LATHAM & WATKINS LLP

Compendium of Securities Law in 2010

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I. SUPREME COURT

A. SUMMARY OF DEVELOPMENTS IN 2010

The Supreme Court decided two noteworthy cases in 2010. In *Merck & Co., Inc. v. Reynolds*, the Court held that under an "inquiry notice" theory, the statute of limitations begins to run on securities fraud claims only when a reasonably diligent plaintiff would have discovered facts to state every element of a claim, including scienter. In *Morrison v. National Australia Bank Ltd., et al*., the Court rejected so-called "F-cubed" claims—claims brought by foreign investors against a foreign company based on shares purchased on a foreign exchange—because the reach of the securities laws does not extend extraterritorially. In addition, the Court granted *certiorari* to two notable cases in 2010. The Court agreed to hear *Matrixx Initiatives, Inc. v. Siracusano*, a case involving the question of whether undisclosed information must be "statistically significant" to be material for purposes of pleading a securities fraud claim. The Court also agreed to hear *First Derivative Traders v. Janus Capital Group, Inc.* to consider whether an investment advisor to a group of mutual funds can be held primarily liable for assisting in the preparation of false or misleading prospectuses for the funds.

B. NOTEWORTHY CASES IN 2010

1. Statute of Limitations

a. *Merck & Co., Inc. v. Reynolds,* 130 S. Ct. 1784 (Apr. 27, 2010)

The Supreme Court interpreted the statute of limitations for claims under Section 10(b) of the Securities Exchange Act of 1934 and other securities fraud actions, holding as a matter of first impression that the requirement that an action be brought within two years after the "discovery of the facts constituting the violation" entails both the time when key facts are actually discovered by a plaintiff as well as when "a reasonably diligent plaintiff" would have discovered such facts. The Court further held that facts showing the Section 10(b) element of scienter are among those that must be "discovered" before the statute of limitations begins to run, but declined to rule on whether the elements of reliance, loss or loss causation must also be "discovered" prior to the initiation of the limitations period. In reaching its conclusions, the Court rejected an inquiry notice standard to the extent that the term "inquiry notice" refers to the point at which a plaintiff possesses sufficient information of wrongdoing such that he or she is on notice of the need for investigation. In a concurring opinion, Justice Scalia stated he would hold that only actual discovery of facts constituting a Section 10(b) claim starts the limitations period.

2. Extraterritorial Reach of Securities Laws

a. *Morrison v. National Australia Bank Ltd., et al.*, No. 08-1191, 130 S. Ct. 2869 (June 24, 2010)

Foreign investors in the National Australia Bank, Ltd (NAB), whose American Depository Receipts (ADRs) trade on the New York Stock Exchange and whose ordinary shares are listed on several foreign exchanges, claimed that one of NAB's American subsidiaries had used fraudulent accounting, resulting in NAB filing an amended Form 10-Q with the US Securities and Exchange Commission. The Supreme Court held that Section 10(b) of the

Securities Exchange Act did not apply extraterritorially, finding that a claim brought by foreign investors against a foreign company based on shares bought on a foreign exchange—a so-called "F-cubed" case—may not be litigated in United States courts under Section 10(b). The Court held that a foreign plaintiff cannot seek the protection of US securities laws for fraud involving securities listed on a non-US stock exchange (even if there is some impact in the US) or for a purchase or sale of stock made outside of the US. In so ruling, the Court rejected decades of Second Circuit authority employing subjective "conduct" and "effects" tests—whether the wrongful conduct occurred in the United States and whether the conduct had a substantial effect in the United States or on United States citizens—in determining whether Section 10(b) applied. The Court reasoned that Section 10(b)'s extraterritorial reach is a merits question, rather than a jurisdictional one, and because the plain language of the statute did not call for its application in cases involving securities traded on foreign exchanges, no such application could be found. Expressing its concern that the United States has "become the Shangri-La of class-action litigation for lawyers representing those allegedly cheated in foreign securities markets[,]" the Supreme Court concluded that Section 10(b) only applied to "transactions in securities listed on domestic exchanges, and domestic transactions in other securities."

C. NOTEWORTHY GRANTS OF CERTIORARI

1. Materiality

a. *Matrixx Initiatives, Inc. v. Siracusano*, 130 S.Ct. 3411 (June 14, 2010)

On June 14, 2010, the Supreme Court granted certiorari in this securities fraud class action brought against a pharmaceutical company and three of its executives for alleged violations of Section 10(b) of the Exchange Act and Rule 10b-5. Plaintiffs alleged that defendants made misleading statements and failed to disclose material facts regarding the safety of one of the pharmaceutical company's primary drugs. The District of Arizona granted the defendants' motion to dismiss on the grounds that the complaint failed to allege a material misrepresentation or omission adequately and also failed to plead scienter sufficiently. The district court's opinion was based in part on its finding that plaintiffs failed to allege materiality because the number of complaints of which defendants purportedly were aware about the drug at issue was not "statistically significant." The 9th Circuit reversed, holding that plaintiffs were not required to plead that complaints about the defendants' drug were statistically significant in order to allege the materiality of any false statements or omissions adequately. In reaching this decision, the 9th Circuit declined to adopt the statistical significance standard articulated by the 2nd Circuit. The Supreme Court granted certiorari to address the question whether a plaintiff can state a claim under Section 10(b) of the Exchange Act "based on a pharmaceutical company's nondisclosure of adverse event reports even though the reports are not alleged to be statistically significant."

2. Primary Liability

a. *Janus Capital Group, Inc. v. First Derivative Traders*, 130 S. Ct. 3499 (June 28, 2010)

On June 28, 2010, the Supreme Court granted certiorari in this securities class action in which plaintiff First Derivative Traders alleged violations of Sections 10(b) and 20(a) of the Exchange Act by the defendants, an asset management firm and the asset management firm's subsidiary. Plaintiff alleged that defendants issued false and misleading statements regarding the existence of, and efforts to prevent, "market timing" practices applied to the mutual funds managed by the defendants. The District of Maryland granted the defendants' motion to dismiss for failure to state a claim, but the 4th Circuit reversed the lower court's decision. The Supreme Court granted certiorari to address the following two questions: (1) whether a "service provider can be held primarily liable in a private securities fraud action for 'help[ing]' or 'participating in' another company's misstatements," and (2) whether a "service provider can be held primarily liable in a private securities-fraud action for statements that were not directly and contemporaneously attributed to the service provider."

II. FIRST CIRCUIT

A. SUMMARY OF DEVELOPMENTS IN 2010

In 2010, the 1st Circuit issued a noteworthy decision in *Genzyme Corp. v. Federal Insurance Co.* In that case, the Court of Appeals held that neither public policy nor the language in a company's D&O policy precluded coverage of a settlement that resolved state law claims that had been made against not only the officers and directors but also the company itself. At the district level, courts within the 1st Circuit issued several notable decisions on motions to dismiss. In *In re Evergreen Ultra Short Opportunities Fund Securities Litigation*, the District of Massachusetts found that plaintiffs successfully alleged securities fraud based on allegations that certain executives had marketed a mutual fund as safe and liquid when it actually was comprised of highly volatile securities. In both *City of Dearborn Heights Act 345 Police & Fire Retirement System v. Waters* and *Isham v. Perini Corp.*, the District of Massachusetts dismissed allegations of securities fraud in part because plaintiffs' complaint had not placed insider stock sales sufficiently in the context of those insiders' overall holdings, and thus failed to create an inference that the sales were "suspicious."

B. NOTEWORTHY CASES IN 2010

1. Pleading Standards for Securities Fraud

a. *In re Evergreen Ultra Short Opportunities Fund Secs. Litig.*, No. 08-11064-NMG, 2010 WL 1253114 (D. Mass. Mar. 31, 2010)

Mutual fund shareholders asserted claims under Sections 11, 12 and 15 of the Securities Act against companies that marketed, managed and advised the fund, as well as some officers, directors and trustees of those companies. Plaintiffs alleged that defendants marketed the fund as a higher-yielding alternative to traditional money-market funds, but still offering safety and stability, when in fact the fund was comprised of illiquid, risky and volatile securities. The district court held that plaintiffs sufficiently alleged that the fund's offering materials contained false statements regarding the fund's objectives, the fund's holding of illiquid assets and comparisons of the fund to other market indices. Specifically, the court found that the defendants' statements about the fund's objectives were more than merely aspirational or "soft" forward-looking statements, but rather were "key guidelines that established the Trust's investment strategy and laid down the basic ground rules it would follow." Similarly, plaintiffs sufficiently alleged the falsity of statements that the fund would not invest in illiquid assets because the fund invested in Rule 144A securities, which were inherently illiquid. The court further held that plaintiffs sufficiently alleged loss causation based on allegations that defendants concealed the riskiness of the fund's investments, which artificially inflated the fund's net asset value (NAV), and that the NAV declined when the alleged false representations were revealed. Finally, the court held that, while trustees could not be liable as statutory sellers under Section 12(a)(2), plaintiffs had alleged control person liability of those trustee defendants based on allegations that the trustees participated in the drafting, preparation and/or approval of the statements contained in the trust's SEC filings, and based on the fact that defendants, as board members, were responsible for ensuring the truth and accuracy of those statements.

b. *City of Dearborn Heights Act 345 Police & Fire Ret. Sys. v. Waters Corp.*, 699 F. Supp. 2d 331 (D. Mass. 2010)

A putative class of shareholders brought claims against issuer and two of its executives for violations of Sections 10(b) and 20(a) of the Exchange Act, alleging that defendants failed to disclose material facts about issuer's slowdown in sales in the Japanese market. The district court held that plaintiffs failed to allege particularized facts to support a strong inference of scienter because: (1) statements by defendants regarding changes in water-testing protocols in Japan did not indicate knowledge of those same conditions when the purportedly misleading statements were made; (2) plaintiffs did not sufficiently allege defendants' knowledge that changes in water testing protocols would result in a material impact on sales; and (3) alleged insider sales were not a significant percentage of defendants' total holdings, defendants did not sell at significantly inflated prices and many "sales" were the exercise of options. Because the court found that plaintiffs had not alleged an underlying Section 10(b) violation adequately, the Section 20(a) claim was dismissed as well.

c. *Isham v. Perini Corp.*, 665 F. Supp. 2d 28 (D. Mass. 2009)

The District of Massachusetts granted defendants' motion to dismiss a putative class action filed by shareholders against a hospitality and gaming industry construction management company and its officers, alleging violations of Sections 10(b) and 20(a) of the Exchange Act. Plaintiffs alleged that defendants knew, but failed to disclose, that the developer of the Cosmopolitan Project, a hotel and casino under construction in Las Vegas, was experiencing financial difficulties and was likely to default on its financing. The district court held that the shareholders' allegations did not support a strong inference of scienter because (1) there was no allegation that any of the individual defendants or other employees of the management company were present at meetings where the developer's financial difficulties were discussed or that anyone conveyed the information discussed, and (2) allegations about officers' sale of stock were not put in the context of the officers' broader holdings sufficient to demonstrate that those sales were "unusual." The court also found that the officers' statements about the company's anticipated revenue and earnings per share, and that the Cosmopolitan Project was "on track," were entitled to protection under the PSLRA safe harbor for forward-looking statements because those statements were accompanied by specific cautionary language about the risks related to ongoing construction projects. Further, the court held that statements about the strength of the Las Vegas gaming market were not rendered misleading by a failure to disclose the impact of the credit crisis, because the statements were of present fact and not about future results.

d. *In re Boston Scientific Corp. Secs. Litig.*, No. 05-11934, 2010 WL 1704043 (D. Mass. Apr. 27, 2010)

The District of Massachusetts granted summary judgment in favor of a defendant medical device company and its executives in a putative securities fraud class action alleging that the company withheld material information and made misleading statements about a medical device that was eventually recalled, in violation of Sections 10(b) and 20(a) of the Exchange Act. Plaintiffs alleged that defendants knew about a design flaw in one of their products, as well as a solution to it, but withheld that information to obtain FDA approval and artificially inflate the price of the company's stock. The court held that plaintiffs failed to demonstrate a strong inference of scienter with respect to the individuals and the company because the evidence showed that testing of the design flaw and the solution had not been completed at the time of the purported misstatements, and therefore defendants would not have had a reason to believe that the product would be subjected to recalls. The court also found no triable question regarding insider trading as evidence of scienter because defendants' trades occurred during "open windows," were made pursuant to 10b5-1 trading plans, were not beyond normal sales patterns, resulted in increased holdings in company stock or were part of a gifted stock. With respect to materiality, the court held that the market was aware of the potential defect in the product at the time of the alleged misstatements and therefore no reasonable investor would have relied on those misstatements. Finally, the court held that plaintiffs failed to prove loss causation because the truth was revealed to the market prior to any purported corrective disclosure. Because the court found that plaintiffs had not alleged an underlying Section 10(b) violation adequately, the court also entered summary judgment for defendants with respect to allegations that defendants had violated Section 20.

e. *SEC v. Forman,* No. 07-11151-RWZ, 2010 WL 2367372 (D. Mass. June 9, 2010)

The SEC asserted claims of securities fraud under Section 17(a) of the Securities Act and Rule 10b-5, false or misleading statements under SEC Rules 13b2-1 and 13b2-2, and aiding and abetting under Section 13 of the Exchange Act and SEC Rules 12b-20, 13a-1, and 13a-13 against defendant controller for making material misstatements regarding a company's revenue and aiding and abetting the company in falsifying its financial statements. Specifically, the SEC alleged that defendant assisted in the improper recognition of revenue acquired from a prepaid transaction with an original equipment manufacturer agreement ("OEM"), and that defendant had knowingly included these material misstatements in the company's 10-Qs, 10-K, press releases, and earnings report conference calls. The SEC and defendant filed cross motions for summary judgment. The court denied the SEC's motion for summary judgment after finding that there was a genuine issue of material fact regarding whether defendant knew the nature of the transaction that contributed to the improper revenue recognition. Defendant's motion for summary judgment was denied in part and allowed in part. The court granted summary judgment as to part of the Section 17(a) count, specifying that there was no evidence that defendant "obtained money or property" by means of the alleged misstatements. The court denied summary judgment as to the rest of claims. The court also made four findings on the securities fraud claims. First, the court found that defendant's role in preparing the publically disseminated financial information was sufficient for primary liability to attach. Second, the court held that the revenue recognition upon the sale to the intermediary was inconsistent with both GAAP and the company's published revenue recognition policy, which dictated that revenue be recognized only upon sale to third parties. Third, the court found that the impact of the revenue misstatements was not immaterial as a matter of law because the misstatements in the filings accounted for approximately 4.5% of total revenue and 7.5% of product license revenue. Finally, the court held that there was sufficient evidence for a jury to conclude that defendant had acted recklessly because he stated he was aware that the transaction at issue was an "exception" to the revenue recognition policy, but he had failed to investigate further the nature of the transaction or to disclose that fact to investors. The court further ruled that allegations of falsifying records, making false statements to accountants and aiding and abetting the company's fraud turned on whether defendant had knowledge of the nature of the transaction at issue, and therefore must be determined by a jury.

2. Insider Trading

a. *SEC v. Binette*, 679 F. Supp. 2d 153 (D. Mass. 2010)

The District of Massachusetts denied defendants' motion to dismiss an SEC action alleging insider trading in violation of Section 10(b) of the Securities Exchange Act and Rule 10b-5. The SEC alleged that defendant Talbot, while working as vice president at an investment management company, unlawfully shared material nonpublic information about the company's attempt to acquire another company with defendant Binette, who used that information to make investments. The court held that the SEC sufficiently alleged materiality because a reasonable investor plausibly could have considered the information Talbot allegedly misappropriated important in deciding whether to buy the stock. The court also held that the SEC's complaint sufficiently alleged Binette's liability, even though he was not a corporate insider, under the "tippee liability" theory because Binette received or misappropriated the nonpublic information, and the court further held that he knew or should have known that Talbot had breached his fiduciary duty to the company.

3. Other

a. *Diaz v. Carrion*, Civil No. 09-2025CCC, 2010 WL 4118075 (D. Puerto Rico Oct. 13, 2010)

A financial institution in Puerto Rico which offers retail and commercial banking services issued a series of press releases which plaintiff shareholders alleged contained false or misleading statements or omitted information regarding liquidity concerns. A shareholder filed a derivative suit in state court against the financial institution as a nominal defendant and nine of its directors individually, alleging five state law causes of action—breach of fiduciary duty, abuse of capacity to control and influence, mismanagement, squandering of assets through payment of bonuses, and unjust enrichment. The complaint did not reference the federal securities laws or any federal statute. Defendants filed a motion to remove the action to federal court on the grounds that the core of the claims asserted either arose under or required substantial determination of federal securities law. Plaintiff moved to remand, contending that his complaint raised no issues of federal law. The court remanded, finding that the plaintiff shareholder's claim was not necessarily federal in character, and that it did not require the resolution of a substantial federal question. Citing the 1st Circuit's reasoning in *Merino Calenti v. Boto*, 24 F.3d 335, 338 (1st Cir. 1994), the court held that because a finding that the director defendants violated federal securities laws was not essential to the question of whether they breached their fiduciary duties, a federal question did not exist to warrant the exercise of federal subject matter jurisdiction over the case.

b. *Genzyme Corp. v. Federal Ins. Co.*, --- F.3d ---, No. 09-2485, 2010 WL 3991739 (1st Cir. Oct. 13, 2010)

A biotechnology corporation issued shares of "tracking stock," designed to track the performance of a particular division of the company. The corporation later eliminated the tracking stock, proposing to exchange it for shares of general company stock. Holders of a particular division's stock filed a securities class action, which the corporation settled. When the corporation's insurance company denied D&O coverage for the settlement paid by the corporation, the corporation sued the insurance company for breach of contract, among other claims. The district court granted the insurance company's motion to dismiss the action, and the plaintiff appealed. The 1st Circuit reversed in part and remanded in part, finding that neither state public policy nor the insurance policy language precluded coverage where the settlement amount paid to securities holders was in part comprised of indemnification of company officers and directors. The Court of Appeals further found that the insurance policy's "bump up" exclusion, which provided that the carrier was not liable for payment in connection with the purchase or proposed purchase of securities issued by the corporation, did not apply to the D&O insurance clause. Accordingly, the court remanded to the district court to determine whether and what amounts paid as part of the settlement were attributable to indemnification of directors and officers, but noted that because of the complex nature of this question, settlement was worth the parties' consideration.

III. SECOND CIRCUIT

A. SUMMARY OF DEVELOPMENTS IN 2010

2010 saw a number of notable decisions from the 2d Circuit. In *Pacific Investment Management Co. LLC v. Mayer Brown LLP*, the 2d Circuit affirmed the dismissal of claims brought against a Mayer Brown attorney related to his role as an advisor to Refco on the ground that the misleading statements and deceptive conduct at issue were made by Refco, not by its advising attorney, and therefore were foreclosed by the Supreme Court's *Stoneridge* decision. The 2d Circuit also affirmed summary judgment for defendants in *In re Omnicom Group, Inc. Securities Litigation*, holding that loss causation was not established by an article that confirmed prior information and news that a member of management had resigned. In *Slayton v. American Express Co.*, the 2d Circuit affirmed dismissal of a complaint on the grounds that the allegedly misleading statements were protected by the PSLRA safe harbor for forward-looking statements. In another decision, the 2d Circuit held that the PSLRA did not require forward-looking statements to be specifically labeled or included in clearly marked sections, and affirmed that where plaintiffs fail to establish knowledge that a statement was misleading, it can be protected under the safe harbor even when warnings are "boilerplate." And in *US v. Kaiser*, the 2d Circuit vacated a conviction for fraudulent misrepresentations because the jury had not been instructed properly on the standards for "conscious avoidance."

Additionally, courts within the Circuit decided several cases related to mortgage-backed securities, credit default swaps and the credit crisis. In *In re Ambac Fin. Group, Inc.*, the Southern District of New York dismissed in part a claim against an insurer that provided default insurance for residential mortgage-backed securities, and insurance in the form of credit default swaps for collateralized debt obligations, finding that statements in March 2008 could not have been materially misleading because the diminished underwriting standards already had been exposed by the disclosure of massive losses by the company. In *In re Lehman Brothers Securities and ERISA Litig.*, the SDNY dismissed certain claims against a depositor for 94 mortgage-backed securities offerings by Lehman Brothers Holdings, Inc. between September 2005 and July 2007, both because the allegedly misleading credit ratings were opinions and because plaintiffs failed to allege that the credit ratings agencies did not actually hold such opinions at the time the disclosures were issued. The court found, however, that plaintiffs' allegations regarding Lehman's alleged failure to disclose that the originators of the loans backing the securities did not follow stated mortgage loan underwriting guidelines were sufficient to survive defendants' motion to dismiss. In *Plumbers & Steamfitters Local 773 Pension Fund v. Canadian Imperial Bank of Commerce,* claims against CIBC related to its disclosure of subprime losses were dismissed in part based on the fact that CIBC had purchased $300 million of its own stock, and plaintiffs failed to allege that defendants received information contrary to their statements. In *Footbridge Ltd. v. Countrywide Home Loans, Inc.*, the SDNY dismissed allegations of fraud relating to the sale of mortgage-backed securities on the grounds that plaintiffs could only allege generalized allegations of motive and could not plead allegations that were specific to defendants as opposed to overall market conditions. Similarly, in *NECA-IBEW Health & Welfare Fund v. Goldman, Sachs & Co.*, the SDNY held that plaintiffs had not pled a Section 11 claim against Goldman Sachs based on its sale of mortgage-backed certificates because a prospectus supplement had warned that the certificates may not be liquid and Section 11 does not permit a claim based on an increased exposure to risk. In *In re Citigroup, Inc.*

Securities Litigation, however, the SDNY allowed claims to be brought against Citigroup based on Citigroup's allegedly misleading disclosures of the extent and value of its CDO holdings, but only allowed such claims to proceed against individual management after February 2007, the date of an alleged meeting where the risks of CDOs were discussed. The court in *Citigroup* also dismissed claims based on Citigroup's sale of[??] Alt-A residential mortgage-backed securities because the alleged misstatements related to Alt-A mortgages rather than the mortgage-backed securities, as well as because plaintiffs had failed to allege that anyone responsible for Citigroup's disclosures had knowledge of any "red flags." Finally, in *In re Fannie Mae 2008 Securities Litigation*, the SDNY held that plaintiffs failed to allege misstatements regarding the company's exposure to subprime mortgages, but allowed claims regarding Fannie Mae's internal risk management and controls. The court also dismissed claims against Fannie Mae's auditor because, it held, Fannie Mae's financial statements could have been supported by a reasonable interpretation of applicable accounting rules.

District courts within the 2d Circuit also ruled several times on jurisdictional issues stemming from the Supreme Court's decision in *Morrison v. NAB*. In both *Cornwell v. Credit Suisse Group* and *In re Alstom SA Securities Litigation*, the SDNY dismissed claims brought by plaintiffs who had purchased shares on foreign exchanges based on the Supreme Court's holding in *Morrison*. Similarly, in *Elliott Associates v. Porsche Automobil Holding SE*, the SDNY dismissed claims brought by US swap purchasers because the securities underlying the swaps traded on a German, rather than a US, exchange.

Lastly, in *Newman v. Family Mgmt. Corp.*, the SDNY dismissed claims brought against a "sub-feeder" fund whose assets were invested in Bernie Madoff's fund. The court held that plaintiffs failed to plead that the defendant knew the Madoff fund was fraudulent and because the fees the fund received were not sufficient to create a fraudulent motive. Relatedly, in *In re Tremont Securities Law, State Law, and Institutional Litigation*, the Southern District of New York dismissed claims against an auditor of funds that invested in Madoff's Ponzi scheme, finding that an auditor has no duty to investigate a third party's finances when performing an audit.

B. NOTEWORTHY CASES IN 2010

1. Pleading Standards for Securities Fraud

a. *Pacific Inv. Mgmt. Co. LLC v. Mayer Brown LLP*, No. 09 1619 cv, 2010 WL 1659230 (2d Cir. Apr. 27, 2010)

The 2d Circuit affirmed the district court's dismissal of shareholder claims against defendant law firm and attorney. Plaintiffs alleged that defendants, in the course of representing a now-insolvent brokerage firm, violated Sections 10(b) and 20(a) of the Exchange Act by (1) facilitating fraudulent transactions between their client and third parties for the purpose of concealing their client's uncollectible debt, and (2) drafting portions of their client's security offering documents containing false information. The circuit court agreed with the district court that plaintiffs failed to state a claim for relief under Rule 10b-5(b) because the false statements in the offering documents that defendants allegedly drafted were not attributable to defendants at the time the statements were disseminated. The court stated: "An attribution requirement makes clear—to secondary actors and investors alike—that those who sign or otherwise allow a statement to be attributed to them expose themselves to liability. Those who do not are beyond the reach of Rule 10b-5's private right of action." The court also affirmed the dismissal of plaintiffs' Rule 10b-5(a) and (c) claims for scheme liability on the ground that the Supreme Court's decision in *Stoneridge* foreclosed liability where plaintiffs were unaware of, and did not rely on, defendants' deceptive conduct or scheme at the time they made their investment. Because plaintiffs failed to plead an underlying violation of federal securities law, the district court also dismissed the Section 20(a) claims.

b. *Slayton v. American Exp. Co.*, 604 F.3d 758 (2d Cir. 2010)

Plaintiffs brought suit against defendant financial services company and its executive officers for issuing an allegedly misleading forward-looking statement in a filing before the Securities and Exchange Commission (the SEC). The complaint alleged that this constituted violations of Sections 10(b) and 20(a) of the Securities Act, and SEC Rule 10b-5. Plaintiffs' alleged that the forward-looking statement was improperly identified as such; that the forward-looking statement was statutorily excluded from the PSLRA safe harbor by reason of its inclusion in a financial statement prepared in accordance with Generally Accepted Accounting Principles (GAAP); that the cautionary statement accompanying the forward-looking statement consisted only of boilerplate language, and therefore was not meaningful; and that the executive officers had issued the forward-looking statement with actual knowledge of its being misleading and false. After the Southern District of New York dismissed plaintiffs' claims for failure to state a claim, plaintiffs appealed to the 2d Circuit, which affirmed the dismissal in its entirety. The court interpreted the PSLRA not to require forward-looking statements to be specifically labeled or included in a discrete, clearly marked section, and held that statements in the MD&A disclosures are not statutorily excluded from the PSLRA safe harbor based on the text and legislative history of the statute. In both cases, the court drew support from the SEC's position as set forth in an *amicus curiae* brief. The court then held that boilerplate warnings that do not convey substantive information about the factors that could cause actual performance to differ from projections are not meaningful to investors, and therefore, cannot qualify for protection under the first prong of the statutory safe harbor. However, because the PSLRA safe harbor provision is written in the disjunctive, defendants were released from liability when plaintiffs failed to establish that the executive officers issued the forward-looking statement with actual knowledge that it was misleading or false.

c. *Tesereteli v. Residential Asset Securitization Trust*, No. 08 Civ. 10637, 2010 U.S. Dist. LEXIS 22435 (S.D.N.Y. Mar. 12, 2010)

Lead plaintiff, a purchaser of mortgage-backed securities, alleged that defendant underwriter was liable under Sections 11 and 12(a)(2) of the Securities Act on the ground that defendant sold securities pursuant to an offering document that contained material false and misleading information. Defendant moved to dismiss on the ground that it was not a Section 12(a)(2) "statutory seller" because plaintiff did not allege it was solicited by, or purchased the security from, defendant. The court rejected that argument because plaintiff alleged that it purchased the security prior to the offering date, at which time defendant was the only seller. The court also held that plaintiff sufficiently alleged that the offering documents misstated the underwriting standards used for the underlying mortgages backing the subject securities. The court did, however, dismiss plaintiff's claims that the offering documents contained misleading statements about the appraisals of mortgage collateral, loan-to-value ratios and the security's ratings. The court found that these were opinions, not statements of fact, and were not actionable under Sections 11 and 12 because plaintiff failed to allege that the speaker did not actually hold the opinions at the time the statements were made.

d. *In re Merrill Lynch Auction Rate Secs. Litig.*, No. 08 Civ. 3037, 2010 WL 1257597 (S.D.N.Y. Mar. 31, 2010)

Plaintiff investors alleged that defendant financial firm manipulated the auction rate securities (ARS) market, in violation of Section 10(b) of the Exchange Act, by creating the appearance of a functioning auction market in which ARS traded in accordance with supply and demand. The court granted defendant's motion to dismiss because (1) with respect to statements encouraging investment in the ARS market, plaintiffs failed to allege which financial advisors made such statements or when, where and to whom the statements were made, and (2) with respect to market manipulation, public disclosures revealed the conduct in the ARS market that plaintiffs allege was not disclosed. According to the court, even if it were to assume defendant had engaged in manipulative conduct, the readily available disclosure of that conduct prevented plaintiffs from sufficiently pleading reliance on any alleged misrepresentations.

e. *In re Hardinge, Inc. Sec. Litig.*, No. 08-CV-6490, 2010 WL 447397 (W.D.N.Y. Feb. 2, 2010)

Plaintiff investors alleged that defendant machine tool company, and two of its individual directors and officers, were liable under Sections 10(b) and 20(a) of the Exchange Act for allegedly failing to disclose its planned transition to a new sales model, and failing to disclose risks associated with that transition. The court granted defendants' motion to dismiss because: (1) certain alleged misstatements, particularly about the Canadian market, were not rendered misleading by the issuer's omission of certain information about its intentions worldwide; (2) many allegedly misleading statements were forward-looking, protected by meaningful cautionary language and were not alleged to have been made with knowledge of their falsity; (3) plaintiffs failed to allege why other statements of historical fact were made misleading by the change in the company's future plans; (4) plaintiffs' allegations regarding the individual defendants' sales of company stock, which were relatively low as a percentage of their stock holdings, and the pressure to perform were insufficient to establish motive and thereby support a "strong inference" of scienter; and (5) the corporate defendants' intention to use the offering to pay down debt and finance inventory buildup was insufficient to establish scienter. Because plaintiffs failed to show a primary securities violation, the court also dismissed plaintiffs' Section 20(a) controlling persons claim.

f. *Cornwell v. Credit Suisse Group*, No. 08 Civ. 3758, 2010 WL 537593 (S.D.N.Y. Feb. 11, 2010)

Plaintiff class, which included both foreign plaintiffs who purchased company shares on a foreign exchange and plaintiffs who had purchased ADRs on the NYSE, alleged that defendant company and its executives had made fraudulent misstatements and omissions regarding their internal practices and the company's finances. Plaintiffs moved to amend their complaint after it was dismissed for lack of subject matter jurisdiction. Ruling on plaintiffs' motion to amend, the court held first that the amendment did not change the allegation that the misstatements all occurred outside of the US and therefore the court lacked jurisdiction over those claims. The court did find, however, that it had subject matter jurisdiction over the claims brought by US residents in part because US institutional investors held 11.4 percent of the company's stock, establishing that the effects of the alleged fraud were felt in the US. Next, the court held on defendants' motion to dismiss that the remaining plaintiffs had sufficiently pled the time, author and fraudulent nature of each alleged misstatement. Although the court concluded that the common practice of tying executives' compensation to the valuation of certain assets could not give rise to an inference of scienter, plaintiffs' allegations—supported by statements from confidential witnesses—that defendants had recklessly ignored or failed to monitor specific information that contradicted their public statements were sufficient to infer scienter. The court then held that allegations of misstatements made before plaintiffs' purchase of stock and a "statistically significant" drop in price after the truth was revealed were sufficient to allege loss causation. Finally, the court found allegations that the executives' positions gave them "intimate knowledge" of company financial statements were plausible enough to state a control person liability claim under Section 20(a).

g. *In re Ambac Fin. Group, Inc.*, No. 08-CV-411, 2010 U.S. Dist. LEXIS 16701 (S.D.N.Y. Feb. 22, 2010)

Defendant insurer provided default insurance for residential mortgage-backed securities and insurance in the form of credit default swaps for collateralized debt obligations. Plaintiff investors alleged that defendant and several of its individual directors and officers, its auditor and its underwriters were liable under Sections 10(b) and 20(a) of the Exchange Act and Sections 11, 12(a)(2) and 15 of the Securities Act for alleged misstatements and omissions regarding their lowered underwriting standards and the amount of their potential liabilities. The court denied part of defendants' motions to dismiss, finding that statements regarding the company's underwriting requirements were material, and that plaintiffs had adequately pled scienter by demonstrating that defendants acted with recklessness. The court dismissed plaintiffs' claims regarding a March 2008 securities offering, however, because plaintiffs failed to plead adequately that the statements were materially misleading, as the diminished underwriting standards had already been exposed by the disclosure of massive losses by the company. Additionally, the court denied defendants' motion to dismiss the Securities Act claim with respect to a February 2007 offering because that offering did not contain sufficient cautionary language to merit protection under the "bespeaks caution" doctrine, but granted defendants' motion with respect to the 2008 offering, which the court held did have sufficient cautionary language.

h. *Ashland Inc. v. Morgan Stanley & Co., Inc.*, 700 F. Supp. 2d 453 (S.D.N.Y. 2010)

Plaintiffs, a specialty chemicals company and its wholly-owned special purpose entity, alleged that defendant trader-broker had engaged in securities fraud as a result of misrepresentations made while marketing student loan auction rate securities ("SLARS"). Specifically, plaintiffs alleged violations of Section 10(b) of the Exchange Act and Rule 10b-5, fraud, promissory estoppel, breach of fiduciary duty, negligence, negligent misrepresentation, and unjust enrichment. The court granted defendant's motion to dismiss the complaint in its entirety for failure to state a claim. The court first found that both plaintiffs had standing to pursue the action; although only the special purpose entity was the actual purchaser of the SLARS, it effectively existed as the parent's alter ego, and therefore standing was proper for both plaintiffs. Addressing the claims on the merits, the court dismissed all allegations of misrepresentations that induced plaintiffs into placing "hold" or "hold-at-rate" orders, as such orders did not relate to the purchase or sale of securities as required by the Exchange Act. The remaining claims did not satisfy the requirements for pleading scienter mandated by the PSLRA. Although defendants' alleged motive of keeping the SLARS market afloat long enough for defendant to exit the market would have been an adequate motive, plaintiffs failed to allege sufficient facts to support the theory. In addition, plaintiffs were sophisticated investors with a large portfolio and an investment committee, and therefore not reasonably entitled to rely solely on defendants' statements, even if the information was non-public. The court dismissed the fraud claims on the same grounds, and the promissory estoppel claim on the basis that the misrepresentations were vague future promises on which an estoppel claim could not be based. The remaining state law claims were preempted by New York's Martin Act, which applied because venue was proper in New York, defendant's place of business was in New York, and the trades were executed and the auctions conducted in New York.

i. *Cayvest Global Mandate Inc. v. Lewis Asset Mgmt. Corp.*, No. 10 Civ. 695, 2010 WL 4910214 (S.D.N.Y. Nov. 22, 2010)

Plaintiff investor alleged that defendant investment fund, its manager, and several of its directors were liable under Sections 10(b) and 20 of the Exchange Act, as well as under New York law for breach of contract, breach of fiduciary duty, and New York securities laws for allegedly making misleading statements and omissions regarding redemption payments, fund assets, the identity of a legal advisor, and conflicts of interest affecting trading and trading flexibility. The court dismissed plaintiff's Section 10(b) and Rule 10b-5 claims because: (1) plaintiff's forward looking statements regarding redemption payments and fund assets were insufficient to support an inference of scienter; (2) defendants actually disclosed potential conflicts of interest in their offering materials; (3) even if defendants had not so disclosed, allegations of conflicts of interest without more, are insufficient to support a fraud complaint; and (4) while defendants did misrepresent the identity of their legal advisor, this misrepresentation was not material and could not support an inference of loss causation. Because plaintiff failed to show a primary securities violation, the court also dismissed plaintiff's Section 20 controlling person claim. Finally, the court dismissed plaintiff's pendant state law claims for lack of complete diversity.

j. *In re Celestica Inc. Secs. Litig.*, No. 07 CV 312(GBD), 2010 WL 4159587 (S.D.N.Y.)

Plaintiffs, purchasers of common stock in defendant corporation, alleged in a consolidated class action complaint that defendants, including the corporation, its former executives, its former controlling owner, and the owner's CEO, violated Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 by making false and misleading statements about the corporation's earnings, profitability, and financial outlook. The misstatements were related to a restructuring of the corporation which was not as successful and more expensive than defendants disclosed. Defendants moved to dismiss, and the court granted the motion based on plaintiffs' failure to attribute the misstatements to each defendant, and a failure to prove scienter as to all defendants. The court applied the heightened pleading standards of Rule 9(b) because the complaint alleged that defendants had acted fraudulently and found that the complaint failed to attribute the alleged misstatements to the controlling owner and its CEO. Plaintiffs had relied on the "group pleading doctrine," which allows attribution based on a defendant's participation in the group preparing the allegedly false statement. The court, while noting that it is not clear whether the group pleading doctrine had survived the PLSRA, also found that plaintiffs had not alleged that the controlling owner defendants had participated in the preparation of the statements, and so the group pleading doctrine was not satisfied. In addition, plaintiffs had not adequately pled scienter as to any defendant. Plaintiffs' attempt to demonstrate motive and opportunity to commit fraud failed because the complaint only alleged the existence of defendants' "economic self interests"—self interests shared by all comparable officers and executives and not sufficient to support an inference of scienter. The defendants' access to company records was not sufficient to support a finding of recklessness either, as plaintiffs were unable to particularize any information which would suggest they possessed information that directly contradicted any of their disclosures. Therefore, plaintiffs were unable to establish any Section 10(b) violations. Without a primary violation, plaintiffs' Section 20(a) claims of control person liability were dismissed as well.

k. *Footbridge Ltd. v. Countrywide Home Loans, Inc.*, No. 09 Civ. 4050, 2010 WL 3790810 (S.D.N.Y. Sept. 28, 2010)

Plaintiff investors alleged that defendant mortgage originator and several affiliated parties violated Section 10(b) of the Exchange Act and Rule 10b-5 by making material misrepresentations and omissions in offering documents and public statements in connection with plaintiff's purchase of mortgage backed securitizations. After denying defendants' motion to strike portions of the plaintiff's complaint, the court considered plaintiffs' allegations in light of Federal Rule of Civil Procedure 9(b) and the PSLRA's heightened pleading standards. The court found that plaintiffs failed to adequately allege fraud in connection with the securitizations central to the complaint; rather, the court noted that plaintiffs pled general allegations regarding defendants' overall commercial practices, adherence to underwriting guidelines, and adverse effects on investors' interests that were insufficient to surpass the heightened pleading standards. Moreover, the court held that plaintiffs failed to allege that defendants made fraudulent statements with the requisite scienter required by the PLSRA. According to the court, the complaint contained conclusory allegations with respect to defendants' motives and efforts to maximize their profits. Additionally, the court noted that while it need not consider the issue of loss causation, it found a serious issue with regards to whether plaintiffs pled loss causation because the complaint failed to explain the extent to which plaintiffs suffered losses as a result of defendants' alleged misstatements. Specifically, the court explained that the complaint did not "include facts which, if proven, would show that the loss in value of plaintiff's [s]ecurities was caused by the alleged misstatements as opposed to the 'broader market declines.'" Finally, the court dismissed plaintiffs' claims pursuant to the group pleading doctrine and theory of successor liability because the court's finding that plaintiffs failed to state a claim against defendant mortgage originator left no basis for claims against defendant directors, officers, and successors.

l. *NECA-IBEW Health & Welfare Fund v. Goldman, Sachs & Co.*, slip op., No. 08 civ. 10783 (MGC) (S.D.N.Y. Oct. 14, 2010).

Plaintiff institutional investor, a purchaser of mortgage-backed certificates, brought suit against affiliated defendants, the underwriter, securitizing entity, pooling and purchasing entity, and three individuals, alleging violations of Sections 11, 12(a)(2), and 15 of the Securities Act. During a hearing on defendants' motion to dismiss, the court denied the motion as to the claims under Sections 12(a)(2) and 15, but reserved judgment as to the claims under Section 11. The court then issued an opinion dismissing the Section 11 claims on the grounds that plaintiff had not alleged a cognizable injury for purposes of Section 11. Plaintiff alleged that the certificates had lost significant value as compared to a secondary market for securities similar securites, and that they were now exposed to more risk as to the timing and amount of future cash flow than was advertised. However, the court found that because the prospectus supplement issued when the securities were offered for sale contained an express warning that the certificates may not be liquid, plaintiff could not have purchased them with an expectation of resale. Further, Section 11 does not permit a claim based on increased exposure to risk. For those reasons, a claim under Section 11 could only be based on a failure to receive the monthly distributions of interest and principal to which plaintiff was entitled. Because plaintiff did not allege that it had not received those distributions, it could not make out a claim under Section 11.

2. Subject Matter Jurisdiction following *Morrison*

a. *Cornwell v. Credit Suisse Group*, No. 08 Civ. 3758, 2010 WL 537593 (S.D.N.Y. Feb. 11, 2010); *Cornwell v. Credit Suisse Group*, __ F. Supp.2d ___, 2010 WL 3069597 (S.D.N.Y. Jul. 27, 2010)

In a class action complaint, lead plaintiff alleged that a company and its executives had made fraudulent misstatements and omissions regarding their internal practices and the company's finances. The lead plaintiffs were of two types: foreign plaintiffs who had purchased company shares on a foreign exchange, and plaintiffs who had purchased American Deposit Receipts on the New York Stock Exchange. The court had already dismissed the complaint for lack of subject matter jurisdiction. On lead plaintiffs' motion to amend, the court held that even if an American subsidiary had "masterminded" the allegedly fraudulent conduct, the relevant conduct took place out of the country and therefore the court could not exercise subject matter jurisdiction. Therefore, foreign plaintiffs' proposed amendments were futile. However, the court also found that, by pleading US residence and the amount of US investors holding company stock, the remaining plaintiffs had adequately pled that the effects of the alleged fraud were felt in the United States and therefore the court had subject matter jurisdiction.

The court then proceeded to determine whether the allegations stated a claim under Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The court found that lead plaintiffs had pled the time, author, and fraudulent nature of each alleged misstatement with sufficient specificity. It held that plaintiffs could not infer scienter because the executives' compensation was tied to the valuation of certain assets, as this was a common arrangement and did not constitute motive and opportunity to commit fraud. However, by quoting confidential witnesses from within the company, plaintiffs adequately pled that defendants had recklessly ignored or failed to monitor information which would contradict their public statements, and this was enough to allege scienter. The court then inferred transaction causation despite lead plaintiffs' failure to explicitly plead it, and held that the alleged misstatements made before lead plaintiffs' purchase of stock and the drop in price after the truth was revealed sufficiently alleged loss causation. Finally, the court found allegations that the executives' positions gave them "intimate knowledge" of company financial statements were plausible enough to state a control person liability claim under Section 20(a).

On July 27, 2010, the court entered an order granting partial judgment on the pleadings in favor of defendants, dismissing plaintiffs who had purchased company shares on foreign exchanges. The court based its decision on the Supreme Court decision in *Morrison*, which repudiated the Second Circuit's "conduct" and "effects" tests and limited the application of Section 10(b) to cases in which the shares were purchased on an American exchange or otherwise sold or purchased in the United States. Following the *Morrison* dicta rather than limiting the case to its facts, the court dismissed plaintiffs who had purchased their shares on foreign exchanges.

b. *In re Alstom SA Secs. Litig.*, No. 03 Civ. 6595, 2010 WL 3718863 (S.D.N.Y. Sept. 14, 2010)

Institutional investors filed a class action lawsuit against defendants, related corporations, their officers and directors, and certain underwriters for violations of Sections 10(b) and 20(a) of the Exchange Act. Following the Supreme Court's decision in *Morrison*, the court directed plaintiffs to show cause why "the claims of plaintiffs who purchased securities on foreign exchanges should not be dismissed." Interpreting *Morrison* to require that the underlying securities transactions themselves must have occurred on a US exchange or otherwise have been purchased in the US, the court dismissed the claims of plaintiffs who purchased the subject securities on foreign exchanges. The court also refused to exercise supplemental jurisdiction over these plaintiffs' claims and adjudicate them under French law for reasons of judicial efficiency and because they could still be pursued in France. Finally, the court ordered plaintiffs to address the Supreme Court decision in *Merck & Co. v. Reynolds* in the arguments regarding timeliness in their upcoming dispositive motions.

3. Materiality

a. *Operating Local 649 Annuity Trust Fund v. Smith Barney Fund Mgmt. LLC,* 595 F.3d 86 (2d Cir. 2010)

Plaintiff investor in mutual funds appealed dismissal of claims that, as part of what amounted to an alleged kickback scheme between mutual funds and a transfer agent, defendants mischaracterized the fees the funds were paying for transfer agent services in several prospectuses in violation of Section 10(b) of the Exchange Act, and breaches of fiduciary duty in violation of Section 36(b) of the Investment Company Act of 1940. The 2^{d} Circuit reversed the dismissal of the Section 10(b) claim, holding that the information about the fee scheme was material because it would demonstrate to the investor that its fiduciary was profiting at shareholders' expense. The court also held that plaintiff had adequately pled loss causation based on allegations that the defendants' misrepresentations caused investors to make and maintain investments in the funds, which were subject to excessively high fees, and that deduction of those fees and expenses reduced the value of the investments over time. The court affirmed dismissal of the Section 36(b) claim on the ground that fiduciary duty claims could only be brought derivatively.

4. Misstatements and Omissions

a. *In re Morgan Stanley Info. Fund Sec. Litig.*, 592 F.3d 347 (2d Cir. 2010)

Appellants brought suit against appellee mutual funds for failure to disclose that affiliated broker-dealers had improperly dismantled the "information barrier" between the research and investment banking functions. Appellants' complaint alleged that the funds relied on research reports issued by the broker-dealers, but did not disclose their alleged conflicts of interest on either their registration statements or Form N-1A, in violation of Sections 11, 12(a) and 15 of the Securities Act. After the District Court for the Southern District of New York dismissed their complaint, appellants appealed to the 2d Circuit, which affirmed the dismissal in its entirety, holding that the registration statements and Form N-1As did not give rise to obligations to disclose the risk that market research would be unreliable because that was a "general risk" of investing. The court also held that appellants were not obligated to disclose the risks associated with the securities research to render their statements not misleading, as the risks were "commonly understood." Finally, the circuit court affirmed the district court's dismissal of control person liability under Section 15, as no primary violation had been established.

b. *In re Lehman Bros. Secs. and ERISA Litig.*, No. 09 MD 2017, 2010 WL 545992 (S.D.N.Y. Feb. 17, 2010)

Plaintiff investors brought claims under Sections 11 and 15 of the Securities Act against directors and officers of the Structured Asset Securities Corporation ("SASCO"), which served as depositor for 94 mortgage-backed securities offerings by Lehman Brothers Holdings, Inc. between September 2005 and July 2007. Plaintiffs alleged that the securities offering documents issued by SASCO failed to disclose that the originators of the underlying loans failed to comply with proper underwriting guidelines, that rating agencies (rather than Lehman) determined the composition of the pool of loans, that there were conflicts of interest between Lehman and the ratings agencies and that the underlying loans could not support the AAA rating. In all but six of the securities issuances, the court held that plaintiffs lacked standing because they could not show any injury resulting from issuances in which they did not purchase shares. With respect to the six offerings for which plaintiffs had standing, the court dismissed plaintiffs' Section 11 claims based on the credit ratings because those ratings were opinions, and plaintiffs failed to allege that the credit ratings agencies did not actually hold such opinions at the time the disclosures were issued. The court found, however, that plaintiffs' allegations regarding Lehman's alleged failure to disclose that the originators of the loans backing the securities did not follow stated mortgage loan underwriting guidelines were sufficient to survive defendants' motion to dismiss. Finally, the court denied defendants' motion to dismiss plaintiffs' Section 15 claim based upon defendants' control of SASCO.

c. *San Diego County Employees Ret. Ass'n v. Maounis*, No. 07 Civ 2618, 2010 WL 1010012 (S.D.N.Y. Mar. 15, 2010)

Plaintiff investors alleged that defendant hedge fund and its individual directors were liable under Section 10(b) of the Exchange Act for alleged misrepresentations regarding the industry concentration of the fund's investments after concentration of the fund's positions within the natural gas industry led to a one-day loss of 35 percent of the fund's assets. Plaintiffs alleged that defendants misrepresented those concentrations in oral statements and within the confidential private placement memorandum incorporated into the parties' subscription agreement. The court dismissed the claims against all defendants, holding that plaintiff, as a sophisticated investor, had agreed by contract to a clear and unambiguous waiver of its right to rely on any oral representations made prior to investment. Additionally, any representations made within the confidential private placement memorandum were protected by the bespeaks-caution doctrine, as the memorandum stated explicitly that the fund managers were free to pursue any investment strategy, including concentration of the fund's positions within a particular industry or market.

d. *Briarwood Invs., Inc. v. Care Inv. Trust Inc.*, No. 07 Civ. 8159, 2010 WL 5422549 (S.D.N.Y. Dec. 29, 2010)

Investors alleged that the registration statement and prospectus associated with the IPO of a real estate investment trust managed by defendants contained materially false and misleading statements in violation of Sections 11, 12(a)(2) and Section 15 of the Securities Act. Defendants moved for summary judgment on the ground that plaintiffs failed to present sufficient evidence that the disclosures contained untrue statements of material fact. In the months leading up to the IPO, defendants opted to utilize short term financing via warehouse facilities from two investments banks. In the draft registration statement, defendants stated that they were in the process of negotiating warehouse facilities and anticipated that the facilities would close shortly after the consummation of the IPO. After defendants filed the registration statement with the SEC in June 2007, they continued negotiations for the warehouse facilities. However, because of market deteriorations in the subprime credit market, negotiations took longer than anticipated and eventually caused defendants to close the facilities on terms less favorable then provided in the original term sheets disclosed to investors. The court noted that defendants testified they genuinely believed that the warehouse facilities would close shortly after the registration statement was filed in June 2007. The court further specified that contemporaneous statements and actions of the investment banks gave the drafters of the IPO documents strong support for providing such disclosures. Additionally, the court explained that while the warehouse facilities eventually closed at terms less favorable to defendants in October 2007, those subsequent events did not impact defendants' beliefs when filing the registration statement in June. Finding no evidence to support plaintiffs' allegation that defendants' disclosure statements in the registration statement were made in bad faith or that defendants did not truly believe the disclosures were accurate, the court granted defendants' motion for summary judgment.

e. *Charter Tp. of Clinton Police and Fire Ret. Sys. v. KKR Fin. Holdings LLC*, No. 08 Civ. 7062, 2010 WL 4642554 (S.D.N.Y. 2010)

Plaintiff investors alleged that defendant specialty finance company's April 2007 registration statement failed to disclose material facts regarding defendant's exposure to losses in the asset backed commercial paper ("ABCP") market in violation of Sections 11 and 15 of the Securities Act. The court dismissed plaintiffs' claims against defendant after finding that plaintiffs failed to identify any facts indicating that defendant knew it faced a significant risk of losses due to its investment in ABCP facilities at the time the registration statement became effective. The court further noted that the registration statement's omission of defendant's $200 million interest in ABCP facilities was, as a matter of law, immaterial. At the time the registration statement became effective, defendant's balance sheet included over $17.5 billion in assets, amounting to 1.1% of the company's total assets. While percentages are not strictly controlling for purposes of determining whether a misrepresentation or omission is material, in light of the registration statement's disclosure of the existence of ABCP facilities and the potential for catastrophe if a decline in the value of the company's real estate investments hampered its ability to obtain financing through the ABCP market, defendant's $200 million interest in the Facilities would be "so obviously unimportant to a reasonable investor that reasonable minds c[an] not differ on the question of [its] importance."

The court also rejected plaintiffs' claim that defendant was liable under the securities laws because its failure to comply with GAAP rendered its financial statements and the Registration Statement materially inaccurate. Plaintiff asserted that, given that the probability of losses embedded in defendant's investments was not remote, GAAP required the company to disclose in its financial statements such potential risk of loss to investors in the form of a description of the nature of the contingent liability. In dismissing this claim, the court explained that the risks presented by general investment and financing strategies, like the one at issue in this case, fall within the purview of general business risks, which, unlike loss contingencies, do not need to be disclosed and do not meet the conditions for accrual under GAAP. Even if the alleged risks fell within GAAP's definition of loss contingency, GAAP requires accrual or disclosure of a loss contingency only when it is "probable" or "reasonably possible" that a loss has already been incurred. Since the complaint failed to allege any facts indicating a "reasonable possibility" that defendant had suffered loss as of the effective date of the registration statement, the court found the claim that defendant's financial statements violated GAAP was meritless.

f. *In re Citigroup Inc. Secs. Litig.*, Nos. 09 md 20701, 07 Civ. 9901, 07 Civ. 10258, 08 Civ. 135, 08 Civ, 136, 2010 WL 4484650 (S.D.N.Y. Nov. 9, 2010)

In a consolidated putative class action, shareholders sued Citigroup and fourteen of its officials, alleging violations of Sections 10(b) and 20(a) of the Exchange Act. The claims alleged misrepresentations and omissions made by defendants at various times regarding the company's holdings of AAA-rated collateralized debt obligations ("CDOs"), mortgages, "Alt-A" residential mortgage-backed securities ("RMBS"), auction-rate securities ("ARS"), leveraged loans and collateralized loan obligations ("CLOs"), and the company's solvency. After defendants moved to dismiss, the court allowed the claims regarding statements about defendants' CDO holdings beginning in February 2007 to go forward, but dismissed all other claims. Plaintiffs alleged that defendants had issued misleading disclosures about the extent and value of their CDO holdings, and the relationship of those holdings to the subprime mortgage market, which caused defendant company's stock price to fall after the company was forced to announce write downs in its holdings. The court found that because defendants had stated in SEC filings that it "may" have exposure to certain variable interest entities ("VIEs"), including CDOs, when in fact it had substantial exposure to CDOs, it was required to disclose the extent of its CDO holdings in order to make its prior statements not misleading. Plaintiffs had also alleged that defendants' decision to classify its CDO holdings separately from "mortgage-related transactions" gave the misleading impression that the CDOs were insulated from the mortgage market. The court agreed and held that defendants should have disclosed the extent to which the CDOs were connected to the subprime mortgage market in order to make the statements not misleading. Finally, plaintiffs alleged that by valuing the CDO holdings at par until October 2007 while market indices were steadily declining, defendants had overvalued the securities. The court allowed these claims to proceed, finding that proper valuation was a factual dispute that could not be decided at the motion to dismiss stage.

The court found further that plaintiffs adequately alleged scienter because defendants' "incongruity between word and deed" created an inference of recklessness. Plaintiffs had demonstrated awareness of CDO risk by: (i) hedging their own position in CDOs and setting up a special purpose vehicle to absorb the credit risks; (ii) conducting internal discussions about the possibility of a CDO market collapse and (iii) defendant's status as the underwriter on the CDOs. However, as against the individual defendants, plaintiff had only sufficiently pled for the seven defendants who had attended meetings at which CDO risks were allegedly discussed. Plaintiffs' claims that defendants had made misleading statements before February 2007 failed because they did not allege that defendants were aware of any risk to highly-rated super-senior CDO tranches of the type held by defendants before that time. However, plaintiffs had adequately stated a claim that the November 2007 announcement of its write down was misleading because defendants had failed to disclose the existence of $10.5 billion in CDOs which the company had hedged despite being aware of the risk that the insurers would default. Plaintiffs also established a material dispute of fact as to whether the CDOs were being properly valued even at the time the position was written down.

Plaintiffs' claims alleging misrepresentations and omissions regarding defendants' position in Alt-A RMBS failed as a matter of law, however. The alleged misstatement related to Alt-A mortgages, but not Alt-A RMBS, which were different investments. Moreover, because this statement was not misleading, plaintiffs could not establish a duty to disclose any information about Alt-A RMBS. Plaintiffs had further alleged that the Alt-A RMBS had been overvalued even when a writedown had been announced in April 2008, but this claim failed because plaintiffs had not pled facts to establish that the holdings of other companies—whose valuations plaintiffs compared to defendants'—were actually comparable assets. As to the SIV positions, plaintiffs had alleged that defendants had a duty to disclose an implicit promise made to their counterparties that they would guarantee the SIVs. However, they had not adequately pled the existence of this promise, and the court dismissed claims that it should have been disclosed and that its non-disclosure also constituted a violation of GAAP. Plaintiffs also failed to establish scienter on behalf of individual defendants alleged to have made misstatements and omissions about defendant company's mortgage company; although plaintiffs pled the existence of "red flags" (such as lawsuits pending against certain mortgage lenders), plaintiffs failed to plead that anyone responsible for the disclosures was aware of the red flags. Similarly, plaintiffs failed to establish that any defendant responsible for disclosures about the ARS holdings was aware that ARS auctions would fail, and plaintiffs' reliance on subsequent write downs to support their allegations of scienter was "hindsight pleading" and not indicative of defendants' knowledge at the time. The court dismissed similar hindsight pleading based on subsequent write downs as to the company's leveraged loan and collateralized loan obligation positions; the statements in question were unrelated to risk management policies or were unactionable statements of opinion. Similarly, a later capital infusion by the government did not make statements about the defendant company's solvency false at the time they were made, and such statements were nothing more than corporate puffery.

As to the Section 10(b) claims the court allowed to proceed, the allegations of scienter against the individual defendants who had participated in meetings about CDO risk were sufficient to plead culpable participation on behalf of those defendants and supported control person liability under Section 20(a). However, the Section 20(a) claims against the remaining defendants—as well as all claims not related to the CDO statements and omissions made after February 2007—were dismissed.

g. *In re Fannie Mae 2008 Sec. Litig.*,
742 F. Supp. 2d 382 (S.D.N.Y. 2010)

Purchasers of common and preferred stock for the class period of November 2006 to September 2008 brought this securities class action under Sections 10(b) and 20(a) of the Exchange Act against Fannie Mae, its senior management, and an outside auditor. The company began to increase its exposure to subprime and Alt-A mortgages in 2006, and had exposure of $405 billion by late 2007, equal to approximately 45% of its total assets. After the housing market crash of 2008, the company became insolvent and went into conservatorship on September 2008, causing the company's stock to plummet. The Southern District of New York had previously dismissed plaintiffs' Securities Act claims, and was thus deciding only plaintiffs' Exchange Act claims. Plaintiffs alleged that defendants intentionally or recklessly disregarded the dangers of the subprime housing market, materially misled investors as to the extent of the company's exposure to the subprime market, and materially misled investors about the ability of the company to manage the risks of such exposure. Plaintiffs also alleged that defendant auditor violated the GAAP and GAAS accounting principles in connection with the filing of allegedly false financial statements during the class period.

The court found that plaintiffs failed to adequately plead material misrepresentations regarding the company's exposure to the subprime market because the company's yearly statements, cited by plaintiffs in their complaint, expressly disclosed the company's increase in subprime exposure and the risks of such exposure. Plaintiffs' allegation of scienter with regard to the company's disclosures of its exposure to the subprime market was also inadequate, as plaintiffs alleged only that the company's senior management was motivated by a desire for personal profits. The court sustained plaintiffs' claims that defendants made material misstatements regarding their internal risk management and controls, finding that statements from internal emails sent by some of defendant's senior management contradicted defendant's public statements and were sufficient to allege that defendants acted recklessly. The court dismissed all of plaintiffs' claims of fraud against the auditor, finding that the flexibility provided by the accounting rules was sufficient to permit the auditor's interpretation of such rules. The court further found that loss causation was satisfied as to plaintiffs' claims regarding internal risk management, where plaintiffs alleged that their losses were caused at least in part by the misstatements, which resulted in the government conservatorship. The court sustained the direct liability claims against individual defendants only as to the CFO and CRO, finding that as the recipient and sender of the key emails relied upon by plaintiffs, they had knowledge of the allegedly inadequate internal risk controls. The court dismissed all claims of direct liability against the two defendant CFOs, finding that plaintiffs failed to prove the CFOs had knowledge of the foregoing.

5. Scienter

a. *Plumbers & Steamfitters Local 773 Pension Fund v. Canadian Imperial Bank of Commerce*, No. 08 Civ. 8134, 2010 U.S. Dist. LEXIS 25041 (S.D.N.Y. Mar. 17, 2010)

Plaintiff investors alleged that defendant bank and four of its executive officers were liable under Sections 10(b) and 20(a) of the Exchange Act for making false and misleading statements about the bank's exposure to fixed-income securities backed by subprime residential mortgages. The court granted defendants' motion to dismiss, holding that plaintiffs failed to allege with particularity facts that gave rise to a strong inference of fraud. Specifically, the court found that defendant purchased $300 million of its own stock during the purported class period, which was inconsistent with fraudulent intent. The court also found that plaintiffs failed to allege specific instances in which defendants received information that was contrary to their public declarations, and knowledge of general economic trends, like the subprime credit crisis, was insufficient to allege a state of mind to defraud. Plaintiffs' allegations of GAAP violations were also insufficient to allege fraud.

b. *In re Reserve Fund Sec. and Derivatives Litig.*, Nos. 09-MD-2011, 09-CIV-4346, 2010 WL 685013 (S.D.N.Y. Feb. 24, 2010)

The SEC alleged that defendant money market fund, its investment advisors and officers and directors were liable under Section 17(a) of the Securities Act, Sections 10(b) and 20(a) of the Exchange Act, and Sections 206(1), (2) and (4) of the Advisers Act for false statements and omissions made in the wake of Lehman Brothers' bankruptcy filing. When Lehman filed for bankruptcy, the fund, which held $785 million in Lehman debt securities, received a flood of redemption requests, causing the per-share net asset value (NAV) to drop below $1.00. The SEC alleged that defendants made false statements to the investing public regarding the level of redemption requests, the fund's resulting liquidity problems and attempts to obtain a credit support agreement to preserve a $1.00 NAV. The court denied defendants' motion to dismiss, holding that the PSLRA's heightened pleading standard for scienter did not apply to actions brought by the SEC, and the Commission's allegations regarding defendants' personal and reputational stakes in the fund and knowledge of the falsity of their statements were sufficient to satisfy Rule 9(b). Further, the court held that the alleged misstatements and omissions were material and that defendants could be held liable for misstatements and omissions made by their sales staff because defendants had approved those communications.

c. *In re Tremont Sec. Law, State Law, and Ins. Litig.*, No. 09 MD 2052, 2010 U.S. Dist. LEXIS 32216 (S.D.N.Y. Mar. 30, 2010)

Plaintiffs brought a class action against several hedge funds, their parent companies, managers and auditors arising out of the funds' investment in Bernard Madoff's Ponzi scheme. They alleged that the auditors of the funds had an obligation under GAAP to detect Madoff's fraud, but instead had missed several "red flags" and failed to notify investors of the riskiness of investing in the funds. The auditors moved to dismiss claims of violations of Section 10(b) of the Exchange Act, as well as common law fraud, breach of a fiduciary duty, aiding and abetting a breach of a fiduciary duty, and negligent misrepresentation. Holding that the auditors had no duty to investigate a third party's finances when auditing a client, the court dismissed the federal securities claims for failure to satisfy the "demanding" requirements for pleading scienter against an auditor. The court held that plaintiffs failed to adequately plead scienter with their claims of common law fraud. The court further held that non-fraud common law claims based on limited partnership interests were preempted by New York's Martin Act when they contained allegations of dishonesty and deception.

d. *In re Bank of Am. Corp. Sec., Derivatives, ERISA Litig.*, No. 09-MD-2058, 2010 WL 3448194 (S.D.N.Y. Aug. 27, 2010)

Shareholders of acquiring corporation brought a direct claim against target corporation and its directors and officers, asserting violations of federal securities laws in concealing and misstating critical aspects of the acquisition. Plaintiffs claimed that defendants were liable under Exchange Act Section 10(b) and Rule 10b-5 for breaching their fiduciary duty by failing to disclose to acquiring corporation's shareholders the parties' bonus arrangement and the allegedly adverse events that occurred while the proxy seeking approval of the acquisition was outstanding. The court dismissed these claims because plaintiffs failed to establish the existence of a fiduciary or similar obligation extending from the acquiring corporation to the shareholders of the target corporation. The court further held that plaintiffs' Section 10(b) and Rule 10b-5 claims must be dismissed because plaintiffs failed to adequately plead scienter because they did not allege how defendants' failure to disclose the losses was "highly unreasonable" and "represent[ed] an extreme departure from the standards of ordinary care ...." The court denied defendants' motion to dismiss plaintiffs' Section 14(a) and Rule 14a-9 claims, holding that false statements allegedly made by target company to acquiring company's shareholders in proxy solicitation were actionable under statutory and regulatory prohibitions against material misstatements or omissions in a proxy statement if they were false at the time they were made.

Plaintiff shareholders also brought a derivative Section 14(a) claim, based on the same core allegations as in the direct securities action, against individuals, who were also defendants in the direct action. The court held that, under Delaware law, shareholders of an acquiring corporation could bring both direct and derivative claims for material misstatements or omissions in a proxy statement because there was a possibility that both the shareholders and the corporation were separately injured by the alleged material misstatements and omissions. The court further held that demand was excused with respect to plaintiffs' claim against directors for deceptive proxy statement. The court reasoned that, since directors faced a "substantial likelihood" of personal liability on claim at the time the suit was commenced, this would have prevented them from exercising their disinterested and impartial judgment in responding to a demand request.

e. *Newman v. Family Mgmt. Corp.*, -- F. Supp. 2d ---, 2010 WL 4118083 (S.D.N.Y. Oct. 20, 2010)

Investors in a "sub-feeder" fund whose assets were ultimately embroiled in the Madoff Ponzi Scheme brought suit against the fund, two of its executives, and several feeder funds in which it invested. Plaintiffs alleged violations of Sections 10(b) and 20(a) of the Exchange Act and multiple state law claims, including fraud, negligent misrepresentation, breach of fiduciary duty, gross negligence and mismanagement, unjust enrichment, malpractice and professional negligence, and aiding and abetting breach of fiduciary duty. The claims were predicated on the defendants' alleged failure to notice red flags that would have indicated that Madoff's operation was fraudulent. Defendants moved to dismiss, and the court granted the motion for failure to adequately plead scienter, preclusion under the Securities Litigation Uniform Standards Act ("SLUSA"), and failure to adequately plead demand futility on certain derivative claims. The court first found that scienter was not adequately pled because the defendant fund's fees were not so exorbitant as to provide the motive to defraud. In addition, the defendant's failure to detect "red flags" in Madoff's dealings could not support a finding of conscious recklessness, as several courts, including the 2d Circuit, had so concluded on the basis that the fraud had gone undetected for twenty years. Having found no primary violation, the court dismissed plaintiff's Section 20(a) claims for control person liability.

Turning to plaintiffs' state law claims, the court dismissed plaintiffs' direct claims because they were precluded by SLUSA. Plaintiffs had argued that their claims did not concern "covered securities" under SLUSA, as they had invested in limited partnership interests that did not constitute "covered securities" under SLUSA and that the claims were not "in connection with" the purchase or sale of covered securities for the same reason. However, the court held that because the fund utilized investment strategies that included "substantial investment" in covered securities, and because Madoff had told investors he would be engaging in securities transactions and had used actual market prices, both preclusion requirements were met. In addition, all of plaintiffs' direct state law claims except for the claims for fraud and negligent misrepresentation alleged an injury, diminution in the value of the partnership, which constituted an injury to the partnership itself and could only be brought derivatively. Finally, the remaining state law claims, which had been properly alleged as derivative claims, were dismissed for failure to adequately plead claim futility. Because the individual defendants did not receive fees so excessive as to rebut the presumption of disinterestedness and were not likely to be held liable due to exculpation clauses in the partnership agreement along with likely preemption under the Martin Act, the court found that demand would not have been futile and that plaintiffs' derivative claims failed as a matter of law.

6. Loss Causation

a. *In re Omnicom Group, Inc. Sec. Litig.*, 597 F.3d 501 (2d Cir. 2010)

Appellant shareholders alleged securities fraud against appellee company and its managers as a result of the issuer's accounting practices surrounding a transaction in which appellee and a private equity firm created and invested in a new company. The Southern District of New York granted appellees' motion for summary judgment on claims brought under Sections 10(b) and 20(a) of the Exchange Act. The 2d Circuit affirmed, holding that appellants had not sufficiently established loss causation. The court found that the fraud on the market presumption had been sufficiently raised to satisfy the requirement of transaction causation, but that appellants failed to establish either a corrective disclosure or a materialization of the risk. With respect to appellants' corrective disclosure arguments, the court found that the disclosure that appellants relied on—a negative news article—did not introduce any new information to the market; it merely presented a "negative characterization" of existing facts. The court further held that the resignation of one of the company's directors did not constitute a materialization of the risk created by appellee's alleged fraud. The resignation also added no new facts to the market, and appellants were unable to allege that any fraud had ever been disclosed to investors. Finding that appellants had not adequately established Section 10(b) liability, the court found that summary judgment was appropriate on appellants' claim of control person liability under Section 20(a).

b. *In re Merrill Lynch Auction Rate Sec. Litig.*, No. 09 MD 2030, 2010 WL 5094296 (S.D.N.Y. Dec. 7, 2010)

Institutional investors alleged that defendants, an underwriter and broker-dealer of auction rate securities ("ARS"), along with its parent company, were liable under Sections 10(b) and 20 of the Exchange Act, as well as under Louisiana state law for breach of contract, breach of fiduciary duty, and New York securities laws for allegedly failing to disclose the broker-dealer's bidding practices in the ARS market, namely that the broker-dealer regularly placed protective bids to prevent auctions from failing and to protect issuers from the higher auction failure interest rate. The court granted in part and denied in part defendants' motion for judgment on the pleadings. The court rejected defendants' federal statute of limitations argument that plaintiffs' claims were time-barred based on a prior action brought by the SEC because plaintiffs had not yet suffered economic loss, a key element of a claim under Section 10(b) and Rule 10b-5, and, as such, the statute of limitations had not commenced before "a complete and present cause of action [could] accrue." Likewise, plaintiffs' state law claims were timely. The court dismissed the Section 10(b) and Rule 10b-5 claims with prejudice because (1) plaintiffs could not demonstrate that defendants' alleged misstatements and manipulative conduct caused their losses nearly one-and-a-half years after defendants disclosed their practices, and (2) plaintiffs could have converted their ARS to traditional fixed or variable rate instruments, but failed to do so. Because plaintiffs failed to show a primary securities violation, the court also dismissed plaintiffs' Section 20 control person claim. The court also dismissed with prejudice plaintiffs' breach of contract, breach of warranty, detrimental reliance, and unjust enrichment claims under Louisiana law. However, the court permitted plaintiffs to proceed on their Louisiana breach of fiduciary duty, intentional and negligent misrepresentation, and fraud claims—the latter only to the extent that they are predicated on alleged fraud or misstatement that occurred prior to defendants' disclosure of their bidding practices.

7. Standing

a. *In re Am. Int'l Group, Inc. Sec. Litig.*, No. 04 Civ. 8141, 2010 U.S. Dist. LEXIS 15453 (S.D.N.Y. Feb. 22, 2010)

Lead plaintiffs, consisting of three public pension funds, alleged that defendant international insurance company was liable under Sections 11 and 15 of the Securities Act and Sections 10(b) and 20(a) of the Exchange Act, and sought class certification of bondholders and equity holders of defendant. Although the court certified the class of stockholders, it denied class certification of the bondholders because lead plaintiffs lacked standing, as they purchased the bonds after filing their complaint, and therefore had knowledge of the existence of the company's material misstatements at the time that they became bond holders. Further, the court held that lead plaintiffs failed to establish the existence of an efficient bond market under the *Cammer* factors and thus were not entitled to rely on the fraud-on-the-market presumption of reliance.

b. *In re Bank of America Corp. Secs. Derivative, and ERISA Litig.*, No. 10 Civ. 1234, 2010 WL 5248815 (S.D.N.Y. Dec. 14, 2010)

Plaintiff, an individual investor filed two separate actions under Sections 10(b) and 20(a) of the Exchange Act alleging material misstatements in connection with Bank of America's acquisitions of Countrywide Financial Corporation and Merrill Lynch & Co: one, a derivative action against current and former officers and directors of Bank of America; and two, a direct claim filed on the investor's own behalf against Bank of America and the same individual defendants. The court held that plaintiff could not maintain both actions simultaneously because plaintiff could not fairly pursue the rights of the corporation while also suing that same corporation directly, and the plaintiff's direct claim against the bank prevented him from being a fair and adequate representative of the other shareholders in a derivative suit. Ultimately, the court dismissed the derivative action.

c. *Lewin v. Lipper Convertibles, L.P.*, No. 03 Civ. 1117, 2010 WL 4669040 (S.D.N.Y. Nov. 17, 2010)

Plaintiff investors in a collapsed hedge fund filed an action under Section 10(b) of the Exchange Act and Rule 10b-5 against the failed fund and its auditor. Plaintiffs received approximately 80 cents on the dollar of their net investments in the liquidation of the bankrupt fund. The liquidation trustee for the collapsed fund had reached a settlement with the auditor; however, plaintiffs in this action opted out of the settlement to avoid releasing their direct claims against the auditor. The court granted the auditor's motion for summary judgment, finding that plaintiffs lacked standing to bring their claims because they had failed to present evidence that they suffered a direct injury. Plaintiffs did not support their claims of direct injury with an expert opinion or other evidence; the auditor on the other hand, provided an expert opinion to refute claims that the plaintiff had standing.

8. Other

a. *S.E.C v. Bank of America Corp.*, No. 09 Civ. 6829, and No. 10 Civ. 0215, 2010 U.S. Dist. LEXIS 15460 (S.D.N.Y. Feb. 22, 2010)

In an effort to resolve two cases alleging that defendant bank violated Section 14(a) of the Exchange Act based on a failure to disclose large bonuses paid to executives and significant losses suffered by target bank in proxy materials, plaintiff SEC and defendant submitted a proposed consent judgment for court approval. The court approved the proposed settlement because the law required judicial deference to decisions made by the SEC.

b. *Copeland v. Fortis*, No. 08 Civ. 9060, 2010 WL 569865 (S.D.N.Y. Feb. 18, 2010)

Plaintiff investors alleged that defendant, an international provider of banking and insurance services, was liable under Sections 10(b) and 20(a) of the Exchange Act for allegedly misrepresenting its financial condition. Plaintiffs' claims were dismissed for lack of subject matter jurisdiction because: (1) the fraud alleged in the complaint was conceived and executed outside of the US, and (2) the complaint failed to establish that the fraudulent activity had a substantial impact on US investors and securities markets. Because plaintiffs had already filed two complaints, the court denied plaintiffs' request for leave to file an amended complaint, instead dismissing the action with prejudice. (This case was decided prior to the Supreme Court's decision in *Morrison*, although it is consistent with the holding in that decision.)

c. *In re Lehman Bros. Sec. and ERISA Litig.*, No. 09 MD 2017, 2010 WL 337997 (S.D.N.Y. Feb. 1, 2010)

Plaintiff investors alleged that defendant credit rating agencies were liable under Sections 11, 12(a)(2) and 15 of the Securities Act as underwriters and sellers of mortgage-backed securities offered by Lehman Brothers Holdings between September 2005 and July 2007. The court dismissed the Sections 11 and 12 claims, finding that the credit rating agencies were not "underwriters" or "sellers" because, while they may have had input into the composition and characteristics of the pools of mortgage loans backing the securities, they did not purchase the securities intending to resell them. Additionally, the court found that plaintiffs' allegation that defendants had "influence" over the securitization and underwriting process was insufficient to support a claim for control person liability.

d. *In re Bernard L. Madoff Inv. Sec. LLC*, 424 B.R. 122 (Bankr. S.D.N.Y. 2010)

In the liquidation of Bernard Madoff's Ponzi scheme under the Securities Investor Protection Act (SIPA), the trustee moved to affirm his determination of how to measure investors' net equity, to deny claims based on an alternative method, and to expunge objections of various claimants to the valuation. To determine the amount of each customer's claims to the remaining customer property properly, the trustee had proposed a method by which the claims were valued according to the amount of money deposited with Madoff less the amount of money withdrawn (the Net Investment method). A number of claimants objected and argued that the dollar amounts of their accounts, or "Net Equity," should be valued according to the dollar value of their account as reflected on their last account statement (the Last Statement method). After deciding that SIPA contemplated its statutory payments to be advances against customer property, and not independent insurance obligations, the court turned to statutory interpretation, precedent, and issues of practicality and equity to guide its determination. Analyzing the definition of "net equity" in SIPA, the court found that customers' "securities positions" were to be derived from the debtors' books and records. Here, only cash deposits and withdrawals could be determined from Madoff's books and records, because the securities positions thereon were entirely fictitious, making the Net Investment method more appropriate than the Last Statement method. By not basing distribution around transfers in furtherance of a Ponzi scheme, this method also was more consistent with the Bankruptcy Code, under which such transfers are avoidable. Next, the court applied *In re New Times Sec. Servs.*, 371 F.3d 68 (2d Cir. 2004), in which a method similar to the Net Investment method had been applied to victims of a Ponzi scheme who had been told they had invested in securities that did not exist. Even though the securities at issue in this case were real, the trades were fictitious and the court held that the arbitrary numbers, and not the arbitrary securities, were at the heart of the *New Times* holding. Finally, the court held that it would be inequitable, given the limited amount of funds available to claimants, to reward further those who had already withdrawn more than they had deposited, which the Last Statement method would have done. All of these considerations made the Net Investment method the most appropriate way to determine Net Equity.

e. *Barron v. Igolnikov*, No. 09 Civ. 4471, 2010 WL 882890 (S.D.N.Y. Mar. 10, 2010)

The Southern District of New York dismissed state law securities claims against corporate and individual operators of 11 "funds of funds" that had allegedly lost $700 million by investing in feeder funds with connections to the Ponzi scheme run by Bernard Madoff. The complaint asserted state law claims of breach of fiduciary duty, aiding and abetting a breach of fiduciary duty, gross negligence and unjust enrichment based on allegations that defendants had ignored red flags and failed to provide proper account statements. The court dismissed the complaint as preempted under the federal Securities Litigation Uniform Standards Act (SLUSA) and New York's Martin Act.

f. *In re American International Group, Inc.*, No. 07 Civ. 10464 (LTS), 2010 U.S. Dist. LEXIS 31286 (S.D.N.Y. Mar. 30, 2010).

Director disinterestedness and demand futility. The Southern District of New York dismissed a shareholder derivative lawsuit against defendant company on the ground that plaintiff, owner and holder of defendant company's common stock since February of 2006, failed to seek redress through the global insurer's board of directors as required by Fed. R. Civ. P. 23.1. Under that rule, a plaintiff bringing a shareholder derivative suit must state with particularity that it has made a demand on the board of directors to take the requested action or the reasons for not making the demand. The court found that plaintiff's generalized allegations as to demand futility based on director compensation and the director's unwillingness to sue themselves failed to give rise to a reasonable doubt that defendant directors were disinterested and independent. The court further held that the plaintiff failed to raise a reasonable doubt as to any of the directors' disinterestedness based on the possibility that they faced a substantial likelihood of personal liability with respect to plaintiff's failure of oversight claim and claims for violations of Section 10(b) of the of 1934 Exchange Act. Specifically, failed to allege particularized facts demonstrating that the directors were aware of the company's exposure to the subprime mortgage market, and that their inaction demonstrated a conscious disregard for their responsibilities to exercise proper oversight over the company. Finally, the court denied plaintiff's claim that demand was excused because the Board's decisions to increase the dividend and repurchase shares, as well as its compensation-related decisions, were sufficient to support an inference that the Board acted in bad faith and without sound business judgment. Similar to its oversight claims, plaintiff failed to allege with sufficient particularity facts that would call into doubt that the Boards' decisions were anything but valid exercises of business judgment. Accordingly, the court dismissed these claims for failure to make pre-suit demand.

g. *In re IMAX Sec. Litig.*, 06 Civ. 6128, 2010 U.S. Dist. LEXIS 135341 (S.D.N.Y. Dec. 29, 2010)

Class action certification. Following an SEC investigation of defendant corporation and its accounting firm's accounting procedures and defendants' subsequent restatement of revenue, investors alleged that defendants violated Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 by issuing materially false and misleading statements concerning the defendant's accounting of theater system revenue. Plaintiff, an individual investor, filed a motion to certify the action as a class action and to certify itself as class representative. The court denied the plaintiff's motion after considering the elements for certification of a class action pursuant to Federal Rule of Civil Procedure 23(a). While the court found that the plaintiff met the numerosity and commonality requirements of Rule 23(a), the court held that the plaintiff did not meet the typicality or the adequacy requirements. Specifically, the court noted that the plaintiff could not establish loss causation and therefore its claims were "subject to unique defenses which threaten to become the focus of the litigation." Thus, the court found that plaintiff's claims were not typical of the class, and therefore did not meet the typicality requirement. The court further specified that plaintiff did not meet the adequacy requirement because plaintiff's close personal and professional relationship with class counsel was troubling, as was the failure to disclose this relationship. The court noted that when a class counsel is closely associated with the class representative there is an inherent risk that the class counsel may allow a settlement less favorable to absent class members' interests. The possibility of impropriety and inadequacy was sufficient in the court's opinion to deny certification with plaintiff as class representative.

h. *Iowa Pub. Employees' Ret. Sys. v. MF Global, Ltd.*, 620 F.3d 137 (2d Cir. 2010)

Bespeaks Caution Doctrine. Plaintiff shareholders appealed the district court's dismissal of their claims of material misstatements against defendant corporation, its parent and underwriters after defendant's stock prices plummeted following the disclosure that a broker evaded trading restrictions. Specifically, plaintiffs alleged that defendants exaggerated risk-management measures and failed to disclose relevant material facts in the issuer's registration statement and prospectus, thereby violating Sections 11, 12(a) and 15 of the Securities Act. The court vacated and remanded the dismissal of plaintiffs' claim, finding that the district court erroneously applied the bespeaks caution doctrine. In particular, the court noted that plaintiffs' allegation of defendants' failure to disclose the fact that risk management protocols did not apply to company employees trading for their own accounts constituted an omission of present fact because the applicability of the risk management system was verifiable when the statements were made. Thus, the court found that the district court applied the bespeaks caution doctrine too broadly because plaintiffs' allegations did not apply solely to forward looking statements. The court explained the difference between forecasts and facts, and specified that the bespeaks caution doctrine does not apply to characterizations which communicate present or historical facts as to measures taken. Additionally, the court affirmed the dismissal of plaintiffs' claim that the prospectus and registration statement failed to disclose deficiencies in controls of client accounts, finding that plaintiffs' alleged losses stemmed from failures to manage risks in non-client accounts. However, the court noted that shortly after the incident, defendants stated that risk management protocols were turned off for brokers who traded for themselves or took customer orders by phone. Therefore, the court vacated and remanded the district court's dismissal of plaintiffs' allegations as they related to risk management of telephone orders.

i. *U.S. v. Kaiser*, 2010 WL 2607140 (2d Cir. 2010)

Jury Instructions; Conscious Avoidance. Defendant, a high-level executive, appealed the Southern District of New York jury verdict convicting him of making fraudulent misrepresentations regarding the financial conditions of the company for which he worked, and ultimately, the financial conditions of the entity that later acquired that company, in violation of federa; securities laws. Defendant argued that the district court's jury instructions regarding the conscious avoidance theory and the "willfulness" requirement of Section 32(a) of the Securities Act were erroneous. The 2d Circuit concluded that because the jury instruction "did not contain [the] two elements necessary for a conscious avoidance charge: 'that knowledge of the existence of a particular fact is established (1) if a person is aware of a high probability of its existence, (2) unless he actually believes that it does not exist,'" the jury instruction with respect to that charge was in error. The court found that there was a reasonable likelihood that the faulty jury instruction affected defendant's substantial rights, and accordingly vacated the district court's judgment and remanded for a new trial. The Second Circuit rejected defendant's claim that the lower court erred with respect to the "willfulness" element of securities fraud, affirming the lower court's holding that willfulness requires proof that the defendant intentionally committed wrongful acts, but does not require knowledge on the part of the defendant that the acts were illegal.

j. *Public Employees' Ret. Sys. of Miss. v. Merrill Lynch & Co., Inc.*, 714 F. Supp. 2d 475 (S.D.N.Y. 2010); *Pub. Employees' Ret. Sys. of Miss. v. Merrill Lynch & Co., Inc.*, No. 08 Civ. 10841, 2010 WL 4903619 (S.D.N.Y. Dec. 1, 2010)

Statute of Limitations; Definition of Underwriter. Investors asserted claims under Sections 11, 12(a)(2), and 15 of the Securities Act in a purported class action against various participants in 84 issuances of mortgage pass-through certificates over 84 separate issuances, asserting that registration statements, prospectuses, and prospectus supplements contained untrue statements and material omissions. Defendants included the issuer and several of its executives, its parent, certain subsidiaries of the parent acting as sponsors or underwriters, four non-affiliated sponsors or underwriters, and two rating agencies. Defendants moved to dismiss, and the court granted the motion as to all claims, some without prejudice. The court first ruled that the claims were not time-barred by the one-year statute of limitations established by Section 13, finding that the evidence that mortgage-backed securities in general were questionable was not sufficient to put plaintiffs on inquiry notice unless the specific certificates at issue had been called into question. The court then dismissed with prejudice the claims as to 65 of the 84 offerings for lack of standing; although Federal Rule of Civil Procedure 23 would allow the named plaintiffs to bring claims based on all offerings, a federal rule is insufficient to create standing, and standing could only be conferred for claims arising from the 19 offerings in which named plaintiffs participated. The court next dismissed the claims against defendant rating agencies, finding that they were not "underwriters" as contemplated by Section 11 by relying on the SEC interpretation and Southern District precedent. Similarly, the court found that allegations that defendant parent company "participated in the drafting and dissemination" of the prospectus supplements was insufficient to plead that it was an underwriter, though it granted leave to amend the complaint as to this defendant.

Turning to the substance of the claims against defendants acknowledged by all parties to be underwriters, the court found that allegations that underwriting guidelines had been "systematically disregarded," contrary to representations in registration statements for some of the issuances, were sufficient to plead Section 11 claims. However, it dismissed two junior underwriters who had drafted registration statements making no such representations. The court also dismissed Section 12(a)(2) claims against the underwriters for lack of standing, finding that plaintiffs had "coyly" avoided making the requisite allegation that they had participated in the sales at issue. Finally, the court dismissed Section 15 claims against parents of the underwriters, a non-affiliate of the underwriters, and the individual defendants on the basis that allegations of control against each were a mere "formulaic recitation" of the elements, and neither the subsidiary/parent relationship nor the mere allegation that a person was an officer or director is sufficient to infer control. The court therefore granted the motion to dismiss as to all claims except the Section 11 claims against one acknowledged underwriter, its parent, and the individual defendants.

Plaintiffs subsequently filed an amended complaint attempting to replead the claims which had been dismissed without prejudice, now alleging that the offering documents contained material misstatements and omissions with respect to the originators' fidelity to the underwriting guidelines, the maximum loan-to-value rations, the appraisals, and the debt-to-income ratios against defendants, the banking parent company, the depositor, and the affiliate and non-affiliate underwriters. With respect to plaintiffs' Section 11 claims, the court dismissed the claims against the non-affiliate underwriters because: (1) plaintiffs allegations that the sponsor of the only offering they underwrote conducted "ineffective diligence" of the underlying loans were insufficient to state a claim; (2) that the non-affiliate underwriters had no duty to make any disclosures because no loan originator contributed more than 20% of the loans in the pool; and (3) plaintiffs claims against the non-affiliate underwriters were time-barred. The court permitted plaintiffs' Section 11 claims against the parent company, the depositor, and the affiliate underwriter to proceed because the remaining plaintiffs, those with standing to sue, pleaded facts of false statements sufficient to survive a motion to dismiss. The court permitted plaintiff's Section 12(a)(2) claims to proceed as to plaintiffs with standing—those who purchased the subject securities from the affiliate underwriter in public offerings. The court also permitted the Section 15 control person claims to proceed against the parent company because plaintiffs alleged a closer connection between the parent company and[the depositor sufficient to survive a motion to dismiss.

k. *Romano v. Kazacos*, 2010 WL 2574143 (2d Cir. 2010)

SLUSA state claim preclusion. Plaintiffs-appellants, retired employees, filed class action complaints in New York State Supreme Court against defendants-appellees, employees of a financial institution., claiming that defendants misrepresented to them that if they retired early, they would be supported throughout their retirement by their investment savings. When the value of the investments dramatically decreased, plaintiffs-appellants brought this class action against defendants in state court asserting state law claims of negligence, breach of fiduciary duty, negligent misrepresentation, breach of contract, and violations of the New York General Business Law. The Second Circuit affirmed the judgment of the district court granting the defendants' motions to dismiss and denying plaintiffs' motions to remand on the basis that plaintiffs' claims were barred by SLUSA.

IV. THIRD CIRCUIT

A. SUMMARY OF DEVELOPMENTS IN 2010

In 2010, the 3d Circuit issued several important decisions, and the district courts in the Circuit issued several others. In *In re Aetna, Inc. Sec. Litig*., the 3d Circuit held that investors failed to allege securities fraud because the company's public statements, despite incorporating historical or present data, were protected as forward-looking statements under the PSLRA safe harbor. In *Martion v. TDI, Inc.*, the 3d Circuit held that a receiver had standing to sue the owners of a brokerage firm and a bank for their roles in enabling the owner of the company in receivership to perpetuate a Ponzi scheme. However, defendants could not be liable for the monetary damages levied against them by a jury because defendants' assistance did not cause the company's short-term loss, and any duties breached by defendants were to the company's investors, rather than to the company itself. At the district level, the District of New Jersey in *Dow Corning Corp. v. BB & T Corp.*, found that allegations that a broker-dealer had misled investors in auction rate securities by failing to inform them that absent the intervention by brokers through the use of support bids at auctions, the market for auction rate securities would collapse were sufficient to survive a motion to dismiss. The District of New Jersey granted defendants' motion to dismiss in *In re Synchronoss Securities Litigation*, finding that a software licensing company was not required to predict that an important client would change its business model, resulting in the client's cancellation of its contract. The court held that even if defendant should have predicted the negative financial impact of such a potential event, plaintiffs would be required to demonstrate that defendant intentionally refused to share this information with the investing public, which plaintiffs failed to do.

B. NOTEWORTHY CASES IN 2010

1. Pleading Standards for Securities Fraud

a. *In re Heartland Payment Systems, Inc*., No. 09-1043, 2009 U.S. Dist. LEXIS 114866 (D.N.J. Dec. 7, 2009)

Plaintiff shareholders alleged that defendant, a payment processing company, committed securities fraud because it failed to disclose in 2008 news of a December 26, 2007 attack on its network computers and made inaccurate and misleading statements about the state of its security and about security expenditures. For example, on a February 13, 2008 earnings call, company executives were asked by analysts whether there was any specific security incident that prompted the company to make certain security expenditures in the fourth quarter of 2007, to which the executives responded "no." Plaintiffs claimed that the statements made on that call were untrue because the company had, in fact, suffered a significant security breach during the December 2007 attack. Plaintiffs also contended that the security breach rendered other statements about the state of the company's security systems false and misleading. The district court dismissed the complaint, holding that the statements about network security expenditures made in the fourth quarter of 2007 could not possibly have been tied to a security breach that occurred on December 26, because December 26 would have been "far too late in the quarter to have been the cause" for the expenditure. As for other statements about the level of security breaches at the company, the court found that as of the time of the earnings call, hackers had not stolen any credit card information from the company, nor had the company suffered any major-headline-making problems sufficient to make the statements false. Any statements made by the company that its network security was adequate or that the company took the issue of security seriously were also neither false nor fraudulent since it was plausible that the company did place a high emphasis on security that was nonetheless overcome by the breach.

b. *National Junior Baseball League v. Pharmanet Dev. Group Inc*., No. 08-5723, 2010 WL 1379735 (D.N.J. Mar. 30, 2010)

Plaintiff filed a putative shareholder class action against defendant, a clinical research organization, and its CEO and CFO, alleging that defendants misrepresented the reasons for contract cancellations, prematurely included revenues from change orders in backlog and direct revenue, incorrectly continued to count a project in backlog after it was delayed and waited too long to take an impairment charge. The district court dismissed the complaint, finding that: (1) plaintiff had failed to allege loss causation because the alleged wrongdoing was not disclosed to the market, (2) the statements by plaintiff's 12 confidential witnesses (CWs) were unreliable because the CWs were not in a position to know about the alleged wrongdoing and/or the CWs' statements were not pled with sufficient particularity, (3) while statements concerning the company's backlog were not protected by the PSLRA's safe harbor for forward-looking statements, the safe harbor did apply to statements about the company's future financial performance and (4) plaintiff failed to plead particularized facts supporting a strong inference of scienter for any defendant. With regard to the lack of scienter, the court noted that (A) the individual defendants held their stock throughout the class period, incurring sizable losses, (B) the CWs' statements were not reliable or sufficiently specific to support scienter and (C) knowledge could not be imputed to the individual defendants based on their positions or the core business doctrine.

c. *Mill Bridge V, Inc. v. Benton*, No. 08-2806, 2009 WL 4639641 (E.D. Pa. Dec. 3, 2009)

Plaintiff asserted numerous claims against defendant, alleging violations of, *inter alia*, Sections 10(b) and 29(b) of the Exchange Act and various rules of the Philadelphia Stock Exchange. Specifically, plaintiff alleged that: (1) defendant board member of the Philadelphia Stock Exchange purchased (through her partnership) plaintiff's shares after the board issued an information memorandum that was negative about the financial condition of the Exchange; and (2) defendant board member failed to disclose to plaintiff the potential sale of the Exchange for a price substantially higher, on a per-share basis, than defendant was offering for plaintiff's shares. The court dismissed plaintiff's Section 10(b) claims predicated on the content of the information memorandum because (a) the complaint failed to allege any "precise participation" by the defendant board member in creating or disseminating the memorandum, and (b) to find liability under these facts would require recognition of the "group pleading doctrine," a doctrine that the 3d Circuit has expressly rejected. The court, however, found that plaintiff's claim predicated on defendant board member's alleged failure to disclose the potential sale of the Exchange survived defendant's motion to dismiss, "albeit quite narrowly." While defendant board member contended that the potential sale of the Exchange did not reach the threshold of materiality due to the fact that the deal was not ultimately consummated, the court found that the negotiations with the prospective third-party buyer "had potential impact on [the stock of the Exchange] by reflecting what an outside investor would pay for such stock—a price per share well above what [the defendant] paid in her transaction with [the plaintiff].” Accordingly, the court allowed this single 10(b) claim to proceed. The court dismissed plaintiff’s Section 29(b) claim, however, because plaintiff had predicated its right to rescission solely on violations of the rules of the Exchange, yet “section 29(b) cannot be interpreted to create a private cause of action to enforce violations of an exchange’s rules.” More pointedly, the court found no basis for believing that securities exchanges, in their “quasi-legislative capacity,” promulgate rules with the intention of subjecting themselves to damages for non-enforcement.

Plaintiffs, shareholders in a newly-merged company, asserted claims under Sections 11 and 15 of the Securities Act, Sections 20(a) and 10(b) of the Exchange Act and Rule 10b-5 against the original company in which they held shares and several of its officers, the merging company, and the new company’s auditor alleging material misstatements or omissions made in a Registration Statement. Specifically, plaintiffs alleged that defendants were responsible for incorrectly stated financial reports, which were subsequently restated by the new company, causing a decline in stock price. The district court granted the auditor’s motion to dismiss because plaintiffs failed to properly allege the standards the auditor violated or how the statements in the audit opinion were false or misleading at the time they were made. However, the court otherwise denied the motions to dismiss (except with regard to one disclosure related to Plaintiffs’ 10(b) claim). The court was persuaded that the alleged misstatements made in connection with the restated earnings were material (it found the value of the additional losses that were reported and the drop in stock price particularly compelling in this determination); and the court also found that plaintiffs sufficiently pled scienter.

d. *Solomon-Shrawder v. CardioNet, Inc.*, No. 09-3894, 2010 WL 3168366 (E.D.Pa. Aug. 10, 2010)

In a Rule 10b-5 class action lawsuit against defendant medical technology company and two of its executives, plaintiff-shareholders alleged that defendants made false and misleading statements following the publication of an analyst’s report negatively evaluating the company’s financial prospects. Specifically, plaintiffs alleged that defendants made overly optimistic statements in response to an analyst’s report predicting imminent reductions in insurers’ reimbursement rates for defendant company’s product. The court dismissed the complaint, finding that plaintiffs did not adequately plead facts demonstrating falsity. Moreover, the court discounted certain information and statements from confidential witnesses upon which plaintiffs’ allegations relied, noting that the court may do so when adequate details regarding the source and reliability of a confidential witness are not made available. Additionally, the court found that plaintiffs did not adequately plead scienter, specifying that defendants’ refusal to believe the report’s claims did not prove fraud or scienter; in fact, defendants attempted to verify the information by directly asking insurers whether they had leaked the information referenced in the analyst’s report.

e. *Snowstorm Acquisition Corp. v. Tecumseh Prod. Co.*, 2010 WL 3735383 (D. Del. Sept. 21, 2010)

Plaintiff alleged securities fraud, common law fraud, and breach of contract after purchasing an engine manufacturer and discovering that the manufacturer’s largest client was in the midst of terminating its relationship with the manufacturer. The source of the alleged misrepresentations was a business consultant brought in to improve the manufacturer's performance. The consultant and the consultancy for which he worked moved to dismiss. The court found that the allegations against the consultant met the heightened particularity requirements of the PSLRA and FRCP 9(b). However, the court dismissed the claims against the consultancy because (1) the specific elements of the securities claims against it were not pled with sufficient particularity; (2) the consultant was acting outside of the scope of his employment by the consultancy when he made the misrepresentations; and (3) the consultancy did not control the company when the misrepresentations were made and thus was not subject to Section 20(a) liability.

f. *Bldg. Trades United Pension Trust Fund v. Kenexa Corp.*, No. 09-2642, 2010 WL 3749459 (E.D. Pa. Sept. 27, 2010)

Plaintiffs alleged securities fraud under Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 after defendant-issuer fell short of revenue and growth estimates made earlier in the year in public filings and by defendant officers. Plaintiffs alleged that defendants made materially false forecasts and material omissions, and that defendants engaged in insider trading, thereby profiting from their misrepresentations and omissions. The court dismissed the complaint, finding that plaintiffs' pleadings did not give rise to a strong inference of scienter because: (1) plaintiffs failed to plead information evidencing that defendants were aware of information inconsistent with that which was publicly disclosed, (2) plaintiffs failed to allege why certain accounting practices—which they asserted were misleading and should have been disclosed—were problematic, and (3) the insider trading of three company executives was not unusual enough in scope or timing to give rise to an inference of scienter. The court noted that many of the alleged misrepresentations were not even false or misleading. The court also held that plaintiffs had not adequately pled the elements necessary to impute third-party statements to defendants, that defendants' forward-looking statements were protected by the PLSRA safe harbor, and that defendants did not make material omissions because their statements did not give rise to a duty to disclose.

2. Misstatements and Omissions

a. *In re Synchronoss Sec. Litig.*, No. 08-4437, 2010 WL 1409664, (D.N.J. Apr. 2010)

Defendants, a software developer for wireless services and its officers, allegedly violated the securities laws by failing to disclose to investors numerous warning signs that its contracts with a major wireless service provider were in jeopardy. The court granted defendants' motion to dismiss because: (1) plaintiffs' claims pointed to general statements of optimism about the company's long-term future growth made by journalists and analysts and did not allege "facts showing that a particular defendant both made the statement to the analyst and controlled the content of the analyst's report," (2) management's publicized pride in their company and optimism in its performance were mere "immaterial puffery incapable of resulting in legal liability," (3) defendants could not be held liable for their failure to predict that the market for their product would dry up as a result of the business activities of an independent company to which the company's sales were tied, (4) plaintiffs failed to allege a single statement made by a defendant that affirmatively led plaintiffs "in the wrong direction," and rather, plaintiffs' allegations merely demonstrate that plaintiffs misinterpreted defendants' statements and (5) defendants were not liable for failing to update rumors because defendants have no duty to "update" statements that they themselves did not introduce into the market.

b. *In re Aetna, Inc. Sec. Litig.*, 617 F.3d 272 (3d Cir. 2010)

Plaintiffs alleged securities fraud after defendant corporation's stock declined following disclosure of increases in its "medical cost ratio," the company having previously expressed its commitment to retaining a "disciplined approach to pricing." The Third Circuit affirmed the lower court's dismissal, finding that defendant's statements, despite incorporating historical or present cost and pricing data, expressed expectations for future earnings and thus were forward-looking statements protected by the PSLRA Safe Harbor. The court also held that the statements were puffery containing merely oblique references to defendant's pricing policy, and were immaterial as a matter of law.

c. *In re DVI, Inc. Sec. Litig.*, 2010 WL 3522090 (E.D.Pa. Sept. 3, 2010)

Plaintiff investors asserted claims under Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 against defendant independent auditor, alleging that the auditor issued "clean" audit reports despite knowledge of material misrepresentations regarding the filer's liquidity. Specifically, plaintiffs alleged that the auditor assisted the company in understating its loan loss reserves and concealing a liquidity crisis. The district court granted in part defendant's motion of summary judgment, finding that certain disclosure events analyzed by plaintiffs did not constitute "corrective disclosures" as a matter of law. The court excluded analysis involving those disclosures that presented solely the "true financial condition" of the company as well as those that neither revealed the truth behind the alleged misrepresentations nor resulted in the materialization of the risk concealed by the alleged misrepresentations. The court further rejected plaintiffs' expert witness testimony regarding an Insolvency Theory of loss causation, whereby any decline in the stock price of a company would be recoverable if the company would be insolvent but for the fraud.

d. *Dow Corning Corp. v. BB & T Corp.*, No. 09-5637, 2010 WL 4860354 (D.N.J. Sept. 27, 2010)

Plaintiffs alleged securities fraud under Section 10(b) of the Exchange Act and Rule 10b-5 after the auction rate securities ("ARS") market collapsed in February 2008, rendering plaintiffs' ARS holdings, purchased through defendant broker-dealer, illiquid. In Fall 2007, the risk of the ARS market collapse allegedly increased, and therefore defendant broker-dealer increasingly used support bids at auction in order to prevent auction failure. Plaintiffs alleged that, during this time, one of defendant broker-dealer's employees made numerous positive statements regarding the condition of the ARS market which were materially false because they failed to disclose that the ARS market "would be illiquid absent intervention by brokers," including defendant. The court agreed. The court additionally found that plaintiffs had adequately alleged scienter by showing that the defendant had a motive to conceal this information in order to sustain the ARS market so that it could dispose of its own ARS holdings. In applying the reasonable reliance factors, the court found the fact that the critical information—that the ARS market was being propped up by support bids from broker-dealers, including defendant—was not publicly available outweighed the fact that plaintiffs were sophisticated investors. The court was not persuaded by defendant's argument that plaintiffs' ARS holdings were simply illiquid rather than valueless, stating that the illiquid holdings were clearly worth less than when they were liquid, and therefore that plaintiffs had adequately pled loss causation. Defendant's statute of limitations defense failed because the defendant claimed that discovery notice occurred prior to when the misleading statements were made—that is, before the claim had even accrued. The court denied the motion to dismiss with respect to defendant broker-dealer. The court granted the motion to dismiss with respect to defendant broker-dealer's parent company, because plaintiffs had attributed actionable conduct only to defendant broker-dealer or "defendants" generally, and never specifically to the parent company.

3. Statute of Limitations

a. *SEC v. Kearns*, No. 09-3599, 2010 WL 715467 (D.N.J. Feb. 23, 2010)

The SEC brought this securities fraud action against the CFO of a medical transcription provider, alleging that he helped further and conceal the company's fraudulent billing scheme and made omissions that created the misleading impression that the company's financial performance was due to legitimate business practices. Defendant moved to dismiss, arguing that plaintiff's suit was time-barred because the limitations period accrued with the alleged *violation* and plaintiff could not establish equitable tolling of the limitations period because it did not plead affirmative acts of concealment separate from the actual fraud. The court rejected that argument, holding that the statute of limitations in 28 U.S.C. Section 2462 is equitably tolled until the date of *discovery* for claims sounding in fraud so long as the plaintiff pursues its claim with diligence. Based on plaintiff's allegations that none of the financial filings prepared by defendant revealed the fraudulent billing scheme and that defendant reassured auditors that the company had no problems with billing, the court concluded that there was no indication on the face of the complaint that plaintiff could have uncovered the fraud before the scheme was revealed. Defendant also argued that none of his statements to shareholders and the public were misleading because his statements that the company's revenues were based on "contract rates" and that increased revenues were due to increased sales were both true. The court, however, held that that the question of whether defendant's statements were accurate raised a disputed issue of fact that could not be decided on a motion to dismiss, although the court did dismiss securities fraud claims based on the company's statements that it followed "disciplined business practices," on the ground that it was apparent on the face of the complaint that such generic statements were not material and did not create an obligation to provide further information.

4. Scienter, *Respondeat Superior*

a. *Belmont v. MB Inv. Partners, Inc.*, No. 09-4951, 2010 WL 2348703 (E.D. Pa. June 10, 2010)

Defendant executive pled guilty to charges of fraud and money laundering after operating a Ponzi scheme through an investment vehicle he controlled. Plaintiff investors brought suit against defendants—the executive, his employer, officers and directors of the employer, entities involved with the employer, and a portfolio manager—alleging violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Defendants moved to dismiss. The complaint failed to state a claim against defendant portfolio manager because there were no allegations that he knew of or participated in the defendant-executive's fraud, and therefore the allegations failed to support an inference of the requisite scienter. The court held that the complaint adequately alleged a *respondeat superior* theory of liability against defendant executive's employer, and that a plaintiff need not plead specific facts demonstrating culpable participation for the purposes of establishing control person liability in order to survive a motion to dismiss. Thus, the remaining motions to dismiss were denied.

5. Other

a. *Marion v. TDI, Inc.*, 591 F.3d 137 (3d Cir. 2010)

Plaintiff, the receiver for a financial services company, sued the owner of a CD brokerage and securities firm and the vice-president of a Florida-based bank, both of whom were alleged to have been responsible for facilitating a Ponzi scheme by the receiver's owner. Plaintiff alleged that defendants allowed the scheme to continue to the detriment of the company by failing both to supervise the owner and, on several occasions, infusing cash into the company through "warehousing" transactions between the company's operation and the bank. After the jury found defendants liable, defendants moved for judgment as a matter of law, arguing that plaintiff did not have standing because receivers can only sue to redress injuries to the entity in receivership, and the only injury in this case was to the investors victimized by the owner's scheme. The trial court denied the motion and defendants appealed. The 3^{d} Circuit affirmed, holding that defendants caused injury to the company, thereby giving the receiver standing to sue. The panel found, however, that defendants could not be liable to the receiver for any monetary damages because (1) defendants' cash infusions did not cause the company any economic loss/damages (to the contrary, they actually increased the company's short-term liquidity), and (2) any failure of defendants to supervise the owner's activities was a duty breached to the company's investors, not to the corporation through which the securities were sold.

V. FOURTH CIRCUIT

A. NOTEWORTHY CASE IN 2010

1. PSLRA Discovery Stay

a. *Latham v. Stein*, Nos. 6:08-2995-RBH, 6:08-3183-RBH, 2010 WL 3294722 (D.S.C, August 20, 2010)

Putative class members brought suit alleging violations of Sections 10(b) and 20(a) against defendant medical device corporation and certain board members, officers, and employees. Over a period of nearly two years, multiple defendants filed motions to dismiss—some of which were granted in part and denied in part—and plaintiffs filed motions to reconsider. The court stayed the case on two occasions, pending the Supreme Court's decision in *Merck & Co., Inc. v. Reynolds*, 129 S.Ct. 2432 (2009), in which the Court held that that the requirement in Section 10 of the Exchange Act that an action be brought within two years after the "discovery of the facts constituting the violation" entails both the time when key facts are actually discovered by a plaintiff as well as when "a reasonably diligent plaintiff" would have discovered such facts.. When the court lifted the stay following the *Merck* decision, defendants' motions to dismiss and plaintiffs' motions to reconsider stood at various stages of litigation. Defendants objected to a proposed Rule 26(f) conference, arguing that the PSLRA automatic stay precluded discovery. The court ruled that discovery could proceed, holding that the purpose of the PSLRA "to prevent abusive, expensive discovery in frivolous lawsuits by postponing discovery until after the Court has sustained the legal sufficiency of the complaint" was not served by a reading which required all motions to dismiss be resolved prior to discovery. As the court had previously found certain of plaintiffs' allegations legally sufficient with respect to certain defendants, there was no indication that plaintiffs needed or intended to use discovery to replead their claims.

VI. FIFTH CIRCUIT

A. SUMMARY OF DEVELOPMENTS IN 2010

In 2010, there were two cases of interest issued by the 5th Circuit, and several by the district courts in the circuit. The 5th Circuit in *SEC v. Cuban* reversed the district court's dismissal of the allegations that Mark Cuban had misappropriated confidential information and engaged in insider trading, finding that Cuban's statements following his receipt of confidential information could be read as an implicit agreement not to trade on the information. The Court of Appeals remanded to the district court to determine the exact nature of the parties' understanding. The 5th Circuit also affirmed the dismissal of RICO and securities fraud claims in *Affco Invs. 2001, LLC v. Proskauer Rose, L.L.P.*, a case which arose from the law firm's role in an allegedly fraudulent tax scheme. The court found that plaintiffs' RICO claim was preempted by the PSLRA and that plaintiffs had failed to plead reliance because they did not allege that they had known the law firm's role in the investments when they made the decision to pursue the tax strategies. In *In re Fossil, Inc. Derivative Litigation*, the Northern District of Texas denied a motion filed by certain officers and directors of a company to dismiss a derivative complaint related to allegations about an options backdating scheme, rejecting defendants' arguments that the company—the nominal plaintiff—could not have relied on the purportedly misleading statements. And in *Apache Corporation v. Chevedden*, the Southern District of Texas agreed with the plaintiff company that a shareholder's Rule 14a-8 proposal could be excluded from its proxy materials because defendants did not meet eligibility requirements. The company had good reason to believe that the registered broker was fictitious, as it was not a participant in the Depository Trust Company and was not a registered broker with the SEC, FINRA or SIPC.

B. NOTEWORTHY CASES IN 2010

1. Pleading Standards for Securities Fraud

a. *In re Arthrocare Corp. Securities Litigation*, 726 F. Supp. 2d 696 (W.D. Tex. July 20, 2010)

Plaintiff stockholders brought class action claims against a company, various executives of the company, and the company's auditor, alleging fraudulent insurance billing, accounting, and internal controls in violation of Section 10(b) of the Exchange Act and Rule 10b-5. Defendants moved to dismiss on the grounds that plaintiffs did not sufficiently plead scienter. The court denied the motions to dismiss of certain executives and the company itself, and granted the motion to dismiss of the auditor and other executives. Regarding the defendant CEO and CFO, the court found that scienter could be inferred from their misstatements made following media reports of the alleged fraud. Because plaintiffs had adequately pled scienter with respect to the CEO and CFO, the court held that plaintiffs had established scienter on behalf of the corporation as well. On the contrary, the court dismissed the claims against two of the company's vice presidents—brought on the theory of control person liability—holding that, because the CEO and CFO were the vice presidents' superiors, the vice presidents could not be considered to have had any influence over the misstatements, nor the requisite control over the alleged fraudulent financial reporting. Lastly, the court found that plaintiffs had not met the high pleading requirements for establishing scienter with respect to the outside auditor because plaintiffs had not demonstrated particularized facts showing that the auditor intended to mislead.

b. *SEC v. Cuban*, No. 09-10996, 2010 WL 3633059 (5th Cir. Sept. 21, 2010)

The SEC asserted claims against Mark Cuban, a well-known businessman, under Section 10(b) of the Exchange Act and Rule 10b-5, alleging that Cuban misappropriated confidential information to engage in insider trading. The SEC alleged that Cuban received confidential information from the CEO of a company in which Cuban owned a minority stake regarding a pending transaction which would decrease the share price. The SEC further alleged that Cuban's statement to the CEO ("Well, now I'm screwed. I can't sell.") constituted an agreement not to trade on the information and to keep it confidential. Accordingly, when Cuban traded on the information, the SEC contended that he was liable under the misappropriation theory of insider trading. Cuban filed a motion to dismiss, arguing that the complaint did not allege the requisite agreement not to trade. The district court agreed, and the SEC appealed. On appeal from the dismissal of the complaint by the district court, the Fifth Circuit vacated the judgment and remanded to the district court for further proceedings. The Fifth Circuit reasoned that Cuban's statement, and his subsequent access to the details of the transaction, could plausibly be read as an implicit agreement not to trade. Therefore, it was necessary to remand to the district court to resolve the precise nature of the understanding between the parties.

2. Reliance

a. *In re Fossil, Inc., Derivative Litig.*, No. 06-cv-1672-F, 2010 WL 2102327 (N.D. Tex. May 19, 2010)

Plaintiff shareholders brought a securities fraud derivative action against directors and officers alleging that defendants took part in an illegal option backdating scheme. Defendants moved to dismiss, arguing that plaintiffs had not pled reliance because the individuals who allegedly relied on misleading financial statement in making the decision to repurchase stock were the same individuals allegedly responsible for issuing those misleading financial statements in the first place. The court rejected defendants' argument, reasoning that it extended too far the fiction that a company is the same as its leadership. Instead, the court held that plaintiffs sufficiently pled reliance even though they did not plead that the company's reliance was based on the reliance of directors who did not take part in the fraud. Specifically, the court stated that a sufficient pleading of reliance does not require a derivative plaintiff to plead that some directors did not take part in the alleged fraud and that the company's reliance is based only on the decisions of such innocent directors.

b. *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, 597 F.3d 330 (5th Cir. 2010)

Plaintiff sought class certification in a putative securities fraud case on the basis of the fraud-on-the-market presumption of reliance. The district court denied class certification and the 5th Circuit affirmed. The court held that plaintiff's failure to demonstrate loss causation—*i.e.*, a causal link between the alleged fraud and a subsequent corrective disclosure—prevented plaintiff from claiming fraud-on-the-market and thus made proof of reliance on a class-wide basis impracticable. First, plaintiff did not demonstrate that defendant had issued a false statement that, when corrected by truthful information, more likely than not caused a decline in the stock price. The court concluded that although plaintiff had demonstrated that defendant's stock price declined as a result of negative information, plaintiff had not demonstrated that the negative information corrected prior misrepresentations. Moreover, the court found significant deficiencies in the expert analysis offered in support of plaintiff's motion for class certification. Plaintiff's expert never accounted for the fact that multiple pieces of negative news were disclosed to the market simultaneously. Having made no effort to disaggregate or account for the multiple strands of information that could have impacted the defendant's stock price, the Court of Appeals found plaintiff's expert analysis to be nothing more than "well-informed speculation" that fell short of the proof necessary to demonstrate loss causation at the class certification stage.

c. *Affco Invs. 2001, LLC v. Proskauer Rose, L.L.P.*, No. 09-20734, 2010 WL 4226685 (5th Cir. Oct. 27, 2010)

Plaintiffs brought suit against defendant law firm alleging RICO and securities fraud claims based on defendant's participation in a scheme to promote and sell investments in a sophisticated income tax avoidance strategy. The district court dismissed both claims, reasoning that (1) the RICO claim was preempted by the PSLRA, and (2) plaintiffs' securities fraud claim failed because plaintiffs had not adequately pled reliance and scienter. The Fifth Circuit affirmed, holding first that plaintiffs' RICO claim was preempted by the PSLRA because plaintiffs' ownership interest in LLCs created under the tax scheme were "securities" under the federal securities laws. Second, the Fifth Circuit held that plaintiffs had not adequately pled reliance because they did not allege that they knew of defendant's role in the tax scheme during the relevant time when they were making their investment decision. Specifically, the court held that explicit attribution is required in order to show reliance under Section 10(b). While plaintiffs alleged that defendant worked with other defendants to promote and sell the tax strategies and that plaintiffs were assured that several national law firms had vetted the tax scheme, plaintiffs did not allege that they ever saw or heard any of defendant's work before making their investment decision or that the promoters ever specifically identified defendant as one of the firms that had vetted the scheme.

3. Other

a. *Apache Corp v. Chevedden*, No. H-10-0076, 2010 U.S. Dist. LEXIS 21906 (S.D. Tex. Mar. 10, 2010)

Plaintiff company sued for a declaratory judgment allowing it to exclude defendant shareholder's Rule 14a-8 proposal from its proxy materials on grounds that defendant failed to meet the Rule 14a-8(b)(2) eligibility requirements. To prove ownership interest in stock, defendant submitted letters from a company purporting to be defendant's broker, which stated that defendant owned the stock and that the broker's master custodian was a member of the Depository Trust Company. Plaintiff argued that the letters were insufficient to establish defendant's eligibility under Rule 14a-8(b)(2) because defendant was required to submit a letter from the entity actually registered on the company's books. The court noted that the Rule's plain language (1) instructs nonregistered shareholders to submit a letter from the "record holder" of the securities rather than from the "registered holder," and (2) states that the "record holder" is usually a broker or bank. The court therefore rejected plaintiff's narrow interpretation of the Rule. Nonetheless, the court held that the letters defendant submitted were not sufficient to establish eligibility under the Rule because plaintiff had identifiable grounds for believing that defendant's proof of eligibility was unreliable, including that the company purporting to be defendant's broker was not a participant in the Depository Trust Company and was not a registered broker with the SEC, FINRA or SIPC. Based on those facts, the court concluded that defendant failed to establish eligibility under Rule 14a-8(b)(2).

VII. SIXTH CIRCUIT

A. SUMMARY OF DEVELOPMENTS IN 2010

The courts of the 6th Circuit issued a number of notable decisions in 2010. First, the 6th Circuit in *Konkol v. Diebold* affirmed the district court's dismissal of a class action alleging individual defendants had violated Section 10(b) of the Exchange Act, finding that the pleadings did not establish the defendants' knowledge of the fraud because the confidential witnesses had insufficient personal interactions with defendants, and because the complaint failed to quantify the size of the alleged accounting violations, precluding the court from finding that the violations were so large or widespread that defendants must have been aware of them. Also, in *Atkinson v. Morgan Asset Management, Inc.*, the Western District of Tennessee denied a shareholder's motion to remand an action asserting that a mutual fund and its advisors had violated state common law and state securities laws. The court held that the action was barred by SLUSA because (1) the "Delaware Carve-Out" exemption to SLUSA did not apply where plaintiff had not actually purchased or sold securities during the class period; rather, plaintiff alleged only that he would have done so but for defendants' misrepresentations, and (2) the common law claims arose from the same conduct as the securities law allegations, and therefore were barred by SLUSA. In a case brought by the SEC, the Eastern District of Michigan in *SEC v. Conaway* upheld a jury's finding that the former CEO of Kmart both violated the Exchange Act by making false public statements regarding the company's financial health, and aided and abetted Kmart's violations of the Exchange Act stemming from the company's fraudulent accounting. The court found that the record supported a conclusion that the former CEO knowingly participated in the company's violations because he personally approved the fraudulent payment scheme and disseminated a cover-up story to Kmart's Board of Directors. Finally, in *Chamberlain v. Reddy Ice Holdings, Inc.*, the Eastern District of Michigan found that plaintiffs had adequately alleged securities fraud as a result of defendants' failure to disclose the existence of illegal market allocation agreements in the packaged ice industry that were critical to the issuer's profitability.

B. NOTEWORTHY CASES IN 2010

1. Scienter

a. *Konkol v. Diebold*, 590 F.3d 390 (6th Cir. 2009)

Plaintiff investors alleged that defendant, a manufacturer of electronic voting machines and ATMs, and its senior management manipulated the company's revenue and issued false earnings reports and financial statements in violation of Section 10(b). The 6th Circuit affirmed the district court's decision to dismiss the complaint on the grounds that plaintiffs failed to allege scienter adequately. First, the court held that general allegations of defendants' access to information because of their senior positions within the company lacked the requisite specificity to support an inference of scienter. Second, because the complaint did not establish the magnitude of the alleged accounting violations, the court could not find that the violations were so "basic" or "pervasive" that they must have been known to defendants. Third, the court found the testimony of confidential witnesses, who described the allegedly fraudulent scheme, inadequate because the confidential witnesses did not allege any specific facts that implied defendants themselves knew of or recklessly disregarded the falsity of the earnings statements.

In fact, the majority of the confidential witnesses did not claim to have had any personal contact or interaction with any of the defendants. The court also found that the district court's failure to explain its decision to deny plaintiffs' motion to amend the complaint was harmless error because the proposed amendment would be futile. The additional facts that the amended complaint would have contained related primarily to post-class period events and therefore did not shed any light on whether defendants were aware of the falsity of the earnings statements at the time they were issued.

b. *In re Regions Morgan Keegan Sec., Derivative, and ERISA Litig.*, 2010 WL 3925265 (W.D. Tenn. Sept. 30, 2010)

Plaintiffs' Exchange Act claims were dismissed because plaintiffs failed to demonstrate that an inference of scienter was at least as compelling as any opposing inference of nonfraudulent intent. The proximity of the fraudulent statements to the later disclosure of the investments' illiquidity could be explained by the proximity of the sudden market crash to the end date of the fund's fiscal year. Allegation that accounting information was disclosed in such a way that only a person with a high degree of sophistication could understand it was undercut by failure to allege that the dollar value of any security was stated incorrectly. Allegation that some defendants may have known about the illiquidity of two of the securities the fund invested in was undercut by fact the two securities were likely a *de minimis* amount in a $2.2 billion dollar fund. And, allegation that defendants were motivated by fees and bonuses, were motives common to corporations and executives generally and, therefore, did not make a cogent case for fraud. However, because the heightened pleading standard of the Exchange Act does not apply to Securities Act claims, the Securities Act claims survived the motion to dismiss.

2. Misstatements and Omissions

a. *Chamberlain v. Reddy Ice Holdings, Inc.*, 2010 WL 5056184 (E.D. Mich. Dec. 6, 2010)

Plaintiff shareholders asserted claims under Sections 20(a) and 10(b) of the Exchange Act and Rule 10b-5 against defendants, a packaged ice manufacturer and its controlling shareholders, for knowingly and recklessly omitting material information regarding allegedly unlawful market allocation agreements among the manufacturer and its two main competitors. Allegedly, these omissions and failures to disclose artificially increased the manufacturer's stock price, which plummeted when the truth behind these omissions became public. The district court denied the motions to dismiss filed by the manufacturer and three officers, while granting one officer's motion to dismiss. The court held that defendants had a duty to disclose the existence of the market allocation agreements since they knew this conduct was unlawful and was the real reason for the manufacturer's profitability. With the exception of one officer, the defendants' alleged failure to do so was sufficient to support plaintiffs' claims that defendants made an omission and a misrepresentation of a material fact in violation of the applicable securities laws. The court also held that a stock price drop following announcement of the unlawful conduct was sufficient to support the loss causation element of plaintiffs' claims.

3. Substantial Assistance

a. *SEC v. Conaway*, No. 2:05-CV-40263, 2010 WL 318283 (E.D. Mich. Jan. 20, 2010)

Following a three-week trial, a jury determined that the defendant, a former CEO of Kmart Corporation, violated Section 10(b) of the Exchange Act, as well as aided and abetted Kmart's violation of Sections 10(b) and 13(b). Defendant filed a motion for judgment as a matter of law or, in the alternative, for a new trial. Other than a finding of fact on one alleged misstatement for which the court determined there was insufficient evidence, defendant's motion was denied and the jury's verdict was upheld. The record supported a conclusion that defendant provided "substantial assistance" to Kmart in the commission of the fraud and that his assistance "was knowingly rendered" because defendant was at the center of Kmart's response to the liquidity crisis, he approved the vast program of delaying payments to Kmart's vendors in a manner that would appear to have invoices "hung up in processing," and he approved a cover story and used it repeatedly to mislead Kmart's Board of Directors, employees and the investing public about the true source of vendor payment delays. Based on this evidence, the jury could conclude that defendant was the driving force behind the fraud and therefore knowingly and substantially participated in violations of Section 10(b) and 13(a). In addition, because of defendant's personal statements on a conference call and his involvement in Kmart's response to the liquidity crisis, including the misrepresentations made by him and others with his knowledge or approval, there was sufficient evidence to uphold the jury's finding of his primary liability.

4. SLUSA

a. *Atkinson v. Morgan Asset Mgmt., Inc.*, 664 F. Supp. 2d 898 (W.D. Tenn. 2009)

Plaintiff, a shareholder in several mutual funds, brought an action on behalf of similarly situated individuals against the funds, their managers, trustees and auditor, as well as various individual defendants, alleging violations of state securities laws and breach of contract, breach of fiduciary duty and negligence. Defendants removed to federal court and plaintiffs filed a motion to remand. The district court denied the motion to remand and dismissed the suit entirely, holding that it was barred by SLUSA. First, the court held that an exemption to SLUSA known as the "Delaware Carve-Out'"—which applies to actions under any state's laws that involve the purchase or sale of securities by the issuer—did not apply because plaintiffs merely alleged they *would* have purchased or sold but for the misrepresentations and omissions, not that they actually purchased or sold during the covered period as required by SLUSA. Second, the court rejected plaintiff's argument that because the breach of contract, breach of fiduciary duty and negligence claims did not require a showing of misrepresentations or omissions, they were not precluded by SLUSA. In so holding, the court noted that the substance—not the label—of a claim is controlling for SLUSA purposes and that the breach of contract, breach of fiduciary duty and negligence claims, at bottom, relied on allegations that defendants misrepresented or omitted facts and thus were precluded by SLUSA.

b. *Demings v. Nationwide Life Ins. Co.* No. 08-4476, 2010 WL 364335 (6th Cir. Feb. 3, 2010)

Plaintiff, a County Sheriff whose office sponsored the deferred compensation plan for its employees, brought state securities law and common law claims against the plan's mutual fund providers. The suit, which was filed by the Sheriff on behalf of the plan and "all other similarly situated" plans, claimed that fund providers wrongfully received, and failed to disclose, payments for directing individual plan contributions into specific investment vehicles. The district court granted defendants' motion to dismiss, holding that the suit was barred by SLUSA and was not saved by SLUSA's "state action" exception. The 6th Circuit affirmed, noting that because Congress intended SLUSA's preclusive effect to be "broad and far reaching," its exceptions were to be read narrowly. Specifically, the court held that the suit was outside the "state action" exception because (1) the Sheriff himself was not entitled to bring the suit as a third party on the office's or plan's behalf because *he* was not a political subdivision within the meaning of the statute, and (2) the Sheriff could not bring the suit on behalf of "all other similarly situated" plans because, to qualify for the state action exception, the political subdivisions must agree to participate and be the only named plaintiffs, which was not the case.

5. Other

a. *Ohio Pub. Employees Ret. Sys. v. Federal Home Loan Mortgage Corp.*, 2010 U.S. Dist. LEXIS 51212 (N.D. Ohio Apr. 22, 2010)

Plaintiff shareholders brought suit against the Federal Home Loan Mortgage Corp. (Freddie Mac) and four of its senior officers, alleging violations of Sections 10(b) and 20(a) of the Exchange Act. After defendants filed a motion to dismiss the complaint, lead plaintiff motioned to partially lift the PSLRA discovery stay, seeking to obtain a closed universe of materials that defendant had already agreed to provide to the government. The court found that lead plaintiff had not met its burden of showing exceptional circumstances necessary to lift the stay. The court distinguished the 2002 *In re Worldcom, Inc.* decision in which a PSLRA discovery stay was lifted, on the grounds that in that case, plaintiffs alleging violations of securities laws were ordered to join the bankrupt defendant in settlement discussions with ERISA plaintiffs, and would be at a disadvantage in such negotiations because the ERISA plaintiffs had already begun the discovery process. Here, in the absence of ongoing settlement discussions in which plaintiff may be unfairly disadvantaged, the court found that plaintiffs' only potential hardship was that they might be unable to prove their case, which the court deemed an inadequate reason to lift the discovery stay. Likewise, the court found that conjecture about defendants' possible future bankruptcy, which could create a factual scenario more analogous to that presented in *Worldcom*, was too speculative a rationale for lifting the stay.

b. *In re Nat'l Century Fin. Enters., Inc., Inv. Litig.*, 2010 WL 5174585 (S.D. Ohio Dec. 13, 2010)

Plaintiffs, institutional investors, asserted claims under Section 1707.43 of the Ohio Securities Act against defendant investment bank, for its role in the sale of the asset-backed securities issued by the Company. Specifically, plaintiffs alleged that the investment bank and the Company were joint sellers, and that the bank was liable as a seller and as one who has "participated in or aided the seller" in the sale of the Company's investment-grade notes, which the Company fraudulently misrepresented as being backed by health care receivables. These sales resulted in a substantial financial loss for plaintiffs. The district court granted defendant's motion for summary judgment, while denying plaintiffs', finding that application of the Ohio Act violated the extraterritoriality principle of the Commerce Clause. This principle "precludes application of a state statute to commerce that takes place wholly outside of the State's borders, whether or not the commerce has effects within the State." The court reasoned that the "commerce" at issue here, was the securities transactions, rather than the fraud perpetrated by the Company. As such, because all of these sales of securities occurred outside of Ohio, it would be inappropriate for an Ohio law to apply to regulate such commerce.

VIII. SEVENTH CIRCUIT

A. SUMMARY OF DEVELOPMENTS IN 2010

The 7th Circuit issued several interesting securities fraud opinions in 2010. In *Schleicher v. Wendt,* the Circuit Court affirmed a grant of class certification, dismissing arguments that short sellers were not entitled to the fraud-on-the-market presumption and that the fraud-on-the-market presumption does not apply when statements appear to slow a price decline rather than hasten it. In *Anderson v. Aon Corp*, the 7th Circuit reversed the district court and held that California state law governed claims brought by holders of securities, and allowed those claims to proceed. In addition, in early 2010, a jury in the 7th Circuit heard a rare securities class action jury trial and found against the defendant. During the second half of 2010, the court in *Jaffe Pension Plan v. Household* limited the damages award to "actual damages" and held that plaintiffs' losses were to be netted against any profits from sales at the inflated price. The court also chose the plaintiff-favored First-In First-Out ("FIFO") method of matching sales and purchases for plaintiffs that engaged in multiple transactions, reasoning that the "actual damages" approach mitigated defendants' concern that the FIFO method would result in windfalls for plaintiffs.

District courts in the 7th Circuit also issued notable decisions in 2010 dealing with loss causation, reliance, pleading Section 12(a)(2) claims with particularity, class certification and allegations based on confidential witnesses. In *Anchorbak, FSB v. Hofer*, the Western District of Wisconsin dismissed a complaint brought against a regional bank lending manager alleged to have manipulated the price of the shares of a fund. According to the court, plaintiffs failed to establish loss causation and reliance because the allegations did not specify that the purchases and sales were not part of a mandatory purchase and sale policy rather than at the manager's discretion. In *Greer v. Advanced Equities, Inc*, the Northern District of Illinois held that Section 12(a)(2) claims based on fraud are to be pled with particularity pursuant to Fed. R. Civ. P. 9(b), and under that standard plaintiffs failed to state a claim. In *In re Northfield Laboratories, Inc. Securities Litigation*, the Northern District of Illinois denied a motion for class certification because plaintiffs' expert report—which had excluded certain key events from its event study—was not sufficient to demonstrate that there was an efficient market for defendant's shares. Accordingly, the court found that plaintiffs could not avail themselves of the fraud-on-the-market theory to establish a presumption of reliance, and plaintiffs must establish reliance individually, precluding class certification under Rule 23. And in *Plumbers & Pipefitters Local Union No. 630 Pension-Annuity Trust Fund v. Allscripts-Misys Healthcare Solutions, Inc.*, the Northern District of Illinois dismissed a complaint because the allegations were based on statements by confidential witnesses and plaintiffs failed to demonstrate adequately that the witnesses were in position to know the facts that they described.

B. NOTEWORTHY CASES IN 2010

1. Pleading Standards for Securities Fraud

a. *In re NeoPharm, Inc. Sec. Litig.*, No. 02-2976, 2010 WL 1335824 (N.D. Ill. Mar. 31, 2010)

Plaintiffs alleged violations of Sections 10(b) and 20(a) of the Exchange Act against officers of biopharmaceutical company based on statements made about the company's experimental drug Liposome Encapsulated Paclitaxel. The court granted in part and denied in part defendant's summary judgment motion, deciding three key issues. First, the court held that plaintiffs had not shown that statements early in the class period were false when made because plaintiffs offered no evidence showing that countervailing facts existed at the time of the statements. Second, the court held that the elements of materiality and scienter could not be resolved on summary judgment where corporate documents showed that executives believed the undisclosed information was of heightened concern to investors and that disclosure would substantially reduce the price of the product. Finally, the court held that defendant's *Daubert* challenge to an expert's loss causation opinion failed where there were factual issues about the materiality and public knowledge of the misstatements at issue.

b. *Anchorbank, FSB v. Hofer*, No. 09-610, 2010 WL 842172 (W.D. Wis. Mar. 5, 2010)

Plaintiffs alleged that a regional bank's lending manager violated Sections 9(a)(2) and 10(b) of the Exchange Act by undertaking a conspiracy to coordinate the purchase and sale of a certain fund's shares to influence its price unlawfully. The court dismissed the complaint, holding that although plaintiffs established a strong inference of scienter, they failed to establish loss causation and reliance. Specifically, the court held that plaintiffs' allegations were insufficient to establish loss causation because plaintiffs had not identified how many shares of stock the fund was required to sell because of the fund's cash-to-stock ratio policy. This failure prevented the court from determining whether it was reasonable to infer that the lending manager's activities were to blame for the increased market activity as opposed to the fund's mandatory policies on buying and selling fund shares. The court further held that plaintiffs failed to establish that they detrimentally relied on the alleged fraud because the fund's purchase and sale of stock appeared to have been dictated by its cash-to-stock ratio policy as opposed to discretionary trading activities by fund employees. Although plaintiffs had already amended their complaint once, the court dismissed the complaint without prejudice because the decision represented the first judicial determination on the adequacy of plaintiffs' allegations.

c. *Fulton County Employees' Ret. Sys. v. MGIC Inv. Corp.*, No. 08-C-0458, 2010 WL 601364 (E.D. Wis. Feb. 18, 2010)

Plaintiffs alleged that defendants made a number of false and misleading statements designed to mask the impact of the subprime crisis on the company's business. The court granted defendants' motion to dismiss. The court first found that, while defendants cast the company's underwriting practices in a positive light, not one statement used adjectives that might cause a reasonable investor to believe that the company's underwriting would allow it to outperform its competitors during the crisis. The court added that plaintiffs could not attribute analyst statements to defendants unless the analysts used direct quotes from defendants. Second, the court found a number of instances where plaintiffs alleged that defendants were making positive statements about the business while withholding data of catastrophic mortgage delinquencies. The court rejected these allegations because plaintiffs failed to support them with sufficient facts demonstrating knowledge contemporaneous with the statements, as opposed to after-the-fact speculation. Finally, the court held that plaintiffs provided no factual basis to conclude that any defendant knew that margin calls would impact the company's so-called "substantial liquidity" because the margin calls occurred just 18 days prior to the statements touting liquidity. The court found it entirely plausible that information about margin calls may not have made its way up the corporate ladder in the days leading up to the statement.

d. *City of Livonia Employees' Retirement Sys. v. Boeing Co.*, No. 09 C 7143, 2010 WL 2169491 (N.D. Ill. May 26, 2010)

Plaintiff brought a putative class action against defendants alleging that they violated Sections 10(b) and 20(a) of the Exchange Act by intentionally deceiving investors about the test and delivery schedule of Boeing's new 787 Dreamliner airplane. The court granted defendants' motion to dismiss, holding that plaintiff failed to plead particularized facts evidencing that defendants engaged in a scheme to defraud investors. The court held that plaintiff's complaint alleged only that defendants knew there was a risk to the delivery timeline and spent time analyzing and investigating the problem to find a solution that would allow it to adhere to the delivery schedule. The court further held that plaintiff lacked standing to sue for statements made after it purchased stock because post-purchase statements cannot affect the price at which plaintiff purchased. Additionally, the court gave no weight to plaintiff's use of purported, confidential emails – where the author was unidentified – because there was no evidence that the person authoring the emails was credible.

2. Misstatements and Omissions

a. *Last Atlantis Capital LLC v. AGS Specialist Partners*, No. 04 C 397, 2010 WL 4365549 (N.D. Ill. Nov. 4, 2010)

Plaintiff direct access customers alleged that defendant specialist brokers violated Rule 10b-5 by knowingly mishandling the execution of orders to buy and sell options. In particular, plaintiffs claimed that defendants knowingly refused to automatically or promptly execute orders, delayed the execution of orders, refused to honor requests to cancel orders, and executed proprietary trades for the defendants' benefit before executing plaintiffs' orders. In an earlier opinion, the court held that the "shingle theory" of the duty of "best execution" does not apply to specialists, such that Rule 10b-5 liability attaches only where specialists make express misrepresentations regarding "best execution" upon which plaintiffs rely. Here, the court held statements were not express misrepresentations regarding "best execution" where the statements constituted mere puffery and were generic. By contrast, the court held statements were express misrepresentations regarding "best execution" where they specifically described defendants' public statement that they would (1) not interject themselves into trades; (2) prioritize public orders over professionals' orders; (3) give equal opportunity and best pricing to all customer orders; (4) institutionalize the pursuit of best execution; and (5) where defendants otherwise expressly referred to their practice of providing "best execution." The court also reiterated its earlier holding that specialists do not owe fiduciary duties to investors because the parties did not have direct communications or a client relationship.

b. *Jones v. Corus Bankshares*, 701 F.Supp.2d 1014 (N.D. Ill. 2010)

Plaintiff investor in a securities fraud class action asserted claims under Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 alleging defendant issuer and issuer's CEO And CFO made false and misleading statements about the issuer's lending practices, capital position, and loan loss reserves that artificially inflated the price of the issuer's common stock. Broadly speaking, plaintiff alleged defendants misrepresented the nature and extent of the issuer's financial troubles and its ability to survive the 2008 economic downturn. The court granted in part and denied in part defendants' motion to dismiss, holding that, as to the issuer and the CEO, plaintiff had sufficiently alleged both scienter and fraud on the basis of false and misleading statements but had failed to allege sufficient facts supporting a strong inference that the issuer's CFO had the requisite scienter when, on behalf of the company, he signed SEC filings containing the allegedly misleading statements.

3. Scienter

a. *Greer v. Advanced Equities, Inc.*, No. 08-4958, 2010 WL 152002 (N.D. Ill. Jan. 15, 2010)

Plaintiffs claimed that they were fraudulently induced to purchase stock by an investment brokerage firm, arguing that the firm lured them into the purchase even though the firm knew about rampant fraud at the underlying company. The firm and its officers moved to dismiss, and the court granted the motion. The court first held that plaintiffs' claim under Section 12(a)(2) of the Securities Act should be judged under the Rule 9(b) requirement for pleading with particularity because all of the allegations were based on fraud. Under that standard, the court held that plaintiffs failed to adequately plead a Section 12(a)(2) claim. The court also rejected plaintiffs' claim under Section 10(b) of the Exchange Act for failure to create a strong inference of scienter in light of plaintiffs' generalized allegations of a financial motive to defraud and mere access to internal information.

b. *Hughes v. Huron Consulting Grp.*, --- F. Supp. 2d ---, 2010 WL 3087501 (N.D. Ill. Aug. 6, 2010)

The court denied defendants' motion to dismiss class plaintiffs' claims for violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5, finding that plaintiffs' adequately pleaded facts giving rise to a strong inference of scienter. Taken as a whole, plaintiffs' factual allegations of the defendants' knowledge of the accounting rule violated, the statements of confidential witnesses regarding the actual knowledge or recklessness of the individual defendants, the resignation of these defendants without severance, the defendants' misrepresentations to outside auditors, and suspicious insider stock sales, were sufficient to meet PSLRA's heightened pleading standard requiring plaintiffs to state particular facts giving rise to a strong inference that defendants acted with the required state of mind.

4. Reliance

a. *Gandhi v. Sitara Capital Mgmt.*, No. 09-3141, 2010 WL 551266 (N.D. Ill. Feb. 9, 2010)

Plaintiffs claimed they were fraudulently induced to place assets with defendants' investment firm, arguing that defendants misrepresented the quality and soundness of their investment decisions, which caused plaintiffs to lose more than 75 percent of their investment. Defendants moved to dismiss, and the court granted the motion in part. The court first held that defendants' Regulation D affirmative defense to plaintiffs' claim under Section 5 of the Securities Act was insufficient at the pleadings stage because plaintiffs did not plead the number of investors to whom defendants sold the securities. The court dismissed plaintiffs' claim under Section 12(a)(2) of the Securities Act, however, because plaintiffs pled that the prospectus at issue was private rather than public. The court further held that plaintiffs' Rule 10b-5 claims were implausible due to plaintiffs' reliance on statements and acts that took place after their initial investment.

b. *Schleicher v. Wendt*, 618 F.3d 679 (7th Cir. 2010)

Plaintiffs filed a securities fraud action against several managers of a corporation, alleging that the managers made misleading statements that caused investors to pay too much for the company's stock. The district court granted class certification and the Seventh Circuit affirmed, rejecting several arguments advanced by defendants. First, defendants argued that the fraud-on-the-market doctrine did not apply because the allegedly false statements slowed the decline in the company's share price rather than inflate the price. The court found this distinction lacked any legal significance. The court also rejected defendants' claim that short sellers do not rely on the market price of shares they purchase and thus, their inclusion in the class precluded certification. Finally, the court rejected the defendants' argument that before certifying the class, the district judge should have determined whether the alleged misrepresentations caused a material change in stock price and whether they were material.

c. *Jaffe Pension Plan v. Household Int'l*, No. 02 C 5893, 2010 WL 5017284 (N.D. Ill. Nov. 22, 2010)

Following a class action jury verdict finding that defendants violated Exchange Act Sections 10(b) and 20(a), the court established procedures for rebutting the presumption of reliance and for calculating individual damages. The court concluded that the only means of rebutting the fraud-on-the-market presumption of reliance that had not been rejected by the jury at trial was a showing that the plaintiff would have purchased the stock at the inflated price even if she had been aware that the price was inflated by the defendants' misrepresentations. With respect to calculating damages, the court limited damages to "actual damages" and held that that plaintiffs' losses were to be netted against any profits from sales at the inflated price. The court also chose the plaintiff-favored First-In First-Out ("FIFO") method of matching sales and purchases for plaintiffs that engaged in multiple transactions, reasoning that the "actual damages" approach mitigated defendants' concern that the FIFO method would result in windfalls for plaintiffs.

5. Class Certification

a. *In re Northfield Labs., Inc. Sec. Litig.*, No. 06 C 1493, 2010 WL 2011945 (N.D. Ill. May 18, 2010)

In a securities fraud class action, plaintiffs moved to certify the class of all persons who purchased defendant company's securities during the class period. Due to a lack of analyst coverage, low trading volume and an unreliable expert report, the court found that plaintiffs failed to establish that the market for the securities was efficient during the class period, and plaintiffs therefore could not avail themselves of the fraud-on-the-market theory of reliance. The expert report was unreliable, according to the court, because the expert's event study excluded events that had the effect of making it appear as though certain disclosures had a greater impact on share price than they actually did. The court thus denied class certification because plaintiffs failed to demonstrate that questions of law or fact common to the class predominated over questions affecting only individual class members.

6. Confidential Witnesses

a. *Plumbers & Pipefitters Local Union No. 630 Pension-Annuity Trust Fund v. Allscripts-Misys Healthcare Solutions, Inc.*, No. 09-4726, 2010 WL 1540125 (N.D. Ill Apr. 13, 2010)

In a securities fraud class action, plaintiff alleged that defendant artificially inflated its stock price by making false and misleading statements regarding a new version of its health-related computer system product. The court granted defendants' motion to dismiss, holding that the allegations, which were drawn upon information and belief from confidential witnesses, did not meet the PSLRA's pleading requirements because plaintiff had not provided a sufficient basis to evaluate the connection between the witnesses and plaintiffs' allegations.

7. Other

a. *Norfolk County Ret. Sys. v. Ustian*, No. 07-7014, 2010 WL 1489996 (N.D. Ill. Apr. 13, 2010)

Plaintiffs alleged various securities law violations stemming from a restatement and re-audit of several years of financial statements. In a prior proceeding, the court had ordered the parties to avoid taking discovery related solely to non-class certification issues until the court ruled on class certification. Thereafter, plaintiffs filed a motion to compel discovery of documents defendants produced to the SEC and nonpublic documents related to the issue of loss causation. Plaintiffs claimed these documents were related to the issue of class certification. The court denied plaintiffs' motion with respect to the SEC documents because plaintiffs failed to explain how the SEC documents were relevant to the class certification issue. The court, however, granted the motion with respect to the loss causation documents, finding that plaintiffs were entitled to those documents for the purpose of exploring whether aspects of the alleged accounting fraud were catalysts for defendants' purported misstatements.

b. *The Lafayette Life Ins. Co. v. City of Menasha*, No. 409-CV-64, 2010 WL 1138973 (N.D. Ind. Mar. 17, 2010)

Plaintiff objected to the magistrate judge's stay of state court proceedings under the PSLRA/SLUSA automatic stay provision. Plaintiff argued that the public documents sought could have been obtained outside of any litigation and the existence of the federal litigation should not prevent it from obtaining the documents. The court denied plaintiff's objection, holding that the public records request was equivalent to discovery in the federal litigation, thus warranting a stay of the state court proceedings.

c. *Shirley v. JED Capital, LLC*, --- F. Supp. 2d ---, 2010 WL 2721855 (N.D. Ill. July 8, 2010)

LLC interest is security. The court denied defendants' motion to dismiss plaintiff's claim for securities fraud where plaintiff established that his investment in an LLC was a security. As plaintiff had no control over the LLC and was essentially a passive investor, the court concluded that plaintiff's agreement to invest in the LLC was an investment contract, and therefore a security, because any profits were to come solely from the managerial and entrepreneurial efforts of others.

d. *Anderson v. Aon Corp.*, ___ F.3d ___, No. 09-1144, 2008 WL 867739 (7th Cir. July 26, 2010)

State law "holder action". Plaintiff shareholder brought a "holder action" claiming that defendant corporation's fraud caused him to hold its stock to his detriment. While not viable under federal securities law, plaintiff asserted the claim under California law, which allows such actions. The district court dismissed, ruling that Illinois law governed and would follow federal law on the issue. The 7th Circuit reversed, finding that Illinois law is "on the fence" with respect to the viability of holder actions and ruling that California law governed. In dicta, the 7th Circuit went on to observe that plaintiff would nonetheless have "a problem showing causation," opining that plaintiff could show an injury only if he would have sold his shares ahead of the stock's decline but that public revelation of the truth would have made it impossible for plaintiff to avoid the loss. The court added that plaintiff could not base his fraud claim on allegations of mismanagement.

e. *City of Livonia Employees' Retirement Sys. v. Boeing Co.*, No. 09 C 7143, 2010 WL 2836361 (N.D. Ill. June 22, 2010)

Leave to Amend. Plaintiff brought a putative class action against defendants alleging that they violated Sections 10(b) and 20(a) of the Exchange Act by intentionally deceiving investors about the test and delivery schedule of Boeing's new 787 Dreamliner airplane. The court originally granted defendants' motion to dismiss, holding that plaintiff failed to plead particularized facts demonstrating a scheme to defraud investors. Plaintiff sought relief from the judgment and for leave to file a second amended complaint. The court granted plaintiff's motion because the proposed second amended complaint resolved the deficiencies in the amended complaint by expanding the class date to include the dates of the allegedly problematic statements and by proffering a putative class representative that purchased stock after the challenged statements were made. Further, the proposed second amended complaint added details about the source of confidential information and the basis of the source's knowledge – detail previously lacking from the amended complaint. Finally, the court held that the proposed second amended complaint adequately alleged scienter. In light of the amended and more fulsome allegations, the court held that defendants had not demonstrated that allowing leave to amend would have been futile.

f. *Fulton County Employees' Retirement Sys. v. MGIC Inv. Corp.*, No. 08-C-0458, 2010 WL 5095294 (E.D. Wis. Dec. 8, 2010)

Leave to Amend. Plaintiff filed suit against defendants alleging they violated Sections 10(b) and 20(a) of the Securities Exchange Act and Securities and Exchange Commission Rule 10b-5 by making false and misleading statements to conceal the impact of the subprime crisis on a joint venture that created mortgage-backed securities. After the court dismissed the complaint for failure to state a claim, plaintiff filed a motion to amend. The court found that plaintiff failed to plead facts supporting its claim that defendants made false statements regarding the value of the joint venture's portfolio. The court also held that defendants were not required to disclose information bearing on the joint venture's liquidity simply because the joint venture disclosed its cash reserves during a conference call: "the securities laws do not hold that once a company mentions a fact, the company is required to provide the context necessary to determine whether that fact is good or bad." The court concluded that amendment was futile and denied the motion.

IX. EIGHTH CIRCUIT

A. SUMMARY OF DEVELOPMENTS IN 2010

In 2010 the 8th Circuit issued a noteworthy decision in *Detroit General Retirement Systems v. Medtronic, Inc.* The appeals court affirmed the lower court's dismissal of securities fraud allegations following the company's suspension of sales of a medical device. The appeals court held that plaintiffs could not demonstrate the falsity of the company's statements regarding the failure rates of the device because they had not identified any contradictory information possessed by defendants at the time the statements were made. The District Court for the Eastern District of Missouri decided a significant case in 2010 as well, finding in *Public Pension Fund Group v. KV Pharmaceutical Co.* that allegations of a pharmaceutical company's failure to disclose opinions from the FDA indicating noncompliance with FDA regulations were insufficient to show that defendants had issued false and misleading financial statements. The court noted that the FDA opinions were only observations, not findings of violations, and the reports were publicly available.

B. NOTEWORTHY CASE IN 2010

1. Pleading Standards for Securities Fraud

a. *Public Pension Fund Group v. KV Pharmaceutical Co.*, No. 4:08-CV-1859 CEJ, 2010 WL 681443 (E.D.Mo. February 22, 2010)

Plaintiffs asserted claims under Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5, alleging defendants gave false and misleading statements and omissions and engaged in a planned scheme to artificially inflate stock prices, maintain management, and defraud investors. Specifically, plaintiffs allege that defendants issued false and misleading statements in their Form-Ks for 2004-2008 stating that they were in compliance with FDA regulations when the FDA had issued Form 483 opinions to defendants during those years indicating non-compliance. Simultaneously, plaintiffs allege that defendants' management engaged in a scheme to conceal non-compliance issues. Defendants moved to dismiss, and the court granted the motion for failure to meet the pleading standards for all claims.

For claims under Section 10(b) and Rule 10b-5(b), the court held that the Form 483s issued by the FDA were only observations and statements regarding compliance were not misrepresentations. Plaintiffs also had not plead any facts to establish defendants were in violation of any FDA regulation. Moreover, defendants had no duty to disclose the Form 483 reports because they were public information. The court further held that plaintiffs failed to sufficiently establish that defendants' management was engaged in a scheme distinct from the misrepresentations to have a claim under Rule 10b-5. Without a claim under another provision, the court held plaintiffs could not assert a claim under Section 20(a).

b. *In re Express Scripts, Inc.*, No. 4:04CV1009 HEA, 2010 WL 2671456 (E.D.Mo. June 30, 2010)

Plaintiffs asserted claims under Sections 10(b) and 20(a) of the Exchange Act, alleging defendants knowingly issued false and misleading statements to inflate the market price of defendants' common stock. Specifically, plaintiffs alleged that in order to induce securities analysts to positively rate their stock, defendants issued overly positive financial statements, advised that they had aligned their business strategy with their clients' to reduce costs to patients, and stated that their new business model would spur growth. Simultaneously, plaintiffs alleged that defendants failed to disclose adverse material facts that were plead in the suit brought by the New York Attorney General alleging defendants fraudulently induced the city to enter into a contract, improperly changed patient medication and improperly sold client data. Defendants moved to dismiss, and the court granted the motion for not meeting the heightened pleading standard under the PSLRA. The court held that plaintiffs were not entitled to rely on the truth of the allegations contained in the suit filed by the Attorney General as specific facts to show defendants issued false and misleading statements. Defendants failed to plead with specificity in their complaint the truth of those allegations, how the allegations were false or misleading when they were made, or how those statements led stock prices to become artificially inflated.

c. *Detroit Gen. Ret. Sys. v. Medtronic, Inc.*, 621 F.3d 800 (8th Cir. 2010)

Plaintiffs alleged securities fraud after Medtronic suspended sales of an internal defibrillator component, having previously informed physicians and investors that failure rates were in line with other devices and may be impacted by variables in the implant procedure. The Eighth Circuit affirmed the lower court's dismissal, finding that Plaintiffs failed to plead material falsity of the challenged statements because the complaint alleged no facts demonstrating that Medtronic or its executives possessed information inconsistent with the preliminary investigation findings disclosed to doctors. The court also held that Plaintiffs failed to plead a strong inference of scienter because the complaint did not allege that raw data concerning failures had been analyzed or reviewed by executives at the time of the disclosure.

X. NINTH CIRCUIT

A. SUMMARY OF DEVELOPMENTS IN 2010

The 9th Circuit issued several important decisions in 2010. In *New York City Employees' Retirement Systems v. Jobs*, the Court of Appeals affirmed a district court's dismissal of Section 14(a) claims brought against a technology company , and several of its directors and officers, on the ground that plaintiffs had not alleged economic loss. The court concluded that plaintiffs properly stated a claim based on allegations that they unwittingly authorized the issuance of shares during several proxy votes without knowing about certain option backdating practices. However, the court held that plaintiffs failed to allege loss causation because they alleged only a dilution of shares, which was insufficient to demonstrate an economic injury. The court therefore affirmed dismissal of plaintiffs' Section 14(a) claim but allowed plaintiffs to replead a Section 10(b) claim based on the same set of facts. In *Miller v. Thane*, the 9th Circuit affirmed a post-trial motion for judgment dismissing shareholder claims where defendants demonstrated that the company's stock price did not decline for several weeks immediately following the alleged corrective disclosure. The court held, in part, that there was substantial evidence (including expert testimony) supporting the district court's conclusion that the company's stock price absorbed the correct information prior to the stock drop. In *United States v. Goyal*, the 9th Circuit reversed a jury verdict against the CFO of a company, entering judgment of acquittal on all fifteen counts and finding that the government failed to offer sufficient evidence that the company made material false statements, that its filings violated GAAP, or that the CFO knowingly made false statements to the company's auditors.

At the district court level, the Western District of Washington was particularly active this year in cases involving Washington Mutual. In one notable case, *In re Washington Mutual, Inc. Securities, Derivative & ERISA Litig.*, the Western District dismissed fraud, negligent misrepresentation, and Section 10(b) claims on the grounds that conclusory assertions that Plaintiffs had "read and relied upon … Offering Circulars" did not satisfy the heightened standard for pleading reliance under Fed. R. Civ. P. 9(b) or equivalent standards under California law (the court, however, denied dismissal of Plaintiffs' related California Corp. Code claims). Also, in *Boilermakers Nat'l Annuity Trust Fund v. WaMu Mortg. Pass Through Certificates, Series AR1*, investors in mortgage-backed securities brought Section 11 claims based on purported misstatements in the issuing company's registration statements. In that case, the Western District permitted claims to proceed based on allegations that the defendant had pressured appraisers to overstate the value of the underlying properties because, if true, the registration statements concerning underwriting standards could be misleading. The court granted dismissal, however, of allegations concerning appraisals and loan-to-value ratios as conclusory because Plaintiffs relied solely on a third party complaint against an appraiser that had no connection to the securities at issue. In a case unreleated to Washington Mutual, *In re Metropolitan Securities Litigation*, the Western District held that plaintiffs alleging Section 20(a) control person violations did not need to allege underlying Section 10(b) violations for each alleged control person. In addition, the court held that control person allegations were not subject to the heightened pleading standards of Fed. R. Civ. P. 9(b), and that it is not necessary to show actual participation in the fraud to find control person liability; rather, Section 20(a) claims can be premised on allegations of actual control over the day-to-day operations of the business. Finally, in *In re REMEC Inc. Securities Litigation*, the Southern District of California granted summary judgment for defendant, finding that plaintiffs had not demonstrated scienter because allegedly inaccurate financials were based on goodwill calculations, which were inherently judgmental, and plaintiffs did not show that defendants had manipulated any underlying assumptions. The court also held that plaintiffs could not establish loss causation because the event study designed by plaintiffs' expert to analyze the impact of the corrective disclosures on the issuer's stock failed to take into account key independent variables, such as the effect of general market and industry developments or other pieces of company-specific news.

B. NOTEWORTHY CASES IN 2010

1. Pleading Standards for Securities Fraud

a. *Burritt v. NutraCea*, No. CV-09-00406-PHX-FJM, 2010 WL 668806 (D. Ariz. Feb. 25, 2010)

Plaintiffs alleged that issuer, CEO and CFO misled investors in violation of Section 10(b) and 20(a) of the Exchange Act by attesting to the accuracy of financial statements that improperly recognized revenue from four specific transactions in violation of GAAP. The court denied the CEO's motion to dismiss, finding that plaintiffs pled a strong inference of scienter based on particularized allegations that the CEO negotiated one of the allegedly improperly recorded transactions, monitored the company's revenue recognition, and had a personal motive for profit. The court also found that plaintiffs adequately pled loss causation based on allegations of a stock price drop shortly after the announcement of an accounting error in February 2009. That the stock price did not drop after a subsequent announcement in April 2009 did not defeat plaintiffs' allegations because, as the court held, a partial revaluation of the company's stock after the initial announcement muted the effect of the second announcement. The court granted the CFO's motion to dismiss, however, finding that plaintiffs' lack of particularized allegations with respect to the CFO's (1) knowledge of the transactions, and (2) motive to commit fraud were insufficient to establish scienter. The court denied defendants' motions to dismiss plaintiffs' Section 20(a) claims because the CEO and CFO were control persons of the company, which was a primary violator in light of plaintiffs' allegations against the CEO. The court also upheld plaintiffs' state law securities claim, finding that plaintiffs sufficiently alleged that defendants made false and misleading statements during conference calls designed to induce the purchase of securities.

b. *N.Y. State Teachers' Ret. Sys. v. Freemont Gen. Corp.*, No. 2:07-cv-5756, 2010 WL 1473265 (C.D. Cal. Mar. 29, 2010)

Plaintiffs brought a securities fraud claim against issuer and its senior officers claiming that defendants made a series of materially false and misleading statements about the issuer's loan origination and underwriting standards, financial statements and internal controls in violation of Section 10(b) of the Exchange Act. The court granted defendants' motion to dismiss the third amended complaint, holding that plaintiffs failed to set forth new facts, disregarded the court's prior order not to include certain allegations found to be "so broad and vague as to not be actionable," and continued to engage in "puzzle pleading." The court further held that plaintiffs had neither described with particularity their confidential witness' reliability and personal knowledge nor established that the proffered statements were themselves indicative of scienter. According to the court, plaintiffs' continued "puzzle pleading" and failure to make separate scienter allegations attributable to each defendant with respect to each statement alleged to be materially false or misleading required dismissal.

c. *In re Rackable Sys. Sec. Litig.*, No. C 09-0222, 2010 WL 199703 (N.D. Cal. Jan. 13, 2010)

In a securities fraud class action, plaintiffs alleged that defendants engaged in a fraudulent scheme to inflate the company's value by misrepresenting its true financial condition. Specifically, plaintiffs asserted that the company's sales and earnings projections were false when made because defendants did not disclose the extent of their sales and use tax liability, failed to account properly for their inventory or disclose that their inventory tracking software was deficient, and misrepresented the nature of the company's relationship with its top three customers. The court granted defendants' motion to dismiss, finding that plaintiffs failed to plead materiality properly because the complaint did not allege that the sales tax charges impacted the company's gross margins during the class period. The court also found plaintiffs' scienter allegations deficient because certain confidential witnesses were not alleged to have had any personal interaction with defendants, defendant who sold stock during class period did not do so at a level that was out of line with his prior trading practices, and defendants' alleged motive to inflate issuer's financial results so that it did not have to draw down on its line of credit is an insufficient motive for fraud. Finally, plaintiffs failed to allege loss causation merely by showing a correlation between the disclosure of the issuer's financial results and a decrease in stock price. In a subsequent ruling (2001 U.S. Dist. LEXIS 88927 (N.D. Cal. Aug. 27, 2010)), the court dismissed plaintiffs' amended complaint with prejudice, holding that even after the inclusion of new facts, plaintiffs failed to properly plead material representations or omissions, scienter, or loss causation.

d. *Desserault v. Yakima Chief Property Holdings, LLC*, No. CV-09-3055-RMP, 2010 WL 2232945 (E.D. Wash. June 3, 2010)

Plaintiff shareholders brought a securities fraud action alleging that defendants, individuals and corporations connected with a member-managed limited liability company, downgraded plaintiffs' status as shareholders in the company such that plaintiffs lost the right to vote and attend member meetings. Plaintiffs further alleged that defendants restructured the company into a new entity, diminishing the value of plaintiffs' interest. Based on these allegations, plaintiffs alleged that defendants violated Section 10(b) and Rule 10b-5, as well as certain state laws. Defendants moved to dismiss the federal claims on the basis that plaintiffs failed to plead with particularity (1) a material misrepresentation and (2) specific facts giving rise to a strong inference of scienter as required by the PSLRA. The court granted defendants' motion to dismiss, holding that plaintiffs failed to plead a misrepresentation and that plaintiffs' allegations did not give rise to a strong inference of scienter because (1) they did not establish an extreme departure from of the ordinary standards of care contemplated by the PLSRA, and (2) the court could infer that the alleged restructuring was effectuated in order to continue the primary business of the company. The court also rejected plaintiffs' assertion that they had sufficiently pled standing under the "forced sale" doctrine because plaintiffs were never required to sell their shares or exchange them for cash. The court declined to exercise supplemental jurisdiction over the supplemental state law claims, which the court dismissed without prejudice.

e. *In re Washington Mutual, Inc. Securities, Derivative & ERISA Litig.*, No. 2:08-md-1919 MJP, 2010 WL 2545415 (W.D. Wash. June 21, 2010)

Plaintiffs alleged that defendants' Offering Circulars and SEC filings contained misstatements regarding defendants' financial condition. plaintiffs pursued the following claims: (1) fraud; (2) negligent misrepresentation; (3) violations of Cal. Corp. Code Sections 25400, 25401, 25501 and attendant claims; (4) Section 10(b) and Rule 10b-5 of the Exchange Act; (5) violations of Section 18 of the Exchange Act; and (6) section 20 of the 1934 Act against defendants' officers and directors. The court dismissed plaintiffs' fraud, negligent misrepresentation, and section 10(b) claims for failure to adequately plead reliance. Plaintiffs' conclusory contention that they "read and relied upon the Offering Circulars" did not satisfy the heightened pleading standard under Fed. R. Civ. P. 9(b) or equivalent standards under California law. The court also found plaintiffs' Section 18 claim to be time barred as plaintiffs failed to bring its claim within one year of admittedly knowing or having reason to know of the alleged misrepresentations. Moreover, since plaintiffs could show no primary violation of its federal claims, the court dismissed its derivative Section 20(a) claim. The court, however, denied defendants' motion to dismiss plaintiffs' Cal. Corp. Code claims. Defendants argued that Sections 25400 and 25500 required defendants to have purchased the same type of security that plaintiffs purchased in order for liability to attach. The court rejected defendants' narrow reading and found sufficient plaintiffs' allegations that defendants engaged in requisite "market activity" since their statements impacted the value of both securities and defendants accrued a benefit from its deception. As for plaintiffs' Section 25041 and 25501 claims, the court held that even though defendants took receipt of money from the sale in New York, it was sufficient that plaintiffs' complaint alleged that the purchase occurred "in California."

f. *Altabet v. CleanTech Biofuels, Inc.*, 2010 WL 2947427 (D. Nev. July 21, 2010)

Plaintiff brought an action against the company and the company's chief executive officer and president, claiming a number of state causes of action and one federal cause of action under Section 10(b). Plaintiff argued that a confidentiality agreement was entered into with the company as an inducement for plaintiff to purchase the company's shares. Plaintiff contended that an email to defendants, purportedly describing the terms of the agreement, proved that an agreement to buy the shares existed. According to plaintiff, defendants' failure to respond to his email or to sell him the shares evidenced defendants' intent to deceive, manipulate or defraud. The court granted defendants' motion to dismiss, finding plaintiff failed to allege sufficient facts on each element of the Section 10(b) claim: (1) plaintiff failed to demonstrate that defendants misrepresented a fact about the securities themselves; (2) plaintiff's only claim regarding defendants' fraudulent intent was based on pure speculation; (3) there was no sale or purchase of a security; (4) there was no transaction and thus no loss caused by the transaction; and (5) plaintiff did not allege specific economic loss or provide evidence of whether the value of the stock rose. As the Section 10(b) claim was the only federal claim, the court then dismissed the case for lack of personal jurisdiction over the defendants.

g. *Rich v. Shrader.*, No. CV 09-CV-0652-MMA (WMc), 2010 WL 3717373 (S.D. Cal. Sept. 17, 2010)

Plaintiff, a retired officer of company, sued the company and several officers alleging violations of federal and state securities laws, including Section 10(b) of the Exchange Act and Rule 10b-5. Specifically, plaintiff alleged that, after he retired, the company exercised its right to repurchase plaintiff's stock at book value, which it then sold as part of a transaction in which the stock was valued significantly above book value. Plaintiff alleged that the repurchase of his stock denied him the benefit of the sale and, because the company did not apprise him of the sale, it omitted a material fact in connection with the repurchase of his stock. The court granted defendants' motion to dismiss. First, the court held that the individual defendants owed plaintiff no special duty to disclose information, in part because the individual defendants were minority shareholders. Second, the court found the company was not a close corporation because it had over 300 shareholders. Third, the subsequent sale transaction could not constitute material, undisclosed information, because the complaint did not allege that defendants had even begun to contemplate the sale at the time the company repurchased plaintiff's shares. Finally, the court held that plaintiff failed to allege scienter because he alleged only that defendants engaged in ordinary business conduct, making decisions designed to increase profit, which did not give rise to a strong inference of scienter. The court next held that plaintiff's California securities claim failed for the same reasons as the federal claims. It further noted that California securities laws do not cover simple non-disclosure, which was the gravamen of plaintiff's claim.

h. *Boilermakers Nat'l Annuity Trust Fund v. WaMu Mortg. Pass Through Certificates, Series AR1*, No. C09-00037MJP, 2010 WL 3815796 (W.D. Wash. Sept. 28, 2010)

Plaintiffs, investors in mortgage-backed securities, filed a class action against defendant company, its officers, and the agencies that issued credit ratings for the securities, alleging violations of Sections 11, 12(a)(2), and 15 of the Securities Act. Defendants moved to dismiss plaintiffs' claims. The court granted defendants' motion as to 25 of the securities, because plaintiffs did not allege that they purchased those securities, and therefore, had no standing to sue for losses related to them under Section 11 or Section 12(a)(2). Next, the court denied dismissal as to plaintiffs' allegations that the company pressured appraisers to overstate the value of the underlying properties because, if true, the registration statements concerning underwriting standards could be misleading. However, the court rejected plaintiffs' allegations concerning appraisals and loan-to-value ratios as conclusory, because plaintiffs relied solely on a separate complaint filed by a third party against an appraiser, which complaint alleged facts that had no connection to the securities at issue. The court also dismissed allegations related to the securities' credit ratings because: (1) that ratings would have been different under a different methodology was immaterial; and (2) the risk that rating agencies (who are paid by the issuer) operated under a conflict of interest was well known. The court found that economic loss was sufficiently pled because plaintiffs alleged that the value of the securities was less than their purchase price. The court declined to address the allegations concerning risk disclosures in the prospectus documents, finding that disclosure adequacy was best decided by the trier of fact. The court dismissed plaintiffs' Section 15 claims against the officers, because conclusory allegations of control based only on their position at the company were insufficient to allege control-person liability. The court also dismissed one plaintiff's claims as time barred, because that plaintiff filed its complaint more than a year after the other plaintiffs had filed, which put the former plaintiff on notice of its claims. Finally, the court dismissed the Section 15 claims against the rating agencies, because plaintiffs alleged nothing regarding the agencies' control over the company's management or day-to-day activities. Because plaintiffs did not present a viable alternative amended complaint, the court granted the rating agencies' dismissal with prejudice.

i. *Albergo v. Immunosyn Corp.*, 2010 WL 3895364 (S.D. Cal. Sept. 30, 2010)

Plaintiffs, investors in a start-up company, asserted claims under Section 10(b) of the Exchange Act and Rule 10b-5, as well as claims under other state and federal laws, against a group of companies and their officers. The court granted defendants' motion to dismiss claims for breach of oral contract, unjust enrichment and fraudulent transfer, but allowed the remaining claims to proceed, including claims for violations of Section 10(b) and Rule 10b-5, fraud and fraud in the inducement, violations of RICO, and conspiracy. In denying defendants' motion to dismiss plaintiffs' 10(b) and Rule 10b-5 claims, the court found, without elaboration, that plaintiffs had successfully argued a strong inference of scienter on the part of defendants. Moreover, although plaintiffs did not provide the exact dates for each of the misrepresentations, they did allege the date of allegedly fraudulent SEC filings, the date of and signatory to an allegedly fraudulent 10-Q, the approximate dates of sales of the new product, and who knowingly took part in these sales and where.

j. *In re Bare Escentuals, Inc. Sec. Litig.*, No. C 09-3268, 2010 U.S. Dist. LEXIS 103612 (N.D. Cal. Sept, 30, 2010)

In a securities class action, plaintiffs alleged defendants made a number of false and misleading statements in violation of Sections 10(b), 20(a), and 20A of the Exchange Act, and Sections 11, 12(a)(2), and 15 of the Securities Act. Defendants moved to dismiss on the basis that the statements at issue were not actually false, that plaintiffs failed to allege scienter, and that many of the statements at issue were protected by the Safe Harbor provision of the PSLRA. Defendants also argued that the relevant statute of limitations barred all of plaintiffs' claims. The court sided with defendants, except for the statute of limitations argument. It held that plaintiffs failed to plead sufficient facts to demonstrate either falsity or scienter, and the PSLRA's Safe Harbor provision applied to those forward-looking statements accompanied by appropriate cautionary language. However, the court determined that ruling on the statute of limitations question would be premature, as it required a fact-intensive determination at the pleadings stage. In dismissing the complaint, the court granted plaintiffs leave to amend.

k. *Allstate Life Ins. Co. v. Robert W. Baird & Co.*, No. CV-09-8162-PCT-GMS, 2010 WL 4581242 (D. Ariz. Nov. 4, 2010)

Plaintiff bond purchasers alleged violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5, as well as certain state laws, against individuals and entities involved in the preparation of bond offering documents based on their failure to disclose critical information concerning the anticipated financial performance of an event center to be constructed using the bond proceeds. Specifically, plaintiffs alleged (1) a failure to disclose two internal "feasibility reports" that yielded more pessimistic projections than those in the statements regarding the projected number of events at the center and attendance at each event, (2) a failure to disclose the decision not to have a third feasibility evaluation performed, and (3) a false implication in the statements that no reports had been generated. An indenture trustee for the bonds also sued defendants on behalf of the bondholders, asserting state law securities, contract and tort claims.

The court denied the motion to dismiss of the issuer and its executives, finding that plaintiffs' claims were adequately pled because the feasibility reports contained critical, objectively verifiable information undermining the statements' projections, the omission of which inflated the value of the bonds until the truth was revealed. Scienter against all defendants (other than the law firms and underwriters that were named) could be inferred based on their intimate knowledge of the feasibility reports and defendants' desire to secure an investment-grade credit rating for the bonds. Section 20(a) control person liability as to the individual defendants and parent corporation was adequately pled, because they either owned or directly controlled at least one primary violator. The court granted the law firms' and underwriters' motions to dismiss because plaintiffs alleged no particularized facts regarding scienter, but rather merely asserted that they "must have known" of the misstatements because they knew of the existence of the feasibility reports. For the reasons discussed in connection with the federal securities claims, the court declined to dismiss most of the state securities claims, except as to the law firms and underwriters. Further, the court held that the Trustee had standing to bring its tort-based claims, because the applicable indenture agreement expressly empowered the Trustee to enforce "all rights" and "any other remedies" of the bondholders. Thus, the court granted in part and denied in part the defendants' motions to dismiss, granting leave to amend those claims it dismissed.

2. Scienter

a. *In re REMEC Inc. Sec. Litig.*, No. 04-CV-1948-MMA (AJB), 2010 WL 1676741 (S.D. Cal. Apr. 21, 2010)

Plaintiffs claimed that issuer and management materially overstated their financial results by failing to recognize millions of dollars in losses related to goodwill impairment, and thereby violated Sections 10(b) and 20(a) of the Exchange Act. The court granted defendants' motion for summary judgment based on plaintiffs' failure to demonstrate scienter and loss causation. Regarding scienter, the court found that plaintiffs could not overcome the nature of goodwill calculation, which "involves a complicated accounting analysis that is infused with the exercise of professional judgment" and can lead to different conclusions "without the presence of fraudulent conduct." Without any direct evidence demonstrating that defendants manipulated the assumptions used in the calculations, the court found no triable issue on the element of scienter. In addition, the court found that plaintiffs could not establish loss causation and that plaintiffs' expert's event study designed to analyze the impact of the corrective disclosures on the issuer's stock was inadmissible under the *Daubert* standard because it did not take into account key independent variables, such as the effect of general market and industry developments or other pieces of company-specific news.

b. *In re Cadence Design Sys., Inc.*, No. C 08-4966, 2010 WL 726515 (N.D. Cal. Mar. 2, 2010)

Plaintiff shareholders alleged that defendants engaged in a fraudulent scheme to inflate the company's stock prices by misrepresenting its earnings after defendants issued a restatement of its financial results for the first and second quarters of 2008. Specifically, plaintiffs asserted that defendants improperly accounted for two large transactions by recognizing revenue immediately for those transactions rather than recognizing revenue ratably over the entire term of the agreements. The court denied defendants' motion to dismiss, finding that plaintiffs had sufficiently pled scienter and established claims under Sections 10(b) and 20(a) of the Exchange Act because: (1) confidential witnesses' statements were sufficiently detailed and based on personal knowledge to show vice-president's involvement with the agreements; (2) shareholders sufficiently alleged strong inference that the vice-president knew that the revenue from the agreements was not recognizable because of his personal involvement with the agreements; (3) a strong inference of scienter with respect to the vice-president also gave rise to a strong inference that other executives were aware of facts about the revenue from the agreements; and (4) shareholders sufficiently established claims for control person liability against officers.

c. *SEC v. Leslie,* No. C 07-3444, 2010 U.S. Dist. LEXIS 76826 (N.D. Cal. July 29, 2010)

In an SEC enforcement action, the SEC alleged that defendants had made misrepresentations to auditors that led to misstated financial results. Defendants moved for summary judgment, which the court granted in part and denied in part. The court found that there was evidence that each defendant had acted with scienter in making false statements to the company's auditors, which satisfied the required mental state for all of the claims except for the internal controls violations and the aiding and abetting claims. The court also found that defendants' misrepresentations were not immaterial as a matter of law. The court determined, however, that the statute of limitations had expired for civil penalties against two of the defendants, and that a director and officer bar would serve no purpose other than punishment, so it denied this request for relief.

d. *Veltex Corp. v. Matin*, 2010 WL 3834045 (C.D. Cal. Sept. 27, 2010)

Plaintiff company brought an action against its securities attorney, an accounting firm, an accountant, and corporate transfer agent, including two of transfer agent's officers, alleging violations of Sections 12 and 17 of the Securities Act, and Section 10(b) of the Exchange Act, as well as two state law claims. The company alleged that defendants engaged in a scheme to artificially inflate the value of the company's stock by disseminating false information into the market and then selling the inflated shares. The court dismissed the company's Section 12 claim for failing to properly allege that it purchased securities, as is required to state such a claim. The court also dismissed the company's Section 17(a) claim, because Section 17(a) does not provide a private right of action. Regarding the Company's Section 10(b) and Rule 10b-5 claims, the company alleged its attorney violated the Exchange Act by drafting opinion letters that contained misrepresentations and by approving the issuance of unrestricted, legend free common stock when no securities law exemption was available. In granting attorney's motion to dismiss, the court held that an attorney's failure to verify the accuracy of all facts provided by the client did not support a strong inference of scienter. The court also dismissed the company's claim that the accounting firm violated the Exchange Act, because the firm's alleged failure to comply with accounting standards did not impact the substance of the financial information at issue. Moreover, the court noted that the company failed to sufficiently plead scienter, because the alleged accounting violations were not accompanied by widespread and significant inflation of the company's revenue in the figures provided by the accountant. The company's claim against the accountant for issuing an audit report that was not GAAP compliant was dismissed with prejudice, because the claim was not brought within the five-year statute of repose. The company's claims against transfer agent's officers were also dismissed, because the company failed to allege scienter. Further, because the company did not allege an independent basis to hold transfer agent liable, that claim was dismissed without prejudice.

Lead plaintiff filed a third amended complaint against a mortgage company and two officers alleging violations of Sections 10(b) and 20(a) and Rule 10b-5. The district court dismissed plaintiff's claims with prejudice, holding that plaintiff failed to plead scienter. The 9th Circuit affirmed, finding that plaintiff's allegations that the officers overrode underwriting guidelines and approved low quality loans were inadequate to establish scienter. Specifically, such allegations amounted to no more than general allegations of mismanagement that failed to provide any details of when or how the underwriting guidelines were violated. Moreover, plaintiff's allegations of friction with an outside auditor and an SEC inquiry—which plaintiff did not allege resulted in a finding of wrongdoing—did not fall within the class period. The court found that plaintiff did not sufficiently identify any violations or tie any such violations to the class period with the "great detail" required to raise a strong inference of scienter. The court did note that, similar to evidence of traditional insider stock sales, an officer's interest in keeping a company going in order to draw a large salary could bear on scienter. Nevertheless, viewing the complaint as a whole, the court found an inference of scienter to be less compelling than an inference of non-fraudulent intent.

e. *Karpov, et al. v. Insight Enters., Inc.*, 2010 WL 4867634 (D. Ariz. Nov. 16, 2010) (slip copy)

Lead Plaintiff filed a consolidated complaint against the company and six current or former officers alleging violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 arising out of the company's February 9, 2009 announcement that it would issue a financial restatement. The original complaint, which had also named company's auditor as a co-defendant, was dismissed without prejudice in April 2010. After another round of motions to dismiss, the district court dismissed the Amended Complaint with prejudice. Relying primarily upon the Ninth Circuit's established precedent regarding the standards for pleading scienter based upon confidential sources (i.e., confidential witnesses), the court concluded that plaintiff had failed (for the second time) to plead particularized facts giving rise to the required "strong inference" of scienter. None of plaintiff's 31 confidential witnesses personally participated in, or had firsthand knowledge of, Insight's class period accounting for "aged" trade credits. Moreover, none of the statements attributed to the 31 CWs were indicative of scienter. In the end, the court concluded that whether viewed individually or holistically (under *Tellabs*), the allegations failed to meet the stringent pleading requirements for alleging scienter in the Ninth Circuit.

3. Misstatements and Omissions

a. *In re Jones Soda Co. Sec. Litig.*, No. 09-35732, 2010 WL 3394274 (9th Cir. Aug. 30, 2010) (unpublished)

Plaintiffs appealed the dismissal of their securities fraud class action against a company and its CEO, wherein they alleged that defendants violated Sections 10(b) and 20(a) of the Exchange Act. At the district court level, plaintiffs alleged defendants misled their the company's investors by overstating its efforts and performance as it entered the soft drink market. Specifically, plaintiffs alleged that the company's CEO falsely stated that the company would be making resource investments, such as hiring additional personnel, making upgrades to its infrastructure, and increasing its sales and marketing expenditures in order to secure investments for the company's entrance into the soft drink market. The district court dismissed plaintiffs' first amended complaint with prejudice. Plaintiffs appealed the district court's decision denying leave to file their proposed second amended complaint. The 9th Circuit affirmed. With regard to falsity, the court found that the proposed amended complaint failed to establish that any of defendants' statements regarding the company's proposed resource investments were false, as opposed to merely optimistic. Specifically, the court determined that, contrary to plaintiffs' contentions, defendants never claimed that their investments were sufficient to ensure that the company's entrance into the soft drink market would be profitable. The court also found that the proposed amended complaint failed to allege scienter, concluding that (1) poor business decisions did not constitute scienter; and (2) the single fact to which plaintiffs pointed to allege scienter—that the company's CEO had allegedly received sales data about the soft drink market before statements about the company's profitability were made—was insufficient to constitute scienter.

4. Loss Causation

a. *In re Metro. Sec. Litig.*, No. CV-04-25-FVS, 2010 WL 300402 (E.D. Wash. Jan. 20, 2010)

Plaintiff shareholders brought a securities class action against a company's two outside auditors under Section 11 of the Securities Act, alleging that one of the auditors convinced the company to employ a tax shelter that would result in $28 million in tax savings. Neither auditor challenged the company's accounting treatment of the tax shelter, which plaintiffs alleged resulted in significantly overstated shareholder equity in two years. The court denied the auditors' motion for summary judgment based on a failure to demonstrate loss causation because the company's share price fell shortly after news of the IRS challenge surfaced, and a jury could thus conclude that the disclosure of the IRS challenge was the materialization of the risk that the company's investors faced. The court found that even though news articles did not specifically disclose the auditors' alleged errors, the articles sufficiently "related back" to the errors by discussing the IRS challenge. The court also denied plaintiffs' summary judgment motion, holding that because other negative news regarding the company surfaced around the time of the devaluation, a jury also could conclude that factors other than disclosure of the errors in the financial statements caused the decline.

b. *Miller v. Thane Int'l, Inc.*, 615 F.3d 1095 (9th Cir. 2010).

The district court affirmed a post-trial motion for judgment on plaintiffs' Sections 12(a)(2) and 15 claims for lack of loss causation, holding that defendants' material misrepresentation did not cause an actionable loss to shareholders because the company stock price, which trades on an inefficient market, did not decline in the weeks immediately following disclosure of the correct information. Plaintiffs appealed, and the 9th Circuit upheld the district court's ruling. The 9th Circuit held (1) a finding of materiality does not foreclose the possibility that a plaintiff lacks loss causation as the two are independent inquiries; (2) even in an inefficient market, stock prices can demonstrate a lack of loss causation; and (3) there was substantial evidence (including expert testimony) supporting the district court's conclusion that the company's stock price absorbed the correct information prior to the stock drop.

5. Control Person Liability

a. *Teamsters Local 617 Pension and Welfare Funds v. Apollo Group, Inc.*, No. CIV 06-2674-PHX-RCB, 2010 WL 653440 (D. Ariz. Feb. 22, 2010)

Shareholders filed suit against various officers and directors alleging that defendants were control persons under Section 20(a) of the Exchange Act based on corporation's misstatements. On a motion for reconsideration, the court, correcting a prior erroneous application of the law, vacated its former dismissals without leave to amend and deemed the claims dismissed without prejudice. The court clarified that under 9th Circuit precedent, plaintiff did not need to show Section 10(b) violations for each Section 20(a) defendant. Further, prior to considering whether each Section 20(a) defendant exercised actual power and control, the court analyzed three "preliminary but significant issues." First, noting a split among district courts, the court relied upon *Siemers v. Wells Fargo & Co.* to hold that the heightened pleading standards of the PSLRA and Rule 9(b) do not apply to Section 20(a) claims. Second, the court held that a plaintiff need not show actual participation or the exercise of power to make out a prima facie Section 20(a) claim, and that, rather than look to an alleged control person's actual participation, the court should instead look to allegations of their participation in the "day-to-day affairs of the corporation and the defendant's power to control corporate actions." Third, the court clarified its prior opinion and noted that it did not hold that an allegation that a defendant signed false financial statements was sufficient to establish control person liability at the pleading stage.

6. Other

a. *New York City Employees' Ret. Sys. v. Jobs*, 593 F.3d 1018 (9th Cir. 2010)

Shareholders of a corporation filed suit in connection with allegations of backdating of stock options. In a consolidated complaint, lead plaintiff alleged that shareholders suffered injury through impairment of their right to a fully informed vote and substantial dilution of their shares as a result of three falsities in the corporation's proxy solicitation, in violation of Sections 14 and 20(a) of the Exchange Act. The alleged falsities allegedly resulted in shareholders "unwittingly" authorizing the issuance of 200 million shares. The 9th Circuit held that the shareholders had adequately pled a direct injury under Section 14 based on allegations that they were prevented from participating in a fully informed vote on the proxy solicitation as a result of the solicitation's alleged falsities. However, the court held that the consolidated complaint failed to adequately plead loss causation, as dilution of shares does not necessarily lead to economic loss. Although the court affirmed the dismissal of the consolidated complaint, it reversed the district court's holding that lead plaintiff had waived a Section 10(b) claim by omitting it from the consolidated complaint after alleging it in a prior complaint. The court therefore granted lead plaintiff leave to amend its complaint to assert a Section 10(b) claim.

b. *United States v. Goyal*, 629 F.3d 912 (9th Cir. 2010)

Failure to prove false statements. The CFO of a company appealed a jury's guilty verdicts against him on one count of securities fraud, seven counts of making false filings with the SEC, and seven counts of making materially false statements to the company's auditors. The 9th Circuit reversed the district court and entered judgment of acquittal on all fifteen counts, finding that the government had failed to put forth sufficient evidence to prove at least one required element of each count the government brought against the CFO. Specifically, the government failed to offer sufficient proof that the company made material false statements, that its filings violated GAAP, or that the CFO knowingly made false statements to the company's auditors.

c. *Foos v. Wells Fargo Bank, N.A.*, No. CIV S-10-2198-FCD-CMK, 2010 WL 5287534 (E.D. Cal. Dec. 17, 2010)

Statute of Limitations following *Merck*. Plaintiff brought a *pro se* action against a bank, claiming civil conspiracy under 18 U.S.C. § 371 and securities fraud under Section 17(a) of the Securities Act, and Sections 10(b) and 12(a) of the Exchange Act. In essence, plaintiff alleged deceptive and misleading conduct by the bank in connection with the sale of plaintiff's home mortgage. The bank moved to dismiss all of plaintiffs' claims. The magistrate judge recommended dismissal of plaintiff's civil conspiracy claim and his Sections 17 and 12(a) securities fraud claims, because none of the applicable statutes provided for a private right of action. The magistrate judge also recommended dismissal of the Section 10(b) claim. Citing the Supreme Court's recent decision in *Merck & Co., Inc. v. Reynolds*, 130 S. Ct. 1784 (2010), the magistrate judge found that the Section 10(b) claim was time-barred because plaintiff filed suit more than two years after he entered into the mortgage, and alleged no facts indicating that he discovered (or should have discovered) facts constituting a Section 10(b) violation at a date later than the execution of the mortgage. Therefore, the court recommended that the district court grant defendant's motion to dismiss without leave to amend.

d. *Maine State Retirement Sys. v. Countrywide Fin. Corp.*, 722 F. Supp. 2d 1157 (C.D. Cal. 2010).

Statute of Limitations. Plaintiffs brought a class action alleging violations of Sections 11, 12, and 15 of the Securities Act arising from alleged misstatements in offering documents for various mortgage-backed securities. The court dismissed the action without prejudice. First, the court found that plaintiffs failed to establish standing to challenge most of the offerings, as they did not allege that they personally purchased many of the separate mortgage-backed securities at issue. Second, the court held that the allegations underlying plaintiffs' claims under Sections 11 and 12 failed to survive the applicable statutes of limitations and repose. Specifically, while the court accepted the general proposition that certain of plaintiffs' claims were legally tolled by the filing of prior state lawsuits under the *American Pipe* doctrine, plaintiffs' complaint failed to make particularized allegations supporting tolling for the individual investors and their claims. The court granted plaintiffs leave to amend their complaint, but noted that *American Pipe* tolling only applied to claims where the lead plaintiffs had standing in the previous action. Were it otherwise, the court held that class action plaintiffs could bring dilatory filings to extend the period in which to find suitable class representatives. The court also dismissed a defendant alleged to be the successor-in-interest to an underwriter of the securities, based on plaintiffs' contradictory allegations that defendant's subsidiary was also the successor-in-interest.

e. *McDonald v. Palacios*, No. 2:09-CV-01470-KJD-PAL, 2010 WL 3238966 (D. Nev. Aug. 12, 2010)

Statue of Limitations. Plaintiff alleged that defendants violated Section 10(b) of the Exchange Act, and Nevada state laws, by making misrepresentations as to the financial health of various companies, shares of which defendants sold to plaintiff. Defendants moved to dismiss the claims, arguing that: (1) the statute of limitations had run on plaintiff's securities fraud claim; (2) the elements of securities fraud, misrepresentation, and scienter were not pled with the requisite particularity under the PSLRA; and (3) the court should abstain under the *Colorado River* doctrine in deference to parallel state proceedings. The court rejected the statute of limitations claim, finding that plaintiff was not put on inquiry notice of the allegedly fraudulent misrepresentations based on revelations about wage violations, financial losses, and the need for additional capital—especially since defendants reassured plaintiff about the companies' future financial prospects. The court similarly rejected defendants' argument that plaintiff failed to adequately plead the elements of material misrepresentation and scienter for his Section 10(b) claim. The complaint adequately alleged material misrepresentations by stating that the financial statements defendants presented to plaintiff violated GAAP, and the underlying financial records were manipulated by defendants to make the companies appear better off financially. Likewise, plaintiff adequately pled scienter by alleging that defendants intentionally manipulated the financial records of the companies, defendants represented that financial statements were prepared according to GAAP, and defendants were the prior owner and bookkeeper for the companies with motive and opportunity to misrepresent financial records. Finally, the court rejected abstention under the *Colorado River* doctrine since the allegedly parallel state court proceedings did not involve any significant overlap in claims and thus, were not "substantially similar" to the federal litigation. Moreover, the court found a federal forum superior and convenient in light of, among other reasons, plaintiff's well-pled Section 10(b) claim. As such, the court dismissed defendants' motion to dismiss in its entirety.

f. *Hildes v. Arthur Andersen*, No. 08-cv-0008-BEN (RBB), 2010 WL 2836769 (S.D. Cal. July 19, 2010)

Leave to Amend. Plaintiff shareholder filed a federal securities action against defendant, independent auditor to company, alleging misstatements in violation of Section 11 of the Securities Act, Sections 10(b) and 14(a) of the Exchange Act, and Rules 10b-5 and 14a-9. Defendant moved to dismiss the Section 11 and Section 14(a) claims on the ground that reliance was inadequately pled. Defendant also moved to dismiss the Section 10(b) claim for failure to plead scienter adequately. Plaintiff moved for leave to amend his complaint to add new allegations and to name several outside directors as defendants. The outside directors moved for leave to intervene for the limited purpose of opposing plaintiff's motion. First, the court granted defendant's motion to dismiss. It held that plaintiff's Section 11 claim was deficient because he alleged that, prior to defendant's alleged misstatements, plaintiff entered into the voting agreement that resulted in the acquisition of his company shares. Because he was committed to purchase shares before the alleged misstatements, negative causation precluded liability. For the same reason, plaintiff could not show causation under Section 14(a). The court denied plaintiff's motion for leave to amend to add additional allegations to bolster his Section 11 and Section 14(a) claims because any amendment would be futile: neither claim could be established given that plaintiff was committed to purchase company shares before the alleged misstatement and no amendment could cure this. With respect to plaintiff's Section 10(b) claim, the court granted defendant's motion to dismiss because plaintiff did not dispute that scienter was inadequately pled. However, the court granted plaintiff's motion for leave to amend the Section 10(b) claim against defendant, because plaintiff's proposed new allegations involved an audit manager that allegedly knew of specific fraud at the company for a significant amount of time, which allegations could give rise to a strong inference of scienter. The court denied leave to amend the Section 10(b) claim against the outside directors, because the proffered new allegations did not show insider knowledge that contradicted public statements, nor did these allegations involve specific conversations or reports in which the outside directors purportedly learned of the adverse information. Finally, the court granted the outside directors' motion to intervene, holding that they had a protectable interest in the litigation as putative named defendants who would have to incur legal defense expenses if plaintiff's motion were granted.

g. *Lopes v. Vieira*, No. CV-F-06-1243-OWW-SMS, 2010 WL 3853287 (E.D. Cal. Sept. 30, 2010)

Definition of "security". Plaintiff claimed that he was misled into investing in a company by an offering memorandum prepared by defendants, which omitted information about the prosecution of a key executive. Defendants moved for summary judgment on the ground that plaintiff's acquisition of a membership and equity interest in the company in exchange for his investment of capital and goods was not a securities transaction governed by the Exchange Act, but rather, a commercial transaction. The court denied summary judgment, finding that regardless of plaintiff's motivation for making the investments, given that the success of plaintiff's interests in the company depended on the efforts of others—over whom plaintiff had no control—the investments were securities as defined by the Exchange Act. The court did, however, grant summary judgment as to plaintiff's California Corporations Code § 25400(d) claim, on the ground that defendants were not "sellers" within the meaning of the statute, because they did not solicit or play any role in inducing plaintiff to purchase the securities. The court further granted summary judgment as to certain damages based on failure to demonstrate loss causation. Plaintiff could not show that omissions in defendants' offering memorandum caused his losses, as he continued to ship his goods to the company even after learning that the company was unable to make timely payments.

h. *George v. Cal. Infrastructure and Econ. Dev. Bank*, No. 2:09-cv-01610-GEB-DAD, 2010 WL 2383520 (E.D. Cal. Jun. 10, 2010)

Reliance and Fraud on the Market. Plaintiff asserted claims under Section 10(b) of the Exchange Act and Rule 10b-5 against an investment bank and a law firm, claiming that they made a series of misleading statements and omissions in a prospectus used to market bonds issued by the bank. Defendants moved to dismiss plaintiff's initial consolidated complaint, but plaintiff filed a first amended complaint, mooting the initial motion to dismiss. In adjudicating defendants' motion to dismiss the amended complaint, the court found that plaintiff failed to allege that he relied on the allegedly materially misleading statements and omissions made by defendants in the prospectus. The court also rejected plaintiff's argument that it should apply the "fraud created the market reliance presumption," where reliance is presumed if a security that is unmarketable is introduced into the market by means of fraud. The court reasoned that the amended complaint's conclusory allegations that the bonds marketed by the prospectus were unmarketable were insufficient to invoke this presumption. Finding that plaintiff failed to allege that he had relied on the prospectus, the court granted defendants' motion to dismiss the amended complaint. However, because it was unclear whether he could state an otherwise viable claim, plaintiff was granted leave to amend for a second time.

XI. TENTH CIRCUIT

A. SUMMARY OF DEVELOPMENTS IN 2010

The district courts in the 10th Circuit issued several notable decisions in 2010. In *In re Semgroup Energy Partners L.P.*, the Northern District of Oklahoma affirmed the viability of the group pleading doctrine after the PSLRA and held that plaintiffs had pled adequately that officers of a general partnership that controlled an issuer, as well as the issuer itself, omitted material information in their financial statements by failing to disclose the liquidity problems of the parent. Further, the District of Kansas granted summary judgment to defendants in *New Jersey v. Sprint Corp.*, finding that plaintiffs failed to present sufficient evidence to show that the company had known it would terminate certain executives at the time the company issued its proxy materials. Finally, the District of New Mexico refused to lift the PSLRA's discovery stay in *In re Thornburg Mortgage, Inc. Securities Litigation*, dismissing the notion that plaintiffs were prejudiced by the defendants' production of relevant documents to governmental agencies conducting investigations. The court emphasized the frequency with which governmental investigations co-existed with securities lawsuits and declined to lift the discovery stay in such an ordinary circumstance.

B. NOTEWORTHY CASES IN 2010

1. Pleading Standards for Securities Fraud

a. *In re Semgroup Energy Partners L.P.*, No. 08-MD-1989-GKF-FHM, 2010 WL 1816434 (N.D. Okla. Apr. 30, 2010)

Plaintiffs alleged that issuer, its parent company, and its officers and directors violated Section 10(b) of the Exchange Act and Sections 11, 12(a)(2) and 15 of the Securities Act by issuing IPO and Secondary Registration documents that included material misrepresentations and omissions. Plaintiffs alleged that defendants failed to disclose to the company's investors the nature of the parent's alleged risky and speculative trading practices, its increasing margins and its liquidity problems. Defendants moved to dismiss by arguing that they had no affirmative duty to disclose information about the parent, even if it was material. The court found that the complaint alleged with sufficient particularity that individual defendants—who were officers and directors of the general partner that controlled the issuer—were insiders and therefore could be liable because the information they possessed could be considered material. The court also rejected individual defendants' argument that the "group pleading" doctrine was no longer viable after the PSLRA. However, with respect to one individual defendant, the court rejected application of the "group pleading" doctrine because, while that defendant had knowledge of the parent's trading activities and financial condition, he did not participate actively in preparing or issuing the allegedly false filings and publications.

b. *In re Level 3 Commc'ns, Inc. Sec. Litig.*, Nos. 09-cv-00200-PAB-CBS, 09-cv-00215-PAB-CBS, 09-cv-00296-PAB-CBS, 09-cv-00606-PAB-CBS, 2010 WL 5129524 (D. Colo. Dec. 10, 2010)

Investors asserted claims under Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 against the defendant company and five of its senior executives, alleging that defendants made misleading statements to investors regarding the progress and success of company's efforts to integrate certain acquired companies. The court dismissed the consolidated class action complaint, finding first that plaintiffs failed to satisfy the pleading requirement of Fed. R. Civ. P. 8(a), which mandates a "short and plain statement of the claim showing that the pleader is entitled to relief." The court further held that plaintiffs did not adequately allege a material misrepresentation or omission, as the complaint did not demonstrate that the statements at issue were untrue or misleading when made. Finally, the court held that plaintiffs failed to plead facts supporting a strong inference of scienter, because the complaint contained no factual allegations indicating any intent on the part of defendants to deceive or defraud investors. Rather, the complaint's allegations showed only defendants' optimism for a smooth integration process and their later acknowledgement of poor business decisions. All claims were dismissed without leave to amend.

2. Misstatements and Omissions

a. *United Food and Commercial Workers Union v. Chesapeake Energy Corp.*, No. CIV-09-1114-D, 2010 WL 3527596 (W.D. Okla. Sept. 2, 2010)

A union, as lead plaintiff, filed a class action complaint asserting claims under Sections 11 and 12(a)(2) of the Securities Act against the company, several individuals, and underwriters, alleging that defendants misstated and omitted specific material facts in the registration statement and prospectus, thus making the statements misleading to investors. Section 15 "control person" liability was also alleged against the individual defendants for these actions, based on their status. Plaintiff identified three categories of material misstatements and omissions, including defendants' failure to properly disclose the risks associated with the shares of company stock held by the CEO, the potential inability of an investment bank to perform its contractual obligations to the company, and the "kick-out" provisions in the company's hedging contracts. The court denied the defendants' motions to dismiss, finding that the plaintiff's allegations were sufficient to state a claim for relief under the Securities Act on the basis that defendants did not disclose material facts. The court held that "the extent to which the alleged omissions were material to [p]laintiff and other investors "[was] . . . a mixed question of law and fact" and that sufficient facts had been alleged for purposes of denying the motion to dismiss in this respect. Finally, the court concluded that the plaintiff had satisfied the pleading requirements under Section 12(a)(2), regarding the defendants' potential liability as "sellers." In reaching this conclusion, the court found that the complaint included sufficient factual allegations regarding the company's and individual defendants' involvement in all stages of the offering, the signing of the registration statement by all of the individual defendants, and the defendant underwriters' solicitation of the purchase of the securities at issue. The court denied the defendants' motions to dismiss.

b. *New Jersey v. Sprint Corp.*, --- F. Supp. 2d ---, 2010 WL 5287567 (D. Kan. Dec. 17, 2010)

The State of New Jersey brought a securities fraud class action on behalf of certain investors against the company and individual defendants, alleging that statements made in the company's proxy materials, announcing that the company had entered into new employment agreements with its two top executives, were misleading. The statements were allegedly misleading, because, at the time they were made, defendants apparently knew that the Board of Directors had met to consider terminating the executives' employment and that such termination was "predictable." Defendants moved for summary judgment on plaintiff's claims under Sections 10(b), 14(a), and 20(a) of the Exchange Act. The court held that the plaintiff failed to present sufficient evidence to raise a genuine dispute as to whether the defendants' statements were false or misleading. The court reasoned that there were "simply too many unknown factors" in the months leading up to the statements to conclude that the executives' termination was "predictable." The court granted summary judgment in favor of the defendants.

3. Scienter

a. *Ajjarapu v. AE Biofuels, Inc.*, 728 F. Supp. 2d 1154 (D. Colo. 2010)

Plaintiffs, the company's former president and his wife, brought a securities fraud action that alleged violations of Section 10(b) of the Exchange Act and Rule 10b-5 against the company, the company's stock transfer agent, and the company's counsel. Following a reverse-merger, new shares of the company were required to contain a restrictive legend preventing transfer of the shares until after the expiration of a one-year holding period. Following the plaintiff's resignation as president, plaintiffs requested that the company's shares be reissued to them without a restrictive legend under Rule 144. When the company denied the request, plaintiffs brought suit based upon the defendants' alleged misrepresentations relating to plaintiffs' ability to sell their shares. In ruling on the company's motion to dismiss, the court found that plaintiffs stated with particularity the allegedly misleading statements and that "a reasonable person would conclude that [the company] knew its statements were false," as the company had issued conflicting instructions allowing other shareholders to receive their shares without a restrictive legend. Thus, the court held that plaintiffs alleged facts sufficient to support a strong inference of scienter. The court denied the company's motion to dismiss the securities fraud claim.

b. *In re SemGroup Energy Partners, L.P., Sec. Litig.*, No. 08-MD-1989-GKF-FHM, 2010 WL 5376262 (N.D. Okla. Dec. 21, 2010)

Defendant companies filed a motion to bifurcate discovery in this putative securities class action arising from the bankruptcy in July 2008 of the corporate parent of the former defendant limited partnership. Defendants sought to "limit discovery to issues relevant to class certification, staying merits discovery pending resolution of plaintiffs' anticipated motion for class certification." The court denied the defendants' motion, finding that bifurcation of discovery was inappropriate in this case for several reasons. The court first found that bifurcation would result in further delay in resolving plaintiffs' claims, given that the case had already been pending for over two years with discovery stayed for most of that time pursuant to the PSLRA. The court further found that the case would likely proceed even if class certification was denied, due to the large number of investors and the size of the losses allegedly incurred by them. In addition, the court concluded that discovery related to class certification was too closely intertwined with merits discovery in this case, rendering bifurcation unworkable. Finally, the court determined that a case management schedule that prioritized class certification would sufficiently alleviate concerns regarding costly discovery.

c. *In re Thornburg Mortgage, Inc. Sec. Litig.*, No. CIV 07-0815 JB/WDS, 2010 WL 2977620 (D.N.M. July 1, 2010)

Lead plaintiffs alleged claims against defendants under Sections 10(b) and 20(a) of the Exchange Act and Sections 11, 12(a)(2), and 15 of the Securities Act. Lead plaintiffs filed a motion for a partial lifting of the PSLRA's discovery stay, making two primary arguments. First, lead plaintiffs argued that because two of the individual defendants absconded with some potentially relevant evidence, the lifting of the stay was necessary to preserve evidence. Second, lead plaintiffs argued that the stay imposed undue prejudice on them, because certain relevant documents had already been turned over to two governmental agencies pursuant to government investigations. Lead plaintiffs also maintained that because the requested documents had previously been produced, lifting the stay would impose a minimal burden. The court denied the motion and refused to lift the discovery stay. The court first found that defendants provided adequate assurances that there would be no spoliation of evidence. In addition, the court held that lifting the discovery stay in this matter would be inconsistent with the PSLRA's plain language and would be adding exceptions to the Statute that Congress did not include. The court stated that "[g]iven the prevalence of SEC and other investigations in fact situations in which plaintiffs lawyers bring class action securities lawsuits, finding exception to the stay for the purpose the lead plaintiffs suggest would eviscerate the stay provision. . . . The Court is not convinced that being at a slight disadvantage in litigation or settlement is the undue prejudice to which Congress referred in drafting the PSLRA."

4. Other

a. *Hein v. AT&T Operations, Inc.*, No. 09-cv-00291-WYD-CBS, 2010 WL 5313526 (D. Colo. Dec. 17, 2010)

Plaintiff, a former account executive at defendant company, brought claims under SOX against the defendant company and two of its executives, alleging that defendants had unlawfully retaliated against her for reporting an alleged SOX violation. Defendants moved for summary judgment on the plaintiff's claims, arguing that she could not prove that she was a covered employee under SOX's whistleblower protection provision of Section 1514A. Defendants maintained that Section 1514A was inapplicable, because the plaintiff's former employer was only a corporate subsidiary and was not itself a publicly traded company. The plaintiff maintained that Section 1514A should be read to include publicly traded corporations and the corporate subsidiaries whose financial information is consolidated in the parent company's financial statements. Due to the absence of 10th Circuit authority on the subject, the court looked to other Circuits to determine whether an employee of a non-public subsidiary was covered under Section 1514A, primarily following the reasoning of an Eastern District of Michigan case, *Rao v. Daimler Chrysler Corp.*, No. 06-13723, 2007 WL 1424220 (E.D. Mich. May 14, 2007). The court held that the plaintiff was not protected under Section 1514A, given the "corporate law principle that parent companies are not liable for their subsidiaries' actions and the fact that Congress supported this rationale by mentioning subsidiaries of public companies in SOX provisions other than § 1514A." Due to these factors, and the public parent company not being named as a defendant, the court granted summary judgment and dismissed plaintiff's retaliation claim with prejudice.

XII. ELEVENTH CIRCUIT

A. SUMMARY OF DEVELOPMENTS IN 2010

The 11th Circuit issued two cases of note in 2010—one addressing pleading standards, and one addressing scienter. In *Edward J. Goodman Life Income Trust v. Jabil Circuit, Inc., et al.*, the 11th Circuit held that plaintiffs' conclusory allegations, including the identification of accounting irregularities in an issuer's financial statements, did not meet the PSLRA's heightened pleading standards. Furthermore, in *In re Scientific Atlanta, Inc. Securities Litigation*, the Northern District of Georgia granted the company's summary judgment motion in a securities fraud action because the record did not provide a method to determine to what extent shareholders' losses were caused by the company's failure to disclose its alleged channel stuffing activities.

B. NOTEWORTHY CASES IN 2010

1. Pleading Standards for Securities Fraud

a. *Edward J. Goodman Life Income Trust v. Jabil Circuit, Inc.*, No. 09-10954, 2010 WL 154519 (11th Cir. Jan. 19, 2010)

In September 2006, nearly six months after the *Wall Street Journal* issued an article highlighting suspiciously timed option grants to technology companies' executives, shareholders filed a class action lawsuit against one technology company, 16 individual directors and officers, and the company's outside auditor, alleging violations of Sections 10(b), 14(a), 20A and 20(a) of the Exchange Act. The 11th Circuit affirmed dismissal, agreeing with the lower court's holding that plaintiffs' conclusory allegations of insider trading and so-called "red flags"—including an admitted violation of GAAP and the WSJ article—failed to plead a strong inference of scienter under the PSLRA. The 11th Circuit also rejected plaintiffs' argument on appeal that forward-looking statements made with "actual knowledge" of their falsity were not protected by the PSLRA's safe-harbor provision. Finally, plaintiffs had not stated a claim under Section 14(a) because their damages, if any, were caused by the defendants' failure to follow corporate policies, not the approval of those policies or the election of directors conducted via proxy. Because plaintiffs failed to allege any predicate violation of the Exchange Act, the claims under Sections 20A and 20(a) also failed.

b. *In re Scientific Atlanta, Inc. Sec. Litig.*, No. 1:01-CV-1950-RWS, 2010 WL 4793386 (N.D. Ga. Nov. 18, 2010)

Plaintiff shareholders in a putative securities fraud class action alleged that defendants engaged in channel stuffing and improper accounting practices in an effort to conceal decreasing demand for defendant company's products. Plaintiffs further alleged that controlling persons at the defendant company disseminated to the investing public materially false and misleading information, and omitted material information, resulting in the artificially inflated price of the defendant company's securities. The court found that to the extent defendants' statements were forward-looking, they were accompanied by sufficiently meaningful cautionary language. The court held that plaintiffs had presented a genuine issue of material fact as to whether the company's actions constituted actionable channel stuffing and improper accounting practices, and as to whether defendants acted with the required scienter. However, because the record provided no method by which a jury could determine how much, if any, of plaintiffs' loss was attributable to defendants' failure to disclose its alleged channel stuffing activities defendants' motion for summary judgment was granted.

2. Scienter

a. *Sheet Metal Workers Local 28 Pension Fund v. Office Depot, Inc.*, No. 10-10688, 2010 WL 5071865 (11th Cir. Dec. 13, 2010) (*per curiam*)

The 11th Circuit upheld the district court's dismissal of plaintiffs' claims under Section 10(b) of the Exchange Act and Rule 10b-5, finding that plaintiffs failed to adequately plead a strong inference of scienter as required by the PSLRA. The court found that plaintiffs' claims were based entirely on speculation and allegations from unnamed witnesses. Furthermore, the court held that the Second Consolidated Amended Complaint failed to: (1) contain factual allegations directly linking the named individual defendants to the alleged fraud; (2) establish that the individual defendants must have known of the fraud because of "glaring accounting irregularities" or other "red flags"; or (3) raise a strong inference of corporate scienter by alleging facts showing that someone responsible for the allegedly misleading statements was aware of the fraud. Thus, the court affirmed the judgment of dismissal.

XIII. D.C. CIRCUIT

A. SUMMARY OF DEVELOPMENTS IN 2010

The D.C. Circuit Court of Appeals issued a significant decision in 2010, holding in *In re InterBank Funding Corp. Securities Litigation* that certifications of financial statements by an auditor do not constitute omissions qualifying for the presumption of reliance in securities fraud claims. The D.C. District Court also decided a noteworthy case in 2010. In *Riordan v. SEC*, the court found that disgorgement orders are not civil penalties and therefore are not subject to a five-year statute of limitations.

B. NOTEWORTHY CASES IN 2010

1. Statute of Limitations

a. *Riordan v. SEC,* 627 F.3d 1230 (D.C. Cir. 2010)

The SEC brought a civil enforcement action against the defendant, the owner of a brokerage firm, for violation of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5. Specifically, the SEC alleged that the defendant paid kickbacks to New Mexico's treasurer in exchange for state business. An SEC administrative law judge found the defendant liable and imposed sanctions, including civil fines and the disgorgement of profits. Defendant petitioned the D.C. Circuit for review, arguing that the disgorgement order was barred under the five-year statute of limitations contained in 28 U.S.C. § 2462, since the order was based on conduct that occurred outside the limitations period. The D.C. Circuit denied the defendant's petition, noting that the five-year statute of limitations period contained in 28 U.S.C. § 2462 applies to an action for the enforcement of a "fine, penalty, or forfeiture." The court held that, in accordance with circuit precedent, disgorgement orders are *not* penalties as long as the disgorged amount is causally related to the wrongdoing. Therefore, because disgorgement is not a "civil penalty," disgorgement is not subject to the five-year statute of limitations.

2. Reliance

a. *In re Interbank Funding Corp. Sec. Litig.*, No. 09-7167, 2010 WL 5299882 (D.C. Cir. Dec. 28, 2010)

Plaintiffs brought a class action against defendant auditor for violation of Section 10(b) of the Exchange Act and Rule 10b-5. Specifically, plaintiffs alleged that they relied on defendant auditor's materially false misrepresentations and omissions when purchasing securities from an investment fund company operating as a Ponzi scheme. After the district court dismissed the complaint, plaintiffs filed a motion for leave to amend. The district court denied plaintiffs' motion, holding that the proposed amendment was futile because it did not adequately plead the reliance element of a Rule 10b-5 claim. Plaintiffs appealed, arguing that the Supreme Court's holding in *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972), entitled them to a presumption of reliance. The D.C. Circuit affirmed the district court's ruling, holding that defendant auditor's failure to disclose the Ponzi scheme and certification of the audited company's financial statements as compliant with Generally Accepted Accounting Principles were not omissions, but rather affirmative misrepresentations to which the "*Affiliated Ute* presumption" did not apply.

3. Remedies and Damages

a. *SEC v. Whittemