disclose government investigations related to its admissions practices. The 9th Circuit affirmed the lower court's order dismissing the complaint with prejudice. First, the court held that plaintiff had failed to plead loss causation sufficiently because there were no allegations that the market became aware that the defendant corporation was engaged in widespread admissions fraud other than "an undocumented assertion" that the its stock drop was the result of the disclosures. Although an admission or finding of fraud is not required before loss causation can be pled, that does not mean a plaintiff asserting securities fraud can avoid alleging the causal connection between defendant's fraud and the actual loss. Second, the court held that the TAC did not establish a strong inference of scienter, as required under the PSLRA. The alleged "suspicious" stock sales, when viewed as a whole, failed to satisfy the strong inference required by the PSLRA given the timing of the sales and the quantities of stock that were sold. The TAC's generalized allegations about the "hands-on" approach of the defendant corporation's senior management similarly failed to establish scienter. Finally, the court held that the TAC did not plead falsity adequately. The TAC had alleged that the defendant corporation's fraudulent practices generally, along with its failure to disclose earlier the government investigations, rendered virtually all of the company's public statements during the class period "affirmatively false or false by way of omission." The court, however, pointed out that the PSLRA's falsity requirement is not satisfied by conclusory allegations that a company's class period statements regarding its financial well-being are per se false based on allegations of fraud generally.

d. *Atlas v. Accredited Home Lenders Holding Co.*, No. 07-488, 2008 WL 80949 (S.D. Cal. Jan. 4, 2008).

Shareholder plaintiffs brought a class suit alleging various securities fraud claims against a mortgage banking company specializing in sub-prime mortgage loans along with various officers and outside directors. Plaintiffs alleged that defendants issued materially false financial statements by misstating their underwriting policies and improperly maintaining a reserve fund for loan defaults several hundred million dollars less than what was required under GAAP and Commission regulations. The small reserve fund enabled defendants to overstate income by a corresponding amount, resulting in an artificially-high stock price. The court upheld plaintiffs' claims under Sections 10(b) and 14(a) of the Exchange Act against the company and the officer defendants, applying the group-published doctrine, but dismissed the claims against the director defendants, holding that group-published doctrine did not apply to outside directors. The court also upheld plaintiffs' Section 20(a) control-person liability claims and the claims for false registration statements under Sections 11 and 15 of the Securities Act. However, the court dismissed the Section 12(a)(2) claims alleging the use of false proxy statements to solicit securities sales, noting that the 9th Circuit required a showing that defendants gained personally from the fraudulent stock sale.

e. *Penn. Ave. Funds v. Borey*, No. 06-1737, 2008 WL 426509 (W.D. Wash. Feb. 13, 2008).

Plaintiff shareholder claimed two other shareholder defendants violated Section 10(b) and the Williams Act for trading on inside information and defrauding investors by not disclosing nonpublic, material information learned during a merger between the issuer and one of the shareholder defendants. Plaintiff's allegations were based on that shareholder defendant's acquisition of 1.57 million shares of the company's stock and its agreement to acquire a 50% stake in the other shareholder defendant's subsidiary which had merged with the company. The court dismissed plaintiff's fraud and insider trading claims under the Williams Act with prejudice and dismissed plaintiff's insider trading claim under Rule 10b-5 with leave to amend. The court rejected plaintiff's Section 10(b) claim because (1) plaintiff's allegations showed that the acquiring shareholder defendant was not in possession of any nonpublic information from the company until after it had made the 1.57 million share purchase and, thus, owed no duty to the company's shareholders at the time of its open market purchases; and (2) the same defendant's acquisition of 50% of the other shareholder defendant's subsidiary had no bearing on the issuer's shareholders. The court also held that the complaint did not comply with the PSLRA's heightened standard of pleading for scienter because it did not provide any detail regarding what confidential information was acquired. The court further dismissed plaintiff's claims under Section 13(e) and Rule 14e-3 of the Williams Act for fraud and insider trading in connection with a tender offer, because the acquiring shareholder defendant did not fail to meet its disclosure obligations, and because it was an offeror at the time of the purchases and only another person, not the offering person, can violate Rule 14e-3 by purchasing the target company's securities.

2. Scienter

a. *Berson v. Applied Signal Tech.*, 527 F.3d 982 (9th Cir. 2008).

Plaintiff investors sued an issuer and two of its officers under Section 10(b) of the Exchange Act. Plaintiffs alleged that defendants misled them by reporting a company backlog, which reported the dollar value of the work the issuer was contracted to do but had not completed yet, that included several revenue-generating contracts that had been stopped and likely were to be canceled entirely. Plaintiffs alleged that these stopped contracts led to a 25% decrease in the issuer's revenue from the preceding quarter, which caused the value of plaintiffs' stock to drop by 16%. The 9^{th} Circuit reversed the district court's dismissal and remanded after finding that: (1) plaintiffs sufficiently pled the existence and effect of the stop-work orders; (2) plaintiffs sufficiently pled the backlog report was misleading; (3) plaintiffs sufficiently pled scienter; (4) plaintiffs sufficiently pled loss causation; and (5) the backlog report was not immune as a "forward-looking" statement. First, the court found that plaintiffs' identification of four witnesses that would testify to the existence and effect of the stop-work orders was sufficient for plaintiffs to have pled, with particularity, the existence of the stop-work orders and that they were included in the backlog report. Second, the court rejected defendants' argument that they had disclosed that the backlog report included stopped contracts, and found that plaintiffs adequately pled that the backlog report was misleading. Third, the court found that plaintiffs adequately inferred that the defendant officers must have known about the stopped contracts, and therefore, sufficiently pled scienter. Fourth, the court found that plaintiffs sufficiently pled loss causation by alleging that the misleading backlog report led to a decrease in the value of their shares. The court noted that neither the 9^{th} Circuit nor the US Supreme Court had decided whether the Fed. R. Civ. P. 8(a)(2) or Fed. R. Civ. P. 9(b) pleading standard applies to loss causation allegations, but that the issue did not need to be decided in this case, because the plaintiffs satisfied the stricter Rule 9(b) standard by pleading loss causation with particularity. Fifth, the court held that the backlog report was not a forward-looking statement, and, therefore, was not immune under the PSLRA.

b. *In re Countrywide Fin. Corp. Derivative Litig.*, No. 07-06923, 2008 WL 2064977 (C.D. Cal. May 14, 2008).

Following a collapse in the defendant issuer's stock price, several groups of plaintiffs filed multiple class and derivative actions against the issuer alleging various state and federal claims. One such action, the *Arkansas Teachers* litigation, alleged derivative claims against the issuer's directors for various Exchange Act violations in addition to state law breach of fiduciary duty and insider trading claims. Following the court's decision to stay the class action claims in favor of similar proceedings in the Delaware Court of Chancery, the defendants in the *Arkansas Teachers* litigation brought motions to dismiss the derivative claims. The court found the plaintiffs adequately had pled facts giving rise to a strong inference of scienter where they alleged with particularity information from multiple confidential witnesses showing company-wide deviations from internal underwriting standards, and all but two of the individual defendants were on board committees tasked with overseeing aspects of the company such that they were in a position to recognize so-called "red flags" in the company's portfolios. Accordingly, the court denied the motions to dismiss as to all defendants except two individuals who were not on board committees where they would have had the opportunity or duty to examine the "red flags."

c. *In re Dura Pharms., Inc. Sec. Litig.*, 548 F. Supp. 2d 1126 (S.D. Cal. 2008).

Plaintiffs alleged that defendants made falsely optimistic public statements regarding imminent FDA approval of a new drug, despite knowledge that the drug's severe design and manufacturing problems virtually guaranteed FDA rejection. In assessing the sufficiency of plaintiffs' allegations, which were made on information and belief, the court considered only those allegations for which plaintiffs had provided "sufficient indicia of reliability." The court therefore disregarded allegations based on confidential witnesses or internal reports where plaintiffs failed to establish that the confidential witnesses or reports were reliable. The court found that optimistic statements made within four months of the company's filing for a New Drug Application were materially misleading, and based on plaintiffs' allegations that a confidential witness attended meetings in which certain officers expressed awareness of the drug's severe development problems, the court ruled that these false statements were made with scienter. The court dismissed the claims against the individual defendants whom plaintiffs failed to establish were similarly aware of the drug's problems.

3. Standing

a. *In re Connetics Corp. Sec. Litig.*, No. 07-02940, 2008 WL 269467 (N.D. Cal. Jan. 29, 2008).

The court addressed a split in the Northern District of California on whether a lead plaintiff in a securities class action must have suffered all or just some of the injuries alleged by the class in order to have standing to bring the suit. It held that the better view is that "once a lead plaintiff demonstrates individual standing on the basis of its own injury in fact, that is the end of the inquiry and the lead plaintiff has standing to assert other related injuries suffered by members of the class." Any remaining questions about the lead plaintiff's qualifications should be resolved by referring to Fed. R. Civ. P. 23. The court then struck several paragraphs from the plaintiff's complaint that were lifted directly from an earlier complaint filed by the Commission. It held that plaintiff's failure to personally investigate and validate the truth and legal reasonableness of the allegations that it lifted from the Commission complaint violated Fed. R. Civ. P. 11(b). Without these stricken allegations, plaintiff failed to plead with particularity sufficient facts to sustain its Sections 10(b) and 20(a) claims. Based on the foregoing, the court granted defendants' motion to dismiss.

4. Section 16(b)

a. *Dreiling v. Company*, No. 05-1339, 2008 WL 496166 (W.D. Wash. Jan. 3, 2008).

A provider of white pages data and an internet company negotiated an agreement to jointly provide white pages services, whereby the internet company would receive cash and stock warrants in the white pages company as compensation. The white pages company, seeking favorable accounting treatment of the warrants it would issue to the internet company, was alleged to have structured the deal with certain conditions which appeared to impose greater obligations upon the internet company than the internet company actually incurred. Plaintiff brought suit under Section 16(b) of the Exchange Act, which prohibits short-swing trading by, among other things, a "group" owning more than 10% of a company's stock. Plaintiff alleged that the two companies coordinated efforts to inflate the value of the white pages company stock through inappropriate accounting procedures. The court granted defendants' motion for summary judgment, holding that coordinating efforts to manipulate stock price was not a cognizable "group purpose" under Section 16(b) because there was no agreed or concerted activity between the two companies to actually buy, hold, vote, or sell the white pages company stock.

b. *Segen v. Rickey*, No. 07-02917, 2008 WL 590505 (N.D. Cal. Feb. 29, 2008).

The district court held that the approval of backdated stock option grants by a properly-constituted committee of a corporation's directors is exempt from liability under Section 16(b) of the Exchange Act. According to the court, all that is required under Rule 16(b)-3(d)(1) to avoid liability under Section 16(b) is that any stock options granted to a corporation's insiders are approved prior to the insiders' receipt of the options. Rule 16(b)-3(d)(1) does not require approval of stock option grants to an insider by a corporation's entire board of directors or committee of non-employee directors in advance of the date actually listed on the option grants at issue.

5. Other Issues

a. *In re Digimarc Corp. Derivative Litig.*, No. 06-35838, 2008 WL 5171347 (9th Cir. Dec. 11, 2008).

Shareholders brought a derivative suit against a corporation and its officers for alleged improper accounting and a claim under Section 304 of Sarbanes-Oxley (for recovery of bonuses and profits from officer impropriety), in the District of Oregon. On appeal, the 9th Circuit affirmed the dismissal of the Section 304 claim, holding that the section did not provide a private right of action. As such, there was no federal question jurisdiction, and the plaintiffs only could maintain their suit if the district court had diversity jurisdiction. The court held that the district court's realignment of the corporation itself as plaintiff – and its resulting destruction of diversity jurisdiction – was in error because the company was antagonistic to the plaintiffs' interests. Accordingly, the court remanded the action to the district court for further proceedings.

b. *Potter v. Hughes*, 546 F.3d 1051 (9th Cir. 2008).

Plaintiffs brought a derivative action against defendant corporation alleging that recent board decisions constituted various violations of fiduciary duties and California corporation laws. Prior to filing suit, one plaintiff had delivered a demand letter to the board naming himself but referring to another plaintiff only as an unnamed shareholder. The district court dismissed the writer of the letter for lack of standing, as he was not a contemporaneous shareholder of the corporation, and dismissed the shareholder plaintiff for failure to make a demand. Only the shareholder plaintiff appealed. The 9th Circuit, after first questioning whether the court had subject matter jurisdiction over the action which largely arose under California state law, determined that resolving the issue was unnecessary because plaintiff lacked standing under Fed. R. Civ. P. 23.1, having failed to make a demand. The court found that it was not enough for the writer of the letter to have submitted a demand letter which referred to plaintiff only as an unnamed shareholder, and that the demand requirement only could be satisfied if the demand identified the shareholder making the demand. Because under this reading plaintiff herself had never made a formal demand, the court concluded that she failed to satisfy the requirements under Rule 23.1. The court also found that her allegations of demand futility were unavailing, as she failed to make any detailed factual allegations demonstrating that a majority of the thirteen-member board was interested in the challenged transactions and thus unable to fairly consider a demand.

c. *In re Extreme Networks, Inc. S'holder Derivative Litig.*, 573 F. Supp. 2d 1228 (N.D. Cal. 2008).

The district court held that plaintiffs failed to plead demand futility adequately and thus their initiation of a derivative suit before making a demand on the defendant corporation's board was inexcusable. It reached this conclusion despite the fact that plaintiffs claimed that the relevant directors were not disinterested or independent, and thus were not capable of considering a demand made on the board, due to their receipt of backdated stock options, filing of false financial statements, administration of allegedly backdated stock option grants, and participation in insider trading. It noted that where, as in the instant matter, a corporation's articles of incorporation immunize its directors from liability except for claims based on fraudulent, illegal, or bad faith conduct, plaintiffs must plead particular facts establishing scienter on the part of the allegedly interested directors in order to establish that the threat of personal liability disqualified them from considering a demand. Having determined that plaintiffs did not adequately establish that the defendant directors acted with scienter or, with respect to a number of plaintiffs' claims, that any wrongdoing was committed in the first place, the court granted the defendant corporation's motion to dismiss.

d. *Indiana Elec. Workers Pension Trust Fund, IBEW v. Dunn*, No. 06-01711, 2008 WL 878424 (N.D. Cal. Mar. 28, 2008).

The district court reaffirmed that claims of demand futility brought in derivative actions must be plead with particularity. In doing so, it rejected plaintiffs' contention that the 3d Circuit's opinion in *In re Tower Air, Inc.*, 416 F.3d 229 (3d Cir. 2005) provided that they did not need to plead particularized facts when alleging demand futility but only needed to meet the notice pleading standard under Fed. R. Civ. P. 8. The court also noted that the circumstances that make a demand futile are determined by the laws of the state in which the subject corporation is incorporated. Pursuant to these standards, the court applied Delaware's demand futility law and dismissed all of plaintiffs' derivative claims with prejudice. Applying Delaware law, the court also dismissed plaintiffs' direct causes of action, holding that the defendant corporation, not plaintiff shareholders, suffered the alleged harm caused by the three direct claims and also would be the beneficiary of any potential legal remedy.

e. *In re Zoran Corp. Derivative Litig.*, No. 06-05503, 2008 WL 941897 (N.D. Cal. Apr. 7, 2008).

The Northern District of California denied preliminary approval of a proposed settlement reached by plaintiff and defendants regarding a derivative action alleging stock option backdating. It noted that, pursuant to Fed. R. Civ. P. 23.1, district judges have a duty to ensure that absent shareholders are treated fairly by settlement agreements reached in derivative actions. After independently evaluating each aspect of the proposed settlement, the court determined that the value of the exclusively non-cash concessions offered by defendants to the corporation were over-exaggerated significantly and, at the same time, unacceptably low given the estimated maximum damages of approximately $16 million and the strong allegations of backdating pled by plaintiff. As such, the court determined that "it has not been shown that the risks of litigation are so severe as to compel this poor settlement."

f. *In re KLA-Tencor Corp. S'holder Derivative Litig.*, No. C06-03445, 2008 WL 2073936 (N.D. Cal. May 14, 2008).

Considering defendant's Special Litigation Committee's (SLC) motion for a protective order to limit the scope of discovery in connection with its motion to terminate, the court held that plaintiffs were entitled to some limited discovery beyond that initially offered by the SLC. The court noted that the SLC explained its investigation and reasons for its conclusions with some specificity, and did not appear to have conducted a "whitewash" investigation. However, the SLC intentionally did not disclose some details of its investigation because of a pending shareholder class action suit. As such, the court found the SLC report "somewhat lacking in terms of the evidentiary support for the conclusions reached," and ordered the SLC to produce additional evidence related to the SLC meetings, the SLC's calculations of stock option gains of certain defendants, and the communications between the individual defendants and the SLC.

XI. TENTH CIRCUIT

A. SUMMARY OF DEVELOPMENTS IN 2008

In 2008, the 10th Circuit issued an important decision regarding a party's standing to challenge a settlement agreement in a federal securities class action. In *New England Health Care Employees' Pension Fund v. Woodruff*, the 10th Circuit held that in order to have standing to challenge a federal securities class action settlement agreement, a non-settling party must demonstrate that it was prejudiced by the settlement. Prejudice, in turn, can be established by proving interference with a party's contractual rights or its ability to seek contribution or indemnification from another party. Moving to the facts of the case before it, the 10th Circuit found that two individual defendants who were former officers of the defendant corporation had standing to challenge the settlement agreement at issue because the agreement barred any claim for indemnity against the defendant company and required the officers to release all claims that they may have had against the company.

Additionally, two district court cases in the 10th Circuit, *New Jersey v. Sprint Corp.* and *W. Palm Beach Firefighters' Pension Fund v. StarTek, Inc.*, addressed the standard for establishing scienter in securities fraud cases. In *Sprint Corp.*, the District of Kansas applied *Tellabs*' "cogent and compelling" standard to deny the defendants' motion for judgment on the pleadings as to a Section 10(b) claim, noting that the non-fraudulent inferences that could be drawn from the complaint were not more compelling than the inferences of scienter identified by the plaintiff. The court then went further and observed that the plaintiff's Section 14(a) claim, which was grounded in negligence, also met the *Tellabs* standard although it did not hold explicitly that the *Tellabs* standard applied to all Section 14 claims. In *StarTek, Inc.*, the District of Colorado applied the same standard as the court had in *Sprint Corp.* to deny a motion to dismiss insider trading claims, holding that the competing inferences of fraudulent and non-fraudulent trading that could be drawn from the allegations in the complaint were equally strong. In a later opinion by the District of Colorado in *StarTek*, *Inc.*, the court granted in part and denied in part the defendants' motion to dismiss, which motion was based on the ground that the plaintiff failed to demonstrate "loss causation" under *Dura*. The court found, on the one hand, that a disclosure by the defendant, prior to the stock drop, that revenue from one main customer had declined and would continue to decline was sufficient forewarning of the subsequent loss of that customer contract, whereas, on the other hand, the defendant's pre-stock drop disclosure of amended contract terms with another main customer were inadequate "partial disclosures" because the defendant did not disclose the extent of price concessions and downplayed the impact of the amended terms.

B. NOTEWORTHY CASES IN 2008

1. Scienter

a. *New Jersey v. Sprint Corp.*, 531 F. Supp. 2d 1273 (D. Kan. 2008).

The court applied the *Tellabs*' "cogent and compelling" standard to Sections 10(b) and 14(a). In doing so, it denied defendants' motion for judgment on the pleadings, holding that plaintiffs had pled scienter adequately. The court held that, of the inferences that could be drawn from the allegations in the complaint, the non-fraudulent inference suggested by defendants was not more compelling than the inference of scienter alleged by plaintiff. In addition, without deciding that the *Tellabs* standard applied to Section 14 claims grounded in negligence, the court found that the inference of negligence that could be drawn from the complaint in this case met that standard.

b. *W. Palm Beach Firefighters' Pension Fund v. StarTek, Inc.*, No. 05-01265, 2008 WL 4838671 (D. Colo. Nov. 6, 2008).

Plaintiff brought a securities class action arising out of defendants' alleged misstatements which implied a healthy sales pipeline and a strong demand from the company's four main customers. Defendants moved to dismiss arguing that investors were aware of both the loss of income from one main customer and the amended contract with another main customer long before the stock drops at issue. As such, defendants maintained that plaintiff could not demonstrate "loss causation" attributable to the disclosure of these facts. Citing *Dura*, the court found that "there must be a relationship between the alleged misrepresentations or false information and losses resulting when the 'true facts' of the defendant's business are revealed." Prior to the stock drop, defendants disclosed that the revenue received from one main customer had declined and would continue to decline. The court thus dismissed plaintiff's claims to the extent they were based on facts relating to the loss of that main customer contract, since the prior disclosures made clear that this revenue was endangered. In contrast, the court denied the motion to dismiss with regard to the allegations relating to another main customer contract that had been amended. While defendants disclosed the amended terms, the court found such statements were "partial revelations," as defendants downplayed the impact and did not disclose the extent of the price concessions.

c. *W. Palm Beach Firefighters' Pension Fund v. StarTek, Inc.*, Nos. 05-01265, 05-01344, 05-01344, 05-01265, 2008 WL 879023 (D. Colo. Mar. 28, 2008).

Plaintiffs relied, in part, on the individual defendants' stock sales during the class period to support their scienter allegations. They brought an insider trading action, alleging that the majority shareholders sold no shares during the two years preceding the class period, but that during the class period, these shareholders sold 83% and 100% of their holdings, respectively. In response, defendants claimed that these sales were not suspicious because prior to the class period, they were restricted from selling their stock pursuant to SEC Rule 144; that they were not alleged to have made any misleading statements; and that the Chairman did not sell any of his stock, and therefore, in calculating the percentage of stock sold by his wife, their collective ownership must be taken into account. The court found that the arguments of both the plaintiffs and defendants presented equally strong inferences as to the trading activity at issue, and therefore, dismissal was not warranted. It denied defendants' motion to dismiss because the competing inferences of fraudulent and innocuous conduct were equally strong.

2. Standing

a. *New England Health Care Employees' Pension Fund v. Woodruff*, 512 F.3d 1283 (10th Cir. 2008).

The issuer defendant in a securities class action had agreements with two former officers to indemnify them for liability arising from such claims. The class plaintiffs, the defendant company, and eleven other individual defendants entered into a settlement agreement, which excluded the two officers. The court held that to have standing to challenge a settlement agreement, a non-settling party must demonstrate that it was prejudiced by the settlement. Prejudice includes any interference with a party's contract rights or a party's ability to seek contribution or indemnification. The court held that the settlement agreement in the instant matter impacted the officers' contribution and indemnification rights by barring any claim for indemnity or any other legal claim against the company. "Such an arrangement . . . essentially strip[s], and, in any event palpably interfere[s] with [the officers'] preexisting rights and potential legal claims." Thus, the court concluded that the two officers had standing to challenge the settlement agreement.

3. Class Certification

a. *In re Nature's Sunshine Prods. Sec. Litig.*, 251 F.R.D. 656 (D. Utah 2008).

Plaintiffs moved for certification of the class of all persons who purchased common stock of defendant corporation. Defendants argued that plaintiffs failed to meet Fed. R. Civ. P. 23(a)'s adequacy of representation prerequisite because plaintiffs' counsel, not plaintiffs themselves, were controlling the litigation. The court found that the class representatives were sufficiently informed to manage the litigation effort and had not abdicated the conduct of the case to their attorneys improperly. The court also found that each representative understood his role, that they adequately would represent the interests of the class, and that defendants had failed to show one of the representative's language barrier would prevent him from being a class representative. In deciding whether common questions predominated, the court found that plaintiffs had shown an efficient market such that reliance on the fraud on the market theory was appropriate. The court declined to require a showing of loss causation at the class certification stage.

XII. ELEVENTH CIRCUIT

A. SUMMARY OF DEVELOPMENTS IN 2008

Several notable securities decisions were handed down in the 11th Circuit in 2008, including four decisions by the 11th Circuit on a variety of issues. In *Mizzaro v. Home Depot, Inc.*, the 11th Circuit affirmed the dismissal of securities fraud claims, finding that the plaintiffs failed to satisfy the heightened pleading requirements in *Tellabs*. The court found that, taken together, allegations that the fraud was widespread and longstanding, and that the individual defendants were high ranking officials in the company who approved the company's financial statements, were insufficient to properly plead scienter. In *Instituto De Prevision Militar v. Merrill Lynch*, the 11th Circuit affirmed the dismissal of state law claims against the defendant for its alleged role in a fraud committed by a non-party, holding that the suit was a "covered class action" under SLUSA and therefore barred. In *Laperriere v. Vesta Ins. Group*, the 11th Circuit analyzed the interplay between Section 20(a) of the Exchange Act, which provides that control persons shall be liable "jointly and severally" with the controlled person committing the underlying fraud, and Section 21(D)(f) of the PSLRA, which subjects "covered persons" who are knowing violators to proportionate, rather than joint and several, liability. The court determined that control persons are covered parties, and therefore are subject to the PSLRA's provisions. The court also found that the statutes are not in conflict but must be read together, with Section 20(a) providing the standard for liability and the PSLRA providing that control persons bear proportionate liability for damages under certain circumstances. And, in *Berman v. Blount Parrish & Co.*, the 11th Circuit, joining other circuits to address the issue, held that Sarbanes-Oxley does not revive claims that had previously expired, even if an action otherwise would have fallen within Sarbanes-Oxley's five-year statute of limitations. In that case, the defendant's alleged conduct occurred within five years of commencement of the suit, but the statute of limitations had expired prior to the enactment of Sarbanes-Oxley.

The lower courts also issued a number of important decisions, including several opinions granting motions to dismiss for failure adequately to plead securities violations. In *Miller v. Dyadic Intern., Inc.*, the court dismissed securities fraud claims brought against the CFO and three board members of the defendant corporation on the ground that the plaintiffs did not meet the PSLRA's heightened pleading requirements. Notably, the court found that emails expressing suspicion of improper practices did not give rise to a strong inference of scienter, where the failure to report those suspicions was not "highly unreasonable" and did not exhibit an "extreme departure from the standards of ordinary care." The court also found insufficient the plaintiffs' reliance on the defendants' high-level positions in the company. The court, however, denied the defendant corporation's and its founder's motions to dismiss, because the plaintiffs alleged specific communications demonstrating the founder's knowledge of the fraudulent conduct. The court also dismissed the plaintiffs' securities fraud claims for failure to meet the heightened pleading requirement in *Sewell v. D'Alessandro & Woodyard, Inc.*, finding that the complaint did not identify specifically who made what misrepresentations, did not distinguish between written and oral misrepresentations, and was too generic overall. The court in *Edward J. Goodman Life Income Trust v. Jabil Circuit* dismissed claims alleging stock option backdating, finding that the plaintiffs did not allege specifically that any particular stock option grant was backdated. In *Venezia Amos, LLC v. Favret*, the court addressed whether an investment in a member-managed LLC was sufficiently "passive" to be characterized as a security, determined that it was, but dismissed the complaint nonetheless because the plaintiff's allegations of fraud were not pled with sufficient particularity.

The lower courts also addressed a number of other issues. In *Badger v. S. Farm Bureau Life Ins. Co.*, the court denied class certification in a Rule 10b-5 action for lack of standing where minority shareholders of a corporation that sold a security sought to sue the company that purchased the security. In a case addressing control person liability, *Bruhl v. PriceWaterhouseCoopers Int'l*, the court found that plaintiffs adequately pleaded control person liability by alleging that an officer of the parent corporation directed a subsidiary to disseminate an allegedly misleading report, and alleging that the same officer had control over many aspects of the subsidiary's administration. In a case dismissing RICO and state law violations, *Eagletech Communications Inc. v. Citigroup, Inc.*, the court found that the PSLRA bar applied because the complaint as a whole alleged stock manipulation. The court rejected arguments that the complaint alleged theft, not securities fraud, and that the alleged conduct would not have been actionable as securities fraud because the plaintiffs lacked standing. In *Grand Lodge of Pa. v. Peters*, the court held that plaintiffs failed to allege that securities purchased in the aftermarket were issued under a particular registration statement, and also addressed the sufficiency of confidential witness allegations. And, in *Vujasin v. Chef Vincent, Inc.*, the court held there was no federal question jurisdiction over the plaintiffs' alleged securities fraud claims arising out of the sale of the "stock" and complete ownership interest in a restaurant, because the "stock" did not have the characteristics necessary to fall under the protections of the Exchange Act.

B. NOTEWORTHY CASES IN 2008

1. Control Person Liability

a. *Laperriere v. Vesta Ins. Group*, 526 F.3d 715 (11th Cir. 2008).

Investors brought a securities action against defendant parent company, seeking to hold the defendant liable as a controlling party under Section 20(a) of the Exchange Act for an underlying fraud committed by a subsidiary. Defendant asserted as an affirmative defense that it was subject only to the proportionate liability provisions of Section 21(D)(f) of the Exchange Act, enacted after Section 20(a) as part of the PSLRA, and not joint and several liability. Investors moved to strike the defendant's Section 21(D)(f) defense, and the district court denied the motion to strike, finding that Section 21(D)(f) "amended" Section 20(a)'s provision for joint and several liability. Upon interlocutory appeal, the 11th Circuit held that Section 20(a) determines *whether* a controlling party is substantively liable for a securities violation committed by a controlled party (*e.g.*, a subsidiary corporation), but does not govern the allocation of damages. The court further held that Section 21(D)(f) applies to "covered persons," and that controlling parties under Section 20(a) are "covered persons." Accordingly, the court held that Section 21(D)(f) applies to Section 20(a) controlling parties, and that, under Section 21(D)(f), controlling parties are subject to proportionate liability rather than joint and several liability, unless the controlling party "knowingly committed a violation of the securities laws." Thus, Section 20(a) determines whether a controlling party is liable, and Section 21(D)(f) determines the allocation of damages.

b. *Bruhl v. PriceWaterhouseCoopers Int'l*, No. 03-23044, 2008 WL 899253 (S.D. Fla. Mar. 31, 2008).

Plaintiffs brought a Section 20(a) claim for control person liability, and defendant moved to dismiss. To state a Section 20(a) claim in the 11th Circuit, a plaintiff must plead facts establishing (1) a primary violation of the securities laws by a controlled person; (2) that the defendant had the power to control the general business affairs of the controlled person; and (3) that the defendant "had the requisite power to directly or indirectly control or influence the specific corporate policy which resulted in the primary liability." Here, the court found plaintiffs' allegations sufficient to support a Section 20(a) claim, where plaintiffs alleged that an officer of the corporate parent directed the subsidiary to "disseminate NAV statements for [certain hedge funds], despite knowing them to be false and misleading," and further alleged that the parent, though an officer, had control over many aspects of the subsidiary's administration, including valuing certain funds' assets. The court also noted plaintiffs' allegations that the parent and the subsidiary's operations were integrated. The court denied the motion to dismiss.

2. Statute of Limitations

a. *Berman v. Blount Parrish & Co.*, 525 F.3d 1057 (11th Cir. 2008).

Investors brought a securities action against bond issuers alleging misrepresentation and omission of material facts in connection with the bond offering. Investors purchased the bonds in May 1998, and filed their suit in March 2003. Investors acknowledged that the three-year statute of limitations contained in Section 13 of the Securities Act expired before they filed their complaint, but argued that the five-year statute of limitations contained in Section 804(b) of the Sarbanes-Oxley applied to their claims, rendering their complaint timely. The district court granted issuers' motion to dismiss the complaint as barred by the statute of limitations, and the investors appealed. The 11th Circuit affirmed the district court's dismissal of the claims, holding that under Section 13's three-year statute of limitations, the investors' claims expired in May 2001, prior to the enactment of Sarbanes-Oxley. The 11th Circuit held that Sarbanes-Oxley did not revive previously expired securities claims, and thus the investors could not benefit from the five-year statute of limitations contained in Section 804(b), even though they filed their complaint within five years of their purchase of the bonds.

3. Pleading Standards for Securities Fraud

a. *Mizzaro v. Home Depot, Inc.*, 544 F.3d 1230 (11th Cir. 2008).

Plaintiffs filed a securities fraud class action against the defendant corporation and several of its officers and directors alleging violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Defendants filed a motion to dismiss for failure to properly plead scienter under the PSLRA. The district court granted the motion. On appeal, the 11th Circuit considered whether the plaintiffs satisfied the heightened pleading requirements as outlined by the U.S. Supreme Court in *Tellabs*. The 11th Circuit affirmed the district court's decision based on its determination that the plaintiffs failed to adequately plead scienter. The court ruled that allegations that (a) the fraud was widespread and longstanding (b) the individual defendants were high ranking officials in the company and (c) the individual defendants approved the companies financial statements were, taken together, an insufficient basis to plead scienter properly. The court however noted that confidential witnesses may support an assertion of scienter if the basis for their knowledge has been shown.

b. *Miller v. Dyadic Intern., Inc.*, No. 07-80948, 2008 WL 5070279 (S.D. Fla. Nov. 25, 2008).

Investors filed a securities fraud action against the defendant corporation and several of its officers and audit committee members alleging violations of Sections 10(b) and 20(a), and Rule 10b-5. Defendants filed individual motions to dismiss, arguing that the plaintiffs did not meet the heightened pleading requirements mandated by the PSLRA, under which a complaint must plead with particularity facts giving rise to a strong inference that the defendants either intended to defraud investors or were severely reckless when they made the allegedly materially false or incomplete statements. The court granted the defendant company's CFO's motion to dismiss, holding that emails expressing suspicions of improper practices did not give rise to a strong inference of scienter where the CFO's failure to report his suspicions were not "highly unreasonable" and did not exhibit an "extreme departure from the standards of ordinary care." With respect to three other individual defendants, the plaintiffs argued that a strong inference of scienter arose from the defendants' high-level positions in the company, including membership on the audit committee and board of directors. The court granted the motion to dismiss as to these defendants as well, holding that the defendants' positions in the company were insufficient to raise a strong inference of scienter. The court denied the motion to dismiss as to the company itself and its founder, however, finding that the plaintiffs pleaded specific communications by the company's founder that demonstrated knowledge of the fraudulent conduct throughout the class period.

c. *Sewell v. D'Alessandro & Woodyard, Inc.*, No. 07-343, 2008 WL 4459260 (M.D. Fla. Sept. 29, 2008).

Plaintiffs filed a securities fraud action against multiple defendants alleging violations of Sections 12(a)(2) and 15 of the Securities Act, Sections 10(b) and 20(a) of the Exchange Act, and Rule 10b-5, as well as several other counts. Defendants moved to dismiss. The court dismissed the fraud-related claims for failure to plead properly the facts under Fed. R. Civ. P. 9(b) and the PSLRA. The court held that the complaint did not set forth specifically who made what misrepresentations, did not distinguish between written and oral misrepresentations, and was too generic overall. The court did not address plaintiffs' non-fraud claims, and granted plaintiffs' leave to amend.

d. *Venezia Amos, LLC v. Favret*, No. 07-146, 2008 WL 410163 (N.D. Fla. Feb. 12, 2008).

Investor in a limited liability company sued the company and its managing member, alleging violations of Sections 10(b) and 20(a) of the Exchange Act. Defendants moved to dismiss for, among other things, failure to state a claim. Defendants argued that the membership interest in the company was not a "security" within the meaning of the Exchange Act because the company was member-managed, and the investment therefore lacked the passivity required to be characterized as a security under the three-part test set forth in *SEC v. W.J. Howey Co.*, 328 U.S.

293, 298-99 (1946) (defining security as "a contract, transaction, or scheme whereby a person (1) invests his money in (2) a common enterprise and is led to (3) expect profits solely from the efforts of the promoter or a third party"). The court found that the investment did constitute a security, because the managing member provided day-to-day management and had sole control over the company. The court nonetheless dismissed the complaint, finding that plaintiff failed specifically to allege "the content of [defendants'] statements and the manner in which they misled plaintiff," and that therefore plaintiff's allegations of fraud were not pleaded with sufficient particularity.

b. *Grand Lodge of Pa. v. Peters*, 550 F. Supp. 2d 1363 (M.D. Fla. 2008).

Plaintiffs brought putative class action under Section 11 of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5, alleging material misrepresentations and fraud by defendants regarding a bank defendant's residential real estate loan portfolio, and material misrepresentations on the bank's Form S-1 Registration Statement in connection with a secondary public offering (SPO). Defendants moved to dismiss the Section 10(b) and Rule 10b-5 claims on the ground that plaintiffs improperly relied upon confidential witnesses in support of their allegations, and moved to dismiss the Section 11 claim on the ground that the lead plaintiff could not establish that the bank securities he purchased were issued under the allegedly false and misleading registration statement. As to the Section 10(b) and Rule 10b-5 claims, the court held that the confidential witnesses were described in sufficient detail with respect to their positions within the company and would have been reliable witnesses, and further held that the statements allegedly made or witnessed by them were sufficiently detailed to suggest reliability and to satisfy the scienter requirements against certain defendants. The court therefore denied the motion to dismiss the Section 10(b) and 10b-5 claims as to some defendants, and granted it as to others. With respect to the Section 11 claims, the court found that, because the lead plaintiff alleged that he purchased his shares in the aftermarket, he could not trace them to the SPO (and hence to the allegedly misleading registration statement). The court declined to follow cases holding that Section 11 plaintiffs need not establish "traceability" at the pleading stage, and dismissed the Section 11 claim for lack of standing.

c. *Edward J. Goodman Life Income Trust v. Jabil Circuit*, 560 F. Supp. 2d 1221 (M.D. Fla. 2008).

Plaintiffs sued a corporation, asserting a variety of claims in connection with alleged stock option backdating, including claims under Section 10(b) and Rule 10b-5, Section 14(a) and Rule 14a-9, Section 20(a) and Section 20A of the Exchange Act. Plaintiffs alleged that defendant maintained a corporate policy prohibiting option backdating, and publicly purported to follow Accounting Principles Board Opinion No. 25, which requires corporations to record compensation costs for backdated stock options. Plaintiffs further alleged that, despite these internal policies and public statements, defendant engaged in stock option backdating without recording compensation costs, and in support of that allegation, listed the dates of a number of stock option grants that plaintiffs claimed were "suspiciously timed." Defendant moved to dismiss, contending that plaintiffs failed adequately to allege backdating. The court held that plaintiffs' allegations were insufficient to allege stock option backdating, because, although plaintiffs alleged that certain grants were timed suspiciously, the complaint did not allege that any specific grant of options was backdated. Because plaintiffs failed to allege actual backdating, the court found that plaintiffs had failed to allege the falsity of defendants' policy stating that it did not engage in backdating. Moreover, because plaintiffs failed adequately to allege backdating, the court found that the remainder of plaintiffs' claims failed as well. The court granted the motion to dismiss.

4. Standing

a. *Badger v. S. Farm Bureau Life Ins. Co.*, No. 06-637, 2008 WL 1884887 (M.D. Fla. Apr. 25, 2008).

Plaintiffs, minority shareholders of a corporation (Holding Company), sought class certification on 10b-5 and Florida common law fraud claims. Holding Company sold a debenture to defendant after approval of the sale by a majority of Holding Company shareholders. Minority Holding Company shareholders who had voted against the sale sued defendant, alleging that the purchase price was based on misrepresentations by defendant. Defendant argued that plaintiffs lacked standing because they were not purchasers or sellers of a security, as required by Rule 10b-5. The court agreed, finding that Holding Company, not plaintiffs, was the seller of the debenture. The court distinguished cases in which shareholders who voted in favor of a merger had standing to bring a direct claim for securities fraud, noting that in those cases, the shareholders exchanged shares in the acquired corporation for shares in the acquiring corporation, but no such exchange had taken place here. The court also addressed the forced seller doctrine, an exception to Rule 10b-5's purchaser or seller requirement, that applies in certain circumstances when a minority shareholder's stock has been converted into a claim for cash as a result of a forced sale. The court found the doctrine inapplicable because plaintiffs had the opportunity to vote on the sale of the debenture, and were simply displeased with the result of the vote. Finally, the court found that plaintiffs could not maintain individual actions for common law fraud, because their allegations were "insufficient to allege an injury to the plaintiffs separate and distinct from the injuries to [Holding Company] and all of its shareholders." The court denied class certification.

5. SLUSA

a. *Instituto De Prevision Militar v. Merrill Lynch*, 546 F.3d 1340 (11th Cir. 2008).

Plaintiff brought a securities class action against defendant corporation asserting state law claims, and contending that defendant, through a pension fund, defrauded it by stealing its money after inducing it to invest in "retirement trust accounts." The suit was brought in federal court, with several others, as ancillary proceedings to a Commission action against the pension fund. The district court granted plaintiff's motion to consolidate several of the ancillary cases for discovery purposes, but subsequently granted defendant's motion to dismiss pursuant to the SLUSA. Plaintiff then amended its original complaint to add a federal securities fraud claim under Section 10(b) and Rule 10b-5 and the district court dismissed for failure to adequately plead the federal claim. On appeal, the 11th Circuit affirmed the ruling, held that plaintiff failed to plead the federal securities fraud claims properly and held that the state claims were barred under SLUSA. The court held that the state claims were barred because they involved a "covered class action" (as they fell within the "group of lawsuits" provision) alleging claims based upon state law causes of action, and that they alleged a misrepresentation or omission "in connection with the purchase or sale" of a "covered security." Further, the court held that the phrase "in connection with the purchase or sale" should be interpreted broadly to include holders of securities in addition to buyers and sellers. The court also held that a hybrid of a "covered security" and a non-covered security satisfied the "covered security" requirement of SLUSA. Finally, the court affirmed the dismissal of the Section 10(b) and Rule 10b-5 claims on the ground that they were inadequately pled.

6. Other Issues

a. *Medkser v. Feingold*, No. 08-11186, 2008 WL 4797512 (11th Cir. Nov. 5, 2008).

Several shareholders filed a direct securities fraud action against the defendants alleging violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Plaintiffs also alleged common law fraud violations as well as common law conspiracy violations. Plaintiffs alleged that defendants made intentional misrepresentations to induce them to invest in a hedge fund and corporation, and subsequently removed plaintiffs' money from these investments and placed it in offshore accounts. Defendants moved for judgment on the pleadings under Fed. R. Civ. P. 12(c), arguing that plaintiffs' claims only could be brought as derivative claims, and that because the corporation was involved in bankruptcy proceedings, such claims only could be brought by the bankruptcy trustee. The 11th Circuit vacated the district court's order granting the motion as to all of the claims except the common law conspiracy claim. The court ruled that the fraud actions were particular to these plaintiffs because they specifically relied upon defendants' misrepresentations, and the fact that other shareholders *may* have been defrauded similarly did not "transform the direct claims into derivative ones." With respect to the civil conspiracy count, however, the court found that it only could be brought as a derivative action because it affected all of the shareholders. The 11th Circuit therefore affirmed the district court's dismissal of that count.

b. *Durgin v. Tousa, Inc.*, No. 06-61844, 2008 WL 2761301 (S.D. Fla. July 15, 2008).

The lead plaintiff in a securities fraud class action withdrew and two other institutional plaintiffs brought renewed motions for appointment as lead plaintiff. The first plaintiff claimed a larger loss but also referred to a second, lower damages figure, which accounted for trades made prior to a corrective disclosure. The second plaintiff claimed lower losses, but argued that the first plaintiff's reference to two damages numbers was evidence that it would not adequately represent the class (specifically, class members who purchased during the class period and sold part of their shares prior to the defendants' disclosures). The court noted that, under the PSLRA, there is a rebuttable presumption that the plaintiff with the greatest financial interest is the most adequate plaintiff. The court further observed that courts routinely analyze loss calculations in terms of trading and removed losses suffered prior to a corrected disclosure, and the first plaintiff's reference to two damages figures was not improper. The court also rejected the second plaintiff's argument that it should be appointed co-lead plaintiff, noting that there was nothing to indicate that the first plaintiff would be an inadequate lead plaintiff, and stating that "allowing co-lead plaintiffs under these circumstances would benefit only the lawyers."

c. *Eagletech Communications Inc. v. Citigroup, Inc.*, No. 07-60668, 2008 WL 3166533 (S.D. Fla. June 27, 2008).

Plaintiffs alleged violations of the U.S. Racketeer Influenced and Corrupt Organizations Act (RICO) as well as violations of several state law claims against various financial institutions and individual defendants. Defendants moved to dismiss all claims, arguing that the RICO claims were barred by the PSLRA, which eliminated "conduct that would have been actionable as [securities fraud]" as a predicate act in RICO actions. Plaintiffs argued that the predicate actions alleged in the complaint constituted theft, not securities fraud, and therefore the PSLRA did not bar the RICO claims. The court rejected that argument, noting that the complaint taken as a whole alleged stock manipulation, and holding that "stock manipulation is a form of securities fraud governed by federal securities laws." Plaintiffs also argued that the PSLRA bar did not apply, because the alleged conduct would not have been actionable as securities fraud on the ground that the plaintiffs lacked standing to sue. The court rejected this argument as well, noting that it is sufficient that the claim could be brought by some plaintiff with proper standing. The court did not dismiss the RICO claims against one of the defendants because he had been criminally convicted of securities fraud and therefore did not fall under the PSLRA bar. The court declined to exercise supplemental jurisdiction over the state law claims, as there was no longer original jurisdiction and questions of state law predominated.

d. *Vujasin v. Chef Vincent, Inc.*, No. 08-22048, 2008 WL 4792049 (S.D. Fla. Oct. 31, 2008).

Plaintiffs brought a securities fraud claim under Section 10(b) of the Exchange Act in connection with the sale of all of the "stock" and complete ownership interest in a restaurant. Defendants moved to dismiss for lack of subject matter jurisdiction arguing that the sale did not involve securities, did not fall under Section 10(b) and therefore did not give rise to federal question subject matter jurisdiction. The court held that the transaction in this case did not involve securities but rather the sale of an entire business where the purchasers only expected profits from their own efforts. Additionally, the court noted that the stocks did not fall within the Exchange Act, because they did not possess any of the characteristics outlined by the US Supreme Court in *United Hous. Found., Inc. v. Forman*, 421 U.S. 837 (1975): "1) whether the stock pays dividends according to profits; 2) whether the stock is negotiable; 3) whether the stock cannot be pledged or hypothecated; 4) whether the stock confers voting rights based upon the number of shares owned; and 5) whether the stocks can appreciate in value." Accordingly, the court found that federal question jurisdiction did not exist. However, the court noted that diversity jurisdiction may exist, and invited the parties to brief the issue.

XIII. DISTRICT OF COLUMBIA CIRCUIT

A. SUMMARY OF DEVELOPMENTS IN 2008

Courts within the District of Columbia Circuit produced two important securities law cases in 2008. In *Republic Prop. Trust*, the district court granted defendants' Rule 12(b) motion to dismiss a securities fraud claim after finding that the limited partnership units at issue in the case were not covered securities under the Exchange Act. Also, in the derivative track of *In re Sunrise Senior Living, Inc.*, the district court ruled that the automatic stay of discovery, which is implemented under PSLRA whenever a motion to dismiss is filed, cannot be lifted absent a need to preserve evidence or a showing of undue prejudice, even where lifting the stay would not be burdensome to the producing party.

B. NOTEWORTHY CASES IN 2008

1. Pleading Requirements for Securities Fraud

a. *Republic Prop. Trust v. Republic Props. Corp.*, 540 F. Supp. 2d 144 (D.D.C. 2008).

Defendants moved to dismiss claims brought against them under Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Plaintiffs had brought claims based on the exchange of limited partnership units for the assignment of a development contract from defendant company. The district court held that the limited partnership units here did not qualify as securities under the Exchange Act's definition of investment contracts, because an investment contract requires an investor be "led to expect profits solely from the efforts of the promoter or third party." In this case the owners of the units purchased were also trustees of the general partner of the selling limited partnership. The court held that because defendants "held management authority in [plaintiff]'s general partner," they could "expect profits from this investment to derive from the efforts of the REIT and by extension [the defendants]," and granted the motion to dismiss.

2. Other Issues

a. *In re Sunrise Senior Living, Inc.*, No. 07-00143, 2008 WL 4726050 (D.D.C. 2008).

Plaintiffs filed a shareholder derivative action against defendant and certain of defendant's directors and officers alleging breaches of fiduciary duties and unjust enrichment. Defendants moved to dismiss the action, automatically triggering a stay on discovery under the PSLRA. Plaintiffs moved to lift this stay partially so they could discover documents which defendants had produced previously to the Commission, as well as documents produced in a parallel lawsuit pending in state court. This automatic stay only can be lifted, in certain circumstances, where the discovery requests sought are both "particularized" and "necessary to preserve evidence or to prevent undue prejudice to [the moving] party." In a matter of first impression for the District of Columbia Circuit, the court ruled that the automatic stay implemented under the PSLRA could not be lifted absent a need to preserve evidence or a showing of undue prejudice, even where lifting the stay would not be burdensome to the defendant. Plaintiffs provided no preservation argument, as the documents requested already were produced to someone else and therefore could not be destroyed completely by defendants. Further, no undue prejudice existed here as both the state court action and the instant action were derivative suits on behalf of the same corporation, and the concurrent Commission investigation resulted in only routine, not undue, prejudice. Therefore, plaintiffs' motion to lift the stay was denied.

The court also evaluated a request to lift the PSLRA discovery stay in a concurrent securities class action involving the same corporate defendant and several of its officers. Following an August 2008 decision to quash a subpoena issued by plaintiffs in light of the stay, plaintiffs filed a motion for reconsideration. On reconsideration, the court found that the plaintiffs' request for the defendant's former CFO's Commission testimony was sufficiently particularized. The court also held undue prejudice existed where the defendant corporation had a confidentiality agreement with the former CFO that barred plaintiffs' communication with him and prevented plaintiffs from obtaining this information. The court ultimately granted the motion to lift the stay only as to the transcript of the former CFO's Commission testimony.

XIV. DELAWARE COURTS

A. SUMMARY OF DEVELOPMENTS IN 2008

In 2008, the Delaware courts decided a number of significant cases on a variety of different issues, including fiduciary duties and personal liability of directors, the responsibilities of Special Litigation Committees (SLC), the advancement rights of a corporation's directors, and the scope of the work product doctrine and attorney-client privilege. In *Berger v. Pubco Corp.*, *In re Transkaryotic Therapies, Inc.* and *Wayne County Employees' Ret. Sys. v. Corti*, the Chancery Court addressed the scope of the fiduciary duty of disclosure. In *Berger,* the court declared that the duty of disclosure is breached where notice of a short-form merger fails to include a copy of the appraisal statute and does not reveal how merger consideration was determined. In *Transkaryotic Therapies,* the court found that violations of the duty of disclosure must be cured in advance of a pending transaction through the request for injunctive relief and that post-closing claims for damages are not cognizable. Similarly, in *Corti*, the court held that claims for breach of the duty of disclosure in mergers should be brought in a motion to enjoin the proposed merger. Additionally, the court noted that projections reviewed by a company's board of directors, but not relied upon by it, do not need to be disclosed in proxy statements.

Addressing the duty of care, in *In re Lear Corp. S'holder Litig.*, the Chancery Court dismissed the plaintiffs' claims for breach of fiduciary duty based on a merger termination fee, finding that the overwhelmingly independent board of directors met regularly, was well-advised, and in their business judgment rationally concluded that the agreement was in the stockholders' best interests. On the topic of directors' personal liability, in *Ryan v. Lyondell Chem. Co.*, the court ruled on a motion for summary judgment that it would allow to proceed to trial the issue of whether independent directors should be exposed to personal liability for their role in the sale of the company, despite the fact that the directors sold the company to the only known buyer for a substantial premium.

The Chancery Court addressed the topic of SLCs in *Sutherland v. Sutherland*, holding that in order for SLCs to demonstrate the good faith, independence, and reasonableness of their investigations they must investigate not just the specific allegations contained in a case's complaint but all claims related to the case. In a separate opinion, also part of the *Sutherland v. Sutherland* litigation, the Chancery Court elaborated on the type of evidence that SLC reports must cite to in order to establish their good faith nature and reasonableness. The court suggested that SLC reports must include record citations to documentary or testimonial evidence when summarizing investigations and factual conclusions, at least in cases involving family-owned corporations and one-member SLCs. It further noted that it would not allow an SLC to supplement an inadequate report where the probative value of the supplemental report would be outweighed by prejudice to the plaintiff and the waste of judicial resources.

The Chancery Court also issued two interesting decisions regarding directors' advancement rights. In *Schoon v. Troy Corp.,* the court held that a corporation could amend its bylaws to remove advancement rights for former directors provided that litigation against any former directors is not threatened by such an amendment. Meanwhile, in *Underbrink v. Warrior Energy Servs. Corp.*, the Chancery Court upheld the validity of a corporation's bylaw that provided for mandatory retroactive advancement rights. The court noted, however, that such retroactive advancement is limited to defending claims "by reason of the fact" of an individual's service as a director.

Also of particular significance, in *Hexion Specialty Chemicals, Inc. v. Huntsman Corp.*, the Chancery Court ruled that documents prepared by or relating to work done by a target corporation's financial advisor were not protected from discovery as work done by a litigation consultant or protected by the attorney-client privilege, work-product doctrine or business strategy immunity.

In *Schoon v. Smith*, the Supreme Court of Delaware clarified the standing requirement for bringing a derivative lawsuit where the individuals seeking to initiate the action are non-shareholder directors of a corporation. The court held that non-shareholder directors of a corporation do not have standing to bring derivative claims on behalf of the corporation. The only exception to this rule is if "a complete failure of justice" would result by denying the non-shareholder directors standing.

Also of note is *Gantler v. Stephens*, in which the Chancery Court held that the business judgment rule protected the decision of an interested board to pursue a share reclassification rather than the sale of a company because this decision was ratified by the company's shareholders.

B. NOTEWORTHY CASES IN 2008

1. Fiduciary Duty

a. *In re Lear Corp. S'holder Litig.*, No. 2728-VCS, 2008 WL 4053221 (Del. Ch. Sept. 2, 2008).

The Chancery Court dismissed plaintiffs' claims for breach of fiduciary duty in connection with an agreement to pay a potential acquirer a termination fee upon shareholder rejection of the proposed acquisition in exchange for additional merger consideration, holding that the overwhelmingly independent board of directors met regularly, was well-advised, and in their business judgment rationally concluded that the agreement could have been in the defendant corporation stockholders' best interests.

b. *Ryan v. Lyondell Chem. Co.*, No. 3176-VCN (Del. Ch. Jul. 29, 2008).

The Chancery Court ruled on a motion for summary judgment that it would allow to proceed to trial the issue of whether independent directors should be exposed to personal liability for their role in the sale of the company — despite selling the company to the only known buyer for a substantial premium.

c. *In re Transkaryotic Therapies, Inc.*, No. 2776-CC, 2008 WL 2699442 (Del. Ch. June 24, 2008).

The Chancery Court held that purported violations of the duty of disclosure should be cured in advance of the pending transaction at issue through a request for injunctive relief. Post-closing claims for damages are not cognizable because they either cannot be monetized adequately or because the former shareholder-plaintiffs will have lost standing to have the alleged injury redressed. Additionally, the court ruled that a delayed claim challenging vote totals for a proposed merger must be proven by clear and convincing evidence.

d. *Berger v. Pubco Corp.*, No. 3414-CC, 2008 WL 2224107 (Del. Ch. May 30, 2008).

The Chancery Court found that the fiduciary duty of disclosure was breached and that minority shareholders were entitled to seek a quasi-appraisal remedy where a company's notice of a short-form merger failed to include a correct copy of the appraisal statute and did not disclose how merger consideration was determined.

2. Business Judgment Rule

a. *Gantler v. Stephens*, No. 2392-VCP, 2008 WL 401124 (Del. Ch. Feb. 14, 2008).

An interested board's decision to pursue a share reclassification instead of a sale of the company was protected by the business judgment rule due to shareholder ratification.

3. Standing

a. *Schoon v. Smith*, No. 554, 2006, 2008 Del. LEXIS 67 (Del. Feb. 12, 2008).

Declining to adopt the New York or ALI model, the Delaware Supreme Court held that non-shareholder directors of a corporation do not have standing to bring derivative claims on behalf of the corporation unless a "complete failure of justice" would result.

4. Special Litigation Committees

a. *Sutherland v. Sutherland*, No. 2399-VCL, 2008 WL 2221770 (Del. Ch. May 29, 2008).

The Chancery Court held that in order for an SLC to show that it conducted a good faith and reasonable investigation, it must fully investigate all of the claims in a case, not merely the specific allegations made in the complaint.

b. *Sutherland v. Sutherland*, No. 2399-VCL, 2008 WL 571253 (Del. Ch. Feb. 14, 2008).

The SLC prepared a report recommending dismissal of the litigation and filed a motion to terminate the derivative action. The plaintiff defended against the motion by challenging the good faith, independence, and reasonableness of the SLC's investigation. The SLC's report summarized its investigation and factual conclusions in a manner that omitted any record citation to documentary or testimonial evidence. Although the court did not go as far as to require all SLC reports to contain such factual citations, it clearly suggested that such citations are necessary in cases involving family-owned corporations and one-member SLCs, such as the instant matter. The court then determined that the probative value of a supplemental report, containing citations to the record, would be outweighed by prejudice to the plaintiff and the waste of judicial resources that would ensue. Ultimately, the court determined that allowing the SLC to supplement its report post-oral argument would unfairly force the plaintiff to take further discovery, brief a new opposition, and prepare for another oral argument.

c. *In re infoUSA, Inc. S'holders Litig.*, No. 1956-CC, 2008 WL 762482 (Del. Ch. Mar. 17, 2008).

As the court "almost invariably" does, it granted the SLC's motion to stay the litigation (and discovery) to allow the SLC time to complete its investigation. The court concluded that creation of the SLC after demand futility was determined was proper, and that independence of the SLC was properly considered if the SLC moved to terminate the litigation after the conclusion of its investigation.

5. Other Issues

a. *Hexion Specialty Chemicals, Inc. v. Huntsman Corp.*, No. 3841-VCL, 2008 WL 3878339 (Del. Ch. Aug. 22, 2008).

Documents prepared by or relating to work done by target corporation's financial advisor were not protected from discovery as work done by a litigation consultant or protected by the attorney-client privilege, work-product doctrine or business strategy immunity.

b. *Wayne County Employees' Ret. Sys. v. Corti,* No. 3534-CC, 2008 WL 2699458 (Del. Ch. July 1, 2008).

The Chancery Court held that claims for breach of the duty of disclosure in mergers should be brought in a motion to enjoin the proposed merger. Additionally, the court noted that projections reviewed by a company's board of directors, but not relied upon by it, do not need to be disclosed in proxy statements.

c. *Weiss v. Swanson,* No. 2828-VCL, 2008 WL 623324 (Del. Ch. Mar. 7, 2008).

The Chancery Court denied defendants' motion to dismiss allegations of spring-loading and bullet dodging when twenty-two of twenty-eight grants were purportedly timed to take advantage of quarterly earnings announcements.

d. *Schoon v. Troy Corp.*, No. 2362-VCL, 2008 WL 821666 (Del. Ch. Mar. 28, 2008).

The court held that an amendment to a corporation's bylaws removing advancement rights for former directors was enforceable where litigation against a former director was not threatened at the time of the amendment. It also concluded that the standing of a current director to seek appraisal was not extinguished by the fact that a third-party, which was not a co-indemnitor of the corporation, had paid the director's legal fees.

e. *Underbrink v. Warrior Energy Servs. Corp.*, No. 2982-VCP, 2008 WL 2262316 (Del. Ch. May 30, 2008).

The Chancery Court found that plaintiffs were entitled to mandatory retroactive advancement under the bylaws of their former employer, which had been recently adopted by unanimous written consent. The court noted, however, that such advancement was limited to amounts incurred defending claims "by reason of the fact" of plaintiffs' service as directors.

XV. SECURITIES & ENFORCEMENT COMMISSION CASES, ADMINISTRATIVE PROCEEDINGS AND RELEASES IN 2008

A. SUMMARY OF DEVELOPMENTS IN 2008

In 2008, the 3^{d}, 9th and 11th Circuits established precedent favoring the Commission. For instance, in *U.S. v. Stringer*, the 9th Circuit held that defendants were not entitled to a dismissal order or suppression of evidence where the defendants' attorney had agreed voluntarily to produce harmful evidence in a civil proceeding. The 9th Circuit held that the Commission did not engage in any "trickery or deceit" in not disclosing the existence of a confidential criminal investigation as the defendants fairly had been warned that a parallel proceeding might be a possibility. Additionally, in *SEC v. Talbot*, the 9th Circuit held that a defendant could be liable under a "misappropriation" theory of insider trading based on the trader's duties owed to the source of the inside information at issue, as opposed to a duty owed to the corporation whose stock he traded. Further, in *Amanat v. SEC*, the 3^{d} Circuit upheld the Commission's cease and desist order and monetary fines against a petitioner who designed and operated a computer trading program that engaged in wash transactions. The 3^{d} Circuit denied the petition for review on the grounds that the Commission's penalties were within its discretion to lodge. In another case involving penalties, in *SEC v. Warren*, the 11th Circuit held that the Commission did not act in bad faith when it sought disgorgement, pre-judgment interest, and a civil penalty against a shareholder with whom the Commission had entered into a consent order, notwithstanding that the shareholder submitted affidavits purporting to show his inability to pay. The 11th Circuit noted that ability to pay is simply a factor in determining whether to impose a penalty, and a court is not prohibited from imposing penalties or disgorgement liability in excess of a violator's ability to pay.

The District of Columbia Circuit also issued two opinions involving the Commission in 2008. In *SEC v. Bolla*, the court ruled that Section 209(e) of the Advisors Act does not authorize courts to impose civil monetary penalties for aiding and abetting violations of the Act. The court also considered the permissibility of FOIA requests filed against the Commission in *Aguirre v. SEC*, holding that although the Investment Advisors Act states that employees of the Commission cannot disclose to outside parties information obtained as a result of an investigation, the Act does not exempt FOIA disclosures. Further, the court noted that the FOIA exemption for trade secrets and confidential commercial information cannot be used to withhold transcripts of depositions.

The district courts also reported a number of notable decisions on a variety of issues in 2008, many of which were pro-Commission. For instance, in evaluating whether certain rights and obligations accorded to private parties were also applicable to the Commission, the Eastern District of Missouri adopted a pro-Commission position, holding, in *SEC v. Kopsky*, that the Commission was entitled to a jury trial in a Section 10(b) action seeking civil penalties just as private parties are permitted. Additionally, in a case addressing the effect of a defendant's invocation of the Fifth Amendment, *SEC v. Brown*, the District of Minnesota rejected the defendants' argument that the court was precluded from granting summary judgment in favor of the Commission as a result of the defendants' invocation, stating that the court could draw an adverse inference as a result thereof. Further, in *SEC v. Berry*, the Northern District of California addressed the applicability of the PSLRA's heightened pleading standards, ruling that the Commission is not subject to the heightened pleading standards unless it actually pleads allegations of fraud.

In *SEC v. Thielbar*, the District of South Dakota addressed the scope of primary liability under Section 17(a) of the Securities Act, holding that a defendant could be held primarily liable under Section 17(a) for directing his staff to record unearned revenues and fictitious profits resulting in a 17% overstatement of profits for the parent corporation, where the defendant knew that those misstatements of revenue would be incorporated into the parent corporation's publicly filed financial statements and thus used in connection with the offer or sale of securities. The court also noted that no showing of scienter was necessary to hold the defendant liable for aiding and abetting a Section 13(a) violation by the parent corporation.

The scope of Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act was addressed by the Middle District of Alabama in *SEC v. Asset Recovery & Mgmt. Trust, S.A.*, in which the court found that the "purchase or sale of a security" requirement was satisfied, notwithstanding that the defendants solicited investments in bank securities that did not exist.

The Southern District of New York clarified the inability to trade after 4 pm using that day's NAV, finding, in *SEC v. Simpson Capital Management, Inc.*, that such trading is deceptive under Rule 22c-1(a) because the timing of the trades communicates a false impression regarding what NAV should have been applied.

The district courts also handed down notable pro-defendant opinions in 2008. For example, the "materiality" of non-public information that was traded on by the defendant was addressed by the Western District of North Carolina in *SEC v. Mangan*, the court holding that the information was immaterial as a matter of law and granting summary judgment in favor of the defendant. The court looked at the movement of the company's stock price, which, after the information was publicly announced, was nine cents above the price at which the defendant made his trade, and twenty-five cents below the price immediately before the public announcement. In *SEC v. Pasternak*, the District of New Jersey concluded that the Commission failed to establish its allegations that the defendants, in their roles as supervisors and senior executives of a registered broker-dealer firm, were primarily and secondarily liable for a firm employee's violations of provisions of the Securities Act and the Exchange Act. In a fact-intensive opinion, the court relied heavily on market conditions that existed during the relevant period, the structure of the firm's business model, the relationship between firm traders and clients, the significant steps the firm took to ensure compliance, and the Commission's failure to establish standards against which a court could measure the alleged improper conduct. Further, even assuming that a violation occurred, the court rejected the Commission's arguments that the defendants could be held primarily liable or liable as control persons based on the evidence presented at trial.

B. NOTEWORTHY CASES IN 2008

1. Pleading Requirements for Securities Fraud

a. *SEC v. Delphi Corp*., No. 06-14891, 2008 WL 4539519 (E.D. Mich. Oct. 8, 2008).

The Commission sued defendant corporation and several of its senior officers under Sections 17(a) of the Securities Act and Sections 10(b), 13(a), 13(b)(2)(a) and 20(e) of the Exchange Act, alleging misstatements in SEC filings and offering documents. Individual defendants filed separate motions to dismiss. The court denied the motions to dismiss, finding that the complaint (1) included facts sufficient to allege scienter under Fed. R. Civ. P. 9(b) and the federal securities laws; (2) adequately plead facts to support Section 17(a) claim because defendant CPA could have anticipated that the internal misstatements at issue would reach the investing public; (3) adequately alleged primary violation of Section 10(b) because it alleged that defendant CPA furnished false information "for disclosure" to the defendant corporation's investors; (4) alleged a viable aiding and abetting claim against defendant CPA based in part on the approval of false work orders with accounting implications; (5) alleged Section 13(b)(5) claim based on allegations that defendant CPA created false books and records; (6) included facts sufficient to support Section 10(b) and 17(a) claims where senior officer was alleged to have "signed key documents and took actions integral to the inflation of operating cash flow and net income numbers with the intended purpose that those materially misstated figures would find their way and be included in [defendant corporation]'s public filings"; (7) alleged Section 13 and Rule 13 aiding and abetting violations based on claim that senior officer "participated and directed schemes to improperly inflate [defendant corporation]'s reported cash flow and net income and feign inventory reductions." The court rejected defendants' request to rule on the SEC's injunction and disgorgement arguments as premature and rejected one defendant's request for severance.

b. *SEC v. Simpson Capital Management, Inc.*, No. 07-6072, 2008 WL 4093046 (S.D.N.Y. Sept. 3, 2008).

The Commission brought a complaint under Section 10(b) of the Exchange Act against defendant capital management firm, its CIO, and head trader. The complaint alleged that defendants' practice of "late trading," in which they traded mutual fund shares after 4 pm but used the NAV set for that day, was deceptive conduct under Rule 10b-5, and that defendants were primarily liable under scheme liability for their actions. Defendants moved to dismiss the complaint for failure to allege deceptive conduct, and also argued that their trades were permissible under Rule 22c-1(a). The court rejected defendants' Rule 22c-1(a) argument that they could trade after 4 pm using that day's NAV if the NAV were set after their trades, and held that all trades benefiting from a day's NAV must be made by 4 pm of that day. The court further held that the complaint properly alleged deceptive conduct under a primary liability theory. The court held that defendants' alleged actions were deceptive because the timing of their trades communicated a false impression regarding what NAV should have been applied to their trades. The court held that because Rule 10b-5(a) and (c) requires only "participation" in an alleged fraud, the extent of defendants' alleged involvement in the late trading scheme would make them primarily liable under Section 10(b). Therefore, the court held that the Commission had made out a claim for deceptive conduct and denied defendants' motion to dismiss.

c. *SEC v. Thielbar*, No. 06-4253, 2008 WL 4360964 (D.S.D. Sept. 24, 2008).

The Commission filed a claim against defendant, the CEO of a subsidiary that was wholly owned by a registered corporation, alleging violations of Section 17(a) of the Securities Act. The complaint alleged that defendant directed his staff to record unearned revenues and fictitious profits, resulting in a 17% overstatement of profits for the parent corporation. Defendant filed a motion to dismiss the complaint. In denying the defendant's motion, the court first ruled that misrepresentations as to income earned which caused a 17% overstatement in a corporation's net income are material. The court then held that Section 17(a)'s prohibition on material misstatements or omissions "in connection with the offer or sale of a security" may extend to cover the officers of subsidiary companies although such officers may not be connected directly to the securities offerings made by the parent corporation. Defendant could be held primarily liable under Section 17(a) in the instant case because he knew that his misstatements of revenue would be incorporated into the parent corporation's publicly filed financial statements, and thus would be used in connection with the offer or sale of securities. Further, in considering whether defendant could be held liable for aiding and abetting a Section 13(a) violation by the parent corporation, the court ruled that no showing of scienter is necessary to prove a civil violation of Section 13(a).

2. Parallel Civil and Criminal Investigations

a. *U.S. v. Stringer*, 521 F.3d 1189 (9th Cir. 2008).

After parallel civil and criminal investigations of a corporation and certain officers by the Commission and the US Attorney's Office resulted in criminal indictments against the officers, defendants moved to dismiss based on government misconduct, arguing that the Commission never disclosed to defendants the existence of the criminal investigation, which had remained confidential. Defendants also moved in the alternative to suppress their deposition testimony, contending that they would have invoked their Fifth Amendment rights against self-incrimination had the Commission Staff Attorney not concealed the existence of the criminal investigation, and to suppress certain privileged evidence that their attorney voluntarily turned over to the Commission that was damaging to the individual defendants. The 9th Circuit reversed the lower court's order of dismissal, ruling that the Commission did not engage in any "trickery or deceit," had no affirmative duty to disclose the existence of the criminal investigation and that the Commission's standard disclosure form warning individuals that any information provided to the Commission may be used against them in subsequent criminal proceedings was sufficient to put defendants on notice. The court also reversed the order suppressing the deposition testimony and evidence; because the Commission's disclaimers were sufficient to put defendants on notice of the criminal investigation, their failure to invoke the Fifth Amendment constituted a voluntary and effective waiver. Moreover, the court ruled that defendants' attorney's voluntary production of harmful evidence arose out of her own conflict of interest in representing both the corporation and the officers, and the Commission had warned the attorney of this potential conflict previously. Accordingly, the court refused to suppress this evidence.

3. Penalties

a. *Amanat v. SEC*, No. 06-5209, 2008 WL 723890 (3d Cir. Mar. 17, 2008).

Petitioner designed and operated a computer trading program that engaged in wash transactions for the sole purpose of obtaining a cash rebate. The Commission found that these actions constituted a willful violation of Section 10(b) of the Exchange Act and Rule 10b-5, barred petitioner from associating with brokers for five years, entered a cease and desist order and imposed $60,000 in fines. The court denied the petition to review, holding there was substantial evidence to support the Commission's determination. Additionally, the petition was denied because the penalties imposed were within the agency's discretion, based on petitioner's risk of violating the securities laws in the future, and the seriousness of the conduct.

b. *SEC v. Warren*, 534 F.3d 1368 (11th Cir. 2008).

The Commission brought an action against a corporation and sole shareholder, alleging violations of federal securities laws. The parties agreed to a consent order stipulating that the shareholder would pay a civil penalty, disgorgement and pre-judgment interest. The shareholder asked that the Commission waive his liability, and submitted financial affidavits purporting to show his inability to pay. The Commission nonetheless moved for summary judgment and the court ordered disgorgement of $6.4 million, pre-judgment interest of $1,981,734.50, and a $75,000 civil penalty. Upon appeal, the shareholder argued that the Commission acted in bad faith by imposing penalties and "ignoring" his inability to pay. The court held that ability to pay is simply a factor in determining whether to impose a penalty, and a court is not prohibited from imposing penalties or disgorgement liability in excess of a violator's ability to pay. The court also noted that even if inability to pay was decisive the shareholder did not establish inability to pay, but rather established that he had the ability to pay a substantial judgment. The court did not decide whether the Commission had an obligation under the consent order to consider the shareholder's financial affidavits in good faith when deciding whether to waive penalties, but found that, even if the Commission did have such an obligation, it did exercise good faith.

c. *SEC v. Bolla*, 550 F. Supp. 2d 54 (D.D.C. 2008).

The Commission brought a civil enforcement action against an investment advisory firm alleging violations of the Investment Advisors Act, and against the firm's co-owner alleging he aided and abetted those violations. The court initially imposed an injunction prohibiting future violations and civil monetary penalties against both defendants, but the District of Columbia Circuit remanded on appeal ordering the district court to narrow the breadth of the injunction. On remand, the court revised the terms of the injunction and neither party challenged these new terms. However, during the remand the co-owner challenged the availability of monetary penalties for aiding and abetting liability under the Advisors Act. The court refused to consider this new argument on remand, but defendant subsequently filed a motion to amend the final judgment under Fed. R. Civ. P. 60(b)(4) which the court properly considered. In a matter of first impression for the District of Columbia Circuit, the court ruled that Section 209(e) of the Advisors Act does not authorize the court to impose civil monetary penalties for aiding and abetting violations of the Act. Such penalties may be imposed on aiders and abettors only as part of administrative proceedings, as expressly provided in Section 203(i) of the Act.

4. Scienter

a. *SEC v. Asset Recovery & Mgmt. Trust, S.A.*, No. 02-1372, 2008 WL 4831738 (M.D. Ala. Nov. 3, 2008).

The Commission brought an action against the defendants for securities fraud alleging violations of Sections 17(a), 5(a) and 5(c) of the Securities Act as well as Section 10(b) of the Exchange Act and Rule 10b-5 in connection with a "prime bank" scheme, in which the defendants solicited investments by telling the prospective investors that their money would be invested in high-yield bank-issued securities not available to the general public, when no such investments existed, and the victims' funds were never returned. The Commission moved for summary judgment, seeking a permanent injunction, disgorgement and a civil monetary penalty, and the court granted the motion. The court found that the "purchase or sale of a security" requirement was satisfied, even though the purported investments in bank securities promoted by the defendants never existed. The victims' investments with the defendants were "investment contracts" and "securities" under Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act. Furthermore, because the defendants did not register the "investments" with the Commission, the court found that they violated Sections 5(a) and 5(c) of the Securities Act, which prohibits the offer or sale of unregistered securities. The court held that the failure of the defendants to conduct an adequate investigation into the investment program showed a level of recklessness sufficient enough to meet the scienter requirement. The court granted the Commission's request for an injunction because it found that the likelihood of recurrence was high, and granted $1.2 million in disgorgement and an additional $1.2 million in civil penalties due to the egregiousness of the violations, the harm to innocent third parties, and the degree of scienter.

5. Fifth Amendment Privilege and Adverse Inference

a. *SEC v. Brown*, 579 F. Supp. 2d 1228 (D. Minn. 2008).

The Commission brought an action against defendants, an investment advisor and its principal, for misappropriation of client funds. The Commission alleged that between 2004 and 2006 defendants used approximately $870,000 of client funds for non-investment purposes. The Commission moved for summary judgment against defendants alleging violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5. The court held that there was no genuine issue of fact to be tried because the evidence on record showed that defendants had scienter in violating these sections. The court rejected defendants' argument that defendant principal's invocation of the Fifth Amendment during discovery meant that the record could not sustain a grant of summary judgment. The court noted that it could draw an adverse inference from this invocation, and the evidence submitted by the Commission supported that defendants acted with scienter and extreme recklessness. The court therefore granted summary judgment against defendants and ordered the parties to file briefs addressing the appropriate civil penalty.

6. Right to Jury

a. *SEC v. Kopsky*, 537 F. Supp. 2d 1023 (E.D. Mo. 2008).

In a Section 10(b) action seeking civil penalties, the court held that the Commission had satisfied the two-part *Tull* test and, thus, was entitled to demand a jury trial under the Seventh Amendment. Specifically, the court found that (1) a civil penalty is analogous to an action in debt which was heard in English courts of law and that (2) a civil penalty imposed as a fine rather than disgorgement is a legal remedy. The court further held that a party's status as plaintiff or defendant was irrelevant to the Seventh Amendment inquiry, and that it had no discretion to deny the Commission's right to demand a jury trial simply because it was a government entity.

7. Backdating Stock Options

a. *SEC v. Berry*, No. 07-4431, 2008 WL 2002537 (N.D. Cal. May 7, 2008).

The district court granted in part and denied in part defendant's motion to dismiss a Commission complaint alleging various claims of securities fraud related to the backdating of stock options by defendant at two companies. The court first addressed the five-year statute of repose established under 28 U.S.C. § 2462. In doing so, it noted that, in the 9th Circuit, claims seeking civil penalties are covered by Section 2462's limitations period while claims seeking disgorgement of ill-gotten gains, permanent injunctions against the violation of securities laws, and an officer and director ban are not. The court further noted, however, that Section 2462 is subject to equitable tolling if fraudulent concealment of operative facts can be established. With respect to claims under Section 10(b), the court reiterated that since the Commission is not a private entity, its allegations were not subject to the PSLRA. As such, only its allegations of fraudulent conduct were required to satisfy Fed. R. Civ. P. 9(b)'s heightened pleading standard while allegations of intent, knowledge, and other states of mind could be pled generally. The court then held that "[s]igning a document containing a false statement can satisfy the conduct prong of Rule 10b-5" as can "[s]ubstantial or intricate involvement in preparing a false statement that is later made by another . . . ." However, it concluded that the Commission's broad allegations that defendant made material misrepresentations merely because she "reviewed," "discussed," and "finalized" certain public filings did not satisfy Rule 9(b)'s heightened pleading standard for allegations of fraudulent conduct. The court further noted, though, that even if the complaint could not sufficiently allege Section 10(b) claims based on specifically identified material misrepresentations, it still could establish liability successfully by alleging participation in a fraudulent scheme.

8. Other Issues

a. *SEC v. Schroeder*, No. 07-03798, 2008 U.S. Dist. LEXIS 46465 (N.D. Cal. May 22, 2008).

The Commission claimed that defendant violated several securities laws. The Commission had been provided, for use in its case, with privileged communications by a company for which defendant formerly had served as president and CEO. The company stated that it would assert its attorney-client privilege to prevent defendant from using these communications in his defense. Defendant moved to dismiss the case on the ground that the company's third-party assertions of privilege would prevent him from presenting potentially viable defenses. Analogizing to federal cases involving the government's third-party assertion of the state secrets privilege, the court stated that third-party assertions of privilege could require the dismissal of a case if the assertions were found to be valid. In the instant matter, because defendant had not yet challenged the validity of the company's assertion of privilege, the court denied defendant's motion to dismiss. The court held that defendant must first establish that the company asserted a valid privilege before it would reach a final decision as to whether the case should be dismissed.

b. *SEC v. Talbot*, 530 F.3d 1085 (9th Cir. 2008).

In April of 2003, defendant, a director of a company, learned at a board meeting that a mortgage company in which his company owned an approximate 10% interest potentially was going to be sold at a significant premium. Defendant soon thereafter purchased on margin a total of $140,000 worth of the mortgage company's stock, which he sold shortly after the pending transaction was announced. Defendant made almost $68,000 in profit from the sale of stock. The Commission brought an action against the defendant alleging that he violated Section 10(b) of the Exchange Act and Rule 10b-5. The district court granted summary judgment in favor of the defendant.

On appeal, the 9th Circuit reversed and remanded the decision of the district court, holding that the defendant could be found liable under a "misappropriation" theory of insider trading. Because the defendant was not an insider at the mortgage company, he could not be held liable under the "classical theory" of liability. The misappropriation theory, however, premises liability on the breach of a duty that a trader owes to the source of the inside information at issue, as opposed to a duty owed to the corporation whose stock he traded. The 9th Circuit found that the district court had misinterpreted *United States v. O'Hagan*, 521 U.S. 642 (1997), to require that there be a continuous chain of fiduciary duties linking the trader to the original source of the inside information for the misappropriation theory to apply. In doing so, it "decline[d] to read an 'originating source' requirement into *O'Hagan*," and held that the defendant could be found liable based on his breach of the fiduciary duty that he owed to the company where he was a director alone. Rather than granting judgment as a matter of law, however, the 9th Circuit merely reversed and remanded the decision of the district court because there remained a genuine issue of material fact as to whether the inside information the defendant allegedly traded on was material.

c. *SEC v. Pasternak*, 561 F. Supp. 2d 459 (D.N.J. 2008).

The Commission filed a complaint against defendants alleging that, in their role as supervisors and senior executives of a registered broker-dealer firm, defendants were primarily and secondarily liable for a firm employee's violations of provisions of the Securities Act and the Exchange Act. In a fact-intensive opinion, the court concluded that the Commission failed to establish any of its allegations by a preponderance of the evidence. Relying heavily on market conditions that existed during the relevant period, the structure of the firm's business model, the relationship between firm traders and clients, the significant steps the firm took to ensure compliance, and the Commission's failure to establish standards against which a court could measure the alleged improper conduct, the court concluded that the Commission failed to establish that the firm employee had violated the Securities Act or the Exchange Act. Further, even assuming that a violation occurred, the court rejected the Commission's arguments that defendants could be held primarily liable. The Commission failed to produce evidence that defendants made misrepresentations about best execution or violated any fiduciary duties owed to their clients, who were, by and large, satisfied with defendants' firm's service. Finally, the court rejected the Commission's control liability theory, holding that the evidence presented at trial failed to demonstrate either that defendant directly or indirectly induced the employee's bad conduct, or that defendant failed to act in good faith.

d. *SEC v. Mangan*, No. 06-531, 2008 WL 3925059 (W.D.N.C. Aug. 20, 2008).

The Commission brought claims against the defendant for violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5, alleging that the defendant traded on his knowledge of non-public information regarding a private investment in public equity (PIPE) transaction. The court held that the materiality of the information regarding the PIPE should be determined as of the time of the defendant's trade. Accordingly, the court evaluated materiality from the time of the defendant's trade until the closing of the market that day. The company's stock closed at $14.25 that day, nine cents above the price at which the defendant made his trade, and twenty-five cents below the price immediately before the public announcement of the PIPE. The court found this price variance to be statistically insignificant and, therefore, held that the information about the PIPE was not material. In reaching this conclusion, the court noted that "[m]any courts have held that information may be deemed immaterial as a matter of law when the public disclosure of such information has a negligible effect on the price of the stock." However, the court also noted that the 4^{th} Circuit "has not specifically opined on whether stock price history alone may determine materiality." Nonetheless, the court granted the defendant's motion for summary judgment and ordered a judgment in favor of the defendant on the grounds that the information about the PIPE was immaterial as a matter of law.

e. *SEC v. Lauer*, No. 03-80612, 2008 WL 4372896 (S.D. Fla. Sept. 24, 2008).

The Commission brought a securities action against an individual defendant alleging violations of Sections 17(a)(1),(2) and (3) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5, both individually and as a control person pursuant to Section 20(a) of the Exchange Act, as well as Sections 206(1) and 206(2) of the Investment Advisors Act of 1940. The Commission moved for summary judgment and asked the court to permanently enjoin the defendant from future violations of these sections, order disgorgement and prejudgment interest, and to reserve jurisdiction to impose civil money penalties. The court granted summary judgment, noting that all of the elements of fraud were established by the undisputed facts, including misrepresentations in "(a) private placement memoranda; (b) investor newsletters; (c) fictitious portfolios; (d) telephone conferences and other meetings with investors; and (e) materially false and misleading net asset values . . . for the [hedge funds]." The misrepresentations "involved the portfolio positions, the status of [fund] audits, the concerns and ultimate resignations of the Funds' domestic auditor and offshore administrator, the background and employment of key personnel, excessive concentration of the illiquid and essentially worthless positions in [a fund], and the whereabouts of the Funds' assets." Further, the court granted a permanent injunction and found the individual defendant liable as a control person on the basis that he exerted control over the defendant company and orchestrated the fraud. The court noted that determining the amount of disgorgement would be fact intensive and reserved its ruling until after an evidentiary hearing. Similarly, the court reserved jurisdiction to impose a civil penalty at the request of the Commission.

f. *Aguirre v. SEC*, 551 F. Supp. 2d 33 (D.D.C. 2008).

Plaintiff, a former Commission employee who was terminated after pursing investigation of a certain investment advisory firm, sued the Commission under FOIA to obtain access to documents. The Commission argued that the documents sought fell within the exemptions listed in FOIA. The court generally concluded that the Commission could not use the FOIA exemptions to withhold the information sought. Among the several FOIA exemptions discussed in the opinion, two general conclusions were notable. First, though the Investment Advisors Act states that employees of the Commission shall not disclose information obtained as a result of any investigation to outside parties, the Act does not qualify as an "Exemption 3 statute" specifically exempting FOIA disclosures. Second, the exemption for "trade secrets and commercial or financial information obtained from a person [that is] privileged or confidential" (Exemption 4) cannot be used to protect transcripts of deposition testimony. Such information is only considered confidential when its disclosure would impair the government's ability to obtain such information in the future, and this is not a concern for the Commission given its ability to compel testimony. Also, there is no basis to believe that disclosure of testimony would adversely impact the quality or reliability of information revealed to the Commission.

XVI. DEVELOPMENTS WITH THE PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD IN 2008

A. NOTABLE RULEMAKING IN 2008

1. Compliance with Section 102(d) of Sarbanes-Oxley

On June 10, 2008, the Public Company Accounting Oversight Board (the PCAOB) adopted rules for annual and special reporting by accounting firms that are registered with the PCAOB. The reporting framework includes two types of reporting obligations of information and events to comply with Section 102(d) of Sarbanes-Oxley. Each year, a registered firm must provide basic information about the firm and its issuer-related practice over the past twelve-month period. This basic information should include audit reports issued by the firm in the past year, certain disciplinary history information about new firm employees, and information about fees billed to issuer audit clients, in various categories of services, as a percentage of the firm's total fees billed. In addition to the annual reporting, these adopted rules identify certain events that, if they occur with respect to a registered firm, must be reported by the firm within thirty days. These reportable events cover a range of events such as a change of name of address for a firm or the institution of specific legal, administrative, or disciplinary proceedings against a firm or certain categories of individuals. The PCAOB will submit the rules to the Commission for approval, and the rules will take effect sixty days after Commission approval. The earliest potential special reporting deadline for any firm would be ninety days after Commission approval. For all firms, the first annual report will be due by June 30, 2009, for the twelve-month period ending March 31, 2009.

2. Proposed Auditing Standards Relating to the Auditor's Assessment of and Responses to Risk

On October 28, 2008, the PCAOB voted to propose for public comment seven new auditing standards relating to the auditor's assessment of and responses to risk. The proposed standards will supersede five interim auditing standards: AU Sec. 311, Planning and Supervision, AU Sec. 312, Audit Risk and Materiality in Conducting an Audit, AU Sec. 313, Substantive Tests Prior to the Balance Sheet Date, AU Sec. 319, Consideration of Internal Control in a Financial Statement Audit, and AU Sec. 326, Evidential Matter.

The proposed risk assessment standards are as follows:

- *Audit Risk in an Audit of Financial Statements*. This proposed standard describes the components of audit risk and the auditor's responsibilities for reducing audit risk to an appropriately low level in order to obtain reasonable assurance in an audit of financial statements.
- *Audit Planning and Supervision*. This proposed standard describes the auditor's responsibilities for planning the audit, including assessing matters that are important to the audit, and establishing an appropriate audit strategy and audit plan. The proposed standard also describes the responsibilities of the engagement partner and other engagement team members for supervising and reviewing the work of the engagement team.

- *Identifying and Assessing Risks of Material Misstatement*. This proposed standard describes the auditor's responsibilities for identifying and assessing risks of material misstatement. The risk assessment process discussed in the proposed standard includes information-gathering procedures to identify risks (*e.g.*, obtaining an understanding of the company, its environment, and its internal control) and analysis of the identified risks.
- *The Auditor's Responses to the Risks of Material Misstatement*. This proposed standard sets forth the auditor's responsibilities for responding to the risks of material misstatement in the general conduct of the audit and specific audit procedures.
- *Evaluating Audit Results*. This proposed standard describes the auditor's responsibilities regarding the process of evaluating the results of the audit in order to form the opinion(s) to be presented in the auditor's report. This process includes evaluating uncorrected misstatements and control deficiencies identified during the audit.
- *Consideration of Materiality in Planning and Performing an Audit*. This proposed standard sets forth the auditor's responsibilities for applying the concept of materiality, as described by the federal securities laws, in planning the audit and determining the scope of the audit procedures.
- *Audit Evidence*. This proposed standard sets forth the auditor's responsibilities regarding designing and applying audit procedures to obtain sufficient appropriate evidence to support the opinion(s) in the auditor's report. In particular, it discusses the principles for determining the sufficiency and appropriateness of audit evidence.

The Board is proposing these standards for a 120-day comment period, ending February 18, 2009.

B. NOTABLE RELEASE IN 2008

1. Auditing Standard No. 6 – Evaluating Consistency of Financial Statements [1] (Jan. 29, 2008).

On January 29, 2008, the PCAOB adopted Auditing Standard No. 6, Evaluating Consistency of Financial Statements (AS No. 6) which supersedes AU Secs. 420 and 9420. The PCAOB acted in response to two actions of the Financial Accounting Standards Board (FASB). In May 2005, the FASB issued statement of Financial Accounting Standards (SFAS) No. 154, *Accounting Changes and Error Corrections*. The FASB also issued an exposure draft of a proposed Statement of Financial Accounting Standards, *The Hierarchy of Generally Accepted Accounting Principles*.

Under SFAS No. 154, accountants are to use retrospective application as the required method for reporting a change in accounting principle, unless impracticable, in the absence of explicit transition requirements specific to a newly adopted accounting principle. The term "restatement" does not refer to changes made to previously issued financial statements to reflect a change in accounting principle under SFAS No. 154. Under AS No. 6, auditors are required to

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[1] PCAOB Release No. 2008-001, PCAOB Rulemaking Docket Matter No. 023.

evaluate the consistency of a company's financial statements and report on inconsistencies. AS No. 6 updates these requirements and aligns them more closely with SFAS No. 154. The new standard also clarifies that the auditor's report should indicate whether an adjustment to prior-period financial statements results from a change in accounting principle or the correction of a misstatement.

In addition, the FASB has proposed to incorporate the GAAP hierarchy into its own standards. Because the GAAP hierarchy identifies the sources of accounting principles and the framework for selecting principles to be used in the preparation of financial statements, the PCAOB believes that these requirements should be located in the accounting standards. The PCAOB amended its interim standards to remove the GAAP hierarchy from the auditing standards. These amendments do not change the principles in AU sec. 411 for evaluating fair presentation of the financial statements in conformity with GAAP. The standard and amendments will be effective sixty days after Commission approval.

XVII. UK

A. SUMMARY OF DEVELOPMENTS IN 2008

There were a number of notable decisions from the United Kingdom in 2008 that may affect the litigation of securities claims but which did not involve securities as the subject matter. For instance, two opinions delivered in early 2008 demonstrated a judicial reluctance to stay proceedings despite the risk of inconsistent judgments from courts or arbitration panels considering related litigation in different jurisdictions. In *Curtis v. Lockheed Martin UK Holdings Ltd.* and *Verity Shipping SA v. NV Norexa*, courts recognized the potential for inconsistent judgments as an important factor in analyzing whether to grant a stay of proceedings. However, in both, the courts determined that the risk of inconsistent judgments was not dispositive of the applications.

In addition, the limits of the implied obligation of confidentiality in the arbitration context continued to evolve last year. In authorizing disclosure of documents generated in an English arbitration to other international proceedings, the High Court, in *Emmott v. Michael Wilson & Partners Ltd.* provided a detailed analysis of both the general obligation of confidentiality in international arbitration and the exceptions to that general obligation.

Also in the alternative dispute resolution context, the court in *Earl of Malmesbury v. Strutt and Parker* held that a party's "unrealistic and unreasonable" stance in mediation is a relevant factor in determining costs to be awarded. Therefore, parties should be advised that extreme positions taken in mediation could negatively impact costs awards.

This past year also saw courts in the United Kingdom address myriad issues relevant to large-scale litigation. For example, in *Hutchinson 3G v. O2*, the High Court, in rejecting a broad request for pre-action disclosure, enumerated various considerations that courts may examine when deciding discretionary document request applications. In *Masri v. Consolidated Contractors International Company SAL and others*, the Court of Appeal employed an anti-suit injunction to restrain foreign proceedings seeking to relitigate a matter. *Masri* highlights the fact that where a defendant has submitted to an English court's jurisdiction, the defendant will likely be unable to re-litigate in a foreign venue. Finally, the High Court clarified the test as to the type of misconduct necessary for the successful use of the unclean hands equitable defense in *Fiona Trust & Holding Corp. v. Privalov*.

In addition to those significant developments, 2009 will see major modifications in United Kingdom law, most notably in the adoption of the Rome I and Rome II Regulations. These Regulations will fundamentally modify the way in which the law applicable to contractual and non-contractual obligations is determined under English law. The potentially important and wide-ranging implications of Rome I and Rome II require renewed consideration of all key cross-border contractual relationships.

B. NOTEWORTHY LEGISLATION AND CASES IN 2008

1. Jurisdiction over Arbitrable Disputes and the Risk of Inconsistent Judgments

a. *Curtis v. Lockheed Martin UK Holdings Ltd.* (Feb. 2008).

A stay request was denied in *Curtis v. Lockheed Martin UK Holdings Ltd.*, in which the defendant sought to stay an English action pending completion of Italian proceedings. The court denied the application because the benefits likely to result from a stay did not "clearly outweigh any disadvantage." Specifically, although a risk of inconsistent decisions existed, that risk was counterbalanced by the fact that a stay merely reduced, and did not eliminate, that risk. Moreover, the significant delay to the resolution of the English claim was found to prejudice the plaintiff, despite the availability of an interest award to compensate for the delay. Because the scales were in near equipoise, a stay was refused.

b. *Verity Shipping SA v. NV Norexa* (Jan. 2008).

The High Court denied an application to continue an anti-suit injunction based on an arbitration in Antwerp. Because of the movant's significant delay in seeking the injunction, and despite the potential injustice to a third party due to the possibility of inconsistent decisions, the court concluded that there was "strong cause or good reason for not granting" the requested relief.

2. Confidentiality and Arbitration Proceedings

a. *Emmott v. Michael Wilson & Partners Ltd.* (Mar. 2008).

In affirming the Court of Appeal's authorization of disclosure of documents generated in an English arbitration to proceedings in New South Wales and the British Virgin Islands, the High Court discussed the impact of confidentiality in international arbitration. The court noted the general rule that arbitration is private and that, by its very nature, arbitration creates an implied obligation on both parties to maintain the privacy of the proceedings. Indeed, arbitration imposes a general obligation on the parties "not to disclose or use for any other purpose any documents prepared for and used in the arbitration, or disclosed or produced in the course of the arbitration, or transcripts or notes of the evidence in the arbitration or the award, and not to disclose in any other way what evidence has been given by any witness in the arbitration."

That general rule, however, does not mean that arbitration is private for all purposes. Although the limits of the confidentiality obligation "are still in the process of development on a case-by-case basis," the court enumerated four exceptions: (1) where there is consent; (2) where there is an order or leave of court; (3) where it is reasonably necessary for the protection of the legitimate interests of an arbitrating party; and (4) where the interests of justice require disclosure. Invoking the interests of justice exception, the court ordered disclosure of the documents at issue, preventing the arbitrating parties from "us[ing] the cloak of confidentiality . . . to mislead[] or potentially mislead[] foreign courts" where the cases in the foreign tribunals raised the same or similar allegations.

3. Pre-Action Disclosure

a. *Hutchinson 3G v. O2 and others* (Jan. 2008).

Overseeing a dispute among cellular telephone providers, the High Court held that principles of effective case management meant that pre-action disclosure of extremely broad classes of documents may not be justified. Applications for pre-action disclosure must clear two threshold requirements: standard disclosure and desirability. With respect to standard disclosure, the court held that the applicant must show "that it is more probable than not that the documents are within the scope of standard disclosure in regard to the issues that are likely to arise." Although the court recognized that "the line will always be difficult to draw," applicants are well-served by refining document requests to ensure compliance. It is not enough to say that the classes of documents were "likely to" or "may well" fall within the test for standard disclosure. With respect to desirability, the court noted that successful applications for pre-action disclosure must present circumstances "outside 'the usual run' to allow the hurdle to be surmounted."

Importantly, even if both threshold requirements are met, pre-action disclosure determinations are still discretionary. Thus, in denying its application, the court noted that plaintiff's substantive claims were speculative, that the disclosure sought was large and unfocused, and that compliance with the request would cost approximately £1 million, but was unlikely to produce sufficient benefit.

4. Banking Litigation

a. *JP Morgan Chase Bank v. Springwell Navigation Corp.* (May 2008).

In this case, the Commercial Court rejected a wide range of claims made by Springwell Navigation Corporation after it suffered substantial losses by investing heavily in emerging market debt. The primary claim was based on the allegation that the bank had a contractual and tortuous duty to advise Springwell as to the appropriateness of its investments, both at the point of sale and on an ongoing basis. The court rejected that claim, finding that the bank owed no such duty. In reaching that conclusion, the court considered a number of factors such as Springwell's level of sophistication, the absence of an advisory agreement, the absence of an indication of an advisory agreement, the role of the bank as salesman that provided merely recommendations and opinions, and the contractual relationship between the parties, which prevented both general and specific advisory duties from arising. Because those factors demonstrated that the intended relationship was for "execution only" purposes, the bank was not held accountable for the losses.

5. Anti-Suit Injunction

a. *Marsi v. Consolidated Contractors International Company SAL and others* (June 2008).

Following the failure of foreign defendants to pay any part of a $55 million judgment, the Court of Appeal held that were a judgment was made against a party that had submitted to an English court's jurisdiction, the court has an ancillary power to grant an injunction restraining the liable party from pursuing or continuing proceedings abroad that attempt to re-litigate the matter. According to the court, that discretionary power should be exercised in accordance with principles of international comity.

6. Recovery of Costs

a. *Earl of Malmesbury v. Strutt and Parker* (May 2008).

In assessing the award of litigation costs, Justice Jack of the Queen's Bench Division considered the claimant's "unrealistic and unreasonable" position at mediation. According to the court, a party's unreasonable stance in a mediation is "not dissimilar in effect" from an unreasonable refusal to engage in mediation. Because "had [claimants] made an offer which better reflected their true position, the mediation might have succeeded," the court reduced the claimant's recoverable costs by twenty percent.

7. Unclean Hands

a. *Fiona Trust & Holding Corp. v. Privalov* (July 2008).

Justice Smith's opinion in this action arising out of complex and substantial fraud claims clarified the test with respect to the equitable defense of "unclean hands" – that is "he who comes to equity must have clean hands." Specifically, for the unclean hands defense to apply there must be a "sufficiently immediate" relationship between the misconduct alleged and the relief sought. Although the opinion went to great lengths to emphasize the fact-sensitivity of the inquiry, the court made some general observations. First, the defense is typically directed towards conduct that is in some way immoral and deliberate. Second, not all misconduct will deprive an applicant of equitable relief. Indeed, some misconduct may be too trivial to merit successful application of the defense. Third, and finally, misconduct should be assessed cumulatively.

8. Revisions to Companies Act of 2006

On October 1, 2008, additional provisions of the Companies Act of 2006 came into force, including sections relating to directors' duties (to avoid conflicts of interest, not to accept benefits from third parties, and to declare interests), the repeal of the restrictions in the Companies Act of 1985 regarding financial assistance for the acquisition of shares in private companies (including the "whitewash" procedure), and provisions on trading disclosures.

9. Forthcoming Changes to the Law

a. Rome I and Rome II

The law applicable to contractual and non-contractual obligations under English law will be fundamentally modified in 2009 as the existing statutory and common law bases for determining the applicable law will be replaced by the Rome I and Rome II Regulations. Although Rome I represents the updating of an existing regime, Rome II is a significant departure from the status quo, permitting parties, for the first time, to choose (subject to some exceptions) the law applicable to their non-contractual obligations.

1. Rome I

Under Rome I, which the United Kingdom will implement on December 17, 2009, parties are free to choose the law that governs their contracts. In the absence of such a selection, Rome I provides that a contract will be governed by the law of the country with which it is most closely connected, as determined by the application of criteria enumerated in the Rome Convention.

2. Rome II

Rome II seeks to standardize the rules by which the law applicable to non-contractual obligations is determined to ensure that the courts of European Union Member States apply the same choice of law rules. Rome II, which took effect January 11, 2009, endeavors to facilitate the mutual recognition of judgments, increase legal certainty, and reduce forum shopping.

The fundamental change introduced by Rome II will effect "non-contractual" obligations, such as torts, breaches of statutory duty, unjust enrichment, and restitutionary claims. Under Rome II, the *lex loci delicti commissi* principle (the law of the place where the harmful act was committed governs) will be replaced by the general rule that the law applicable to non-contractual obligations will be determined based on where the damage occurs or is likely to occur, regardless of the country or countries in which the act giving rise to the damage occurred. There are, however, significant exceptions, including when: (1) the tort is "manifestly more closely connected" with another country; (2) there are mandatory rules of the forum; (3) application of a provision of the chosen law is "manifestly incompatible" with the forum's public policy; (4) the parties have agreed on a particular law to govern their non-contractual obligations; and (5) the parties have their habitual residence in the same country. It is also important to note that special rules apply to product liability, unfair competition, environmental damage, intellectual property, and industrial actions.

In addition, Rome II provides that the governing law of a non-contractual obligations arising out of pre-contractual dealings, whether the contract was actually concluded or not, will be the law that applies to the contract itself. Although in English law, pre-contractual negotiations are generally inadmissible and irrelevant, the effect of Rome II is that parties to abortive negotiations who included a governing law clause in their draft agreement may find themselves bound by the law in relation to any non-contractual liabilities which may arise, such as negligent misrepresentation or breach of confidence. This will require great care during cross-border negotiations to ensure that foreign law does not impose unexpected obligations on the parties. For example, some jurisdictions imply obligations of good faith in commercial negotiations – obligations not recognized under English law.

Rome II also allows parties to agree on the law that will govern non-contractual obligations. Such agreements can be made prior to the event causing damage only where the parties are pursuing a commercial activity, provided the agreement is freely negotiated. Conversely, agreements between the parties as to the applicable governing law which post-date the event can be made irrespective of whether or not the parties engage in commercial activity.

Finally, Rome II has "universal application," which means that the courts of Member States will always apply Rome II to determine non-contractual obligations even if the application of those rules results in the substantive law of a non-Member State being selected. Should the law of a non-Member State govern, the court presumably will have to hear expert evidence on the relevant principles of that governing law.

b. Civil Justice Council's Report – "Improving Access to Justice Through Collective Actions"

In an effort to assist in the development of a more efficient and effective procedure for collective actions, the Civil Justice Council published "Improving Access to Justice Through Collective Actions." The Civil Justice Council made a number of recommendations to improve collective actions including: (1) a generic collective action should be introduced as a cause of action in the civil courts; (2) a wide range of representative parties should be able to bring collective actions, including individual litigants with a direct interest in the dispute, designated bodies (such as charities, trade unions, and public interest bodies), and *ad hoc* bodies; (3) collective actions should be brought on either an opt-in or opt-out basis, and it should be for the court to determine the most appropriate basis; (4) collective actions should be approved by the courts (in other words, the courts would carry out a preliminary assessment of the merits of the claims advanced collectively); (5) in the case of opt-out collective actions, the court should be able to aggregate damages; and (6) the "loser pays" principle should continue to apply. The Civil Justice Council invited the Lord Chancellor to provide a formal response.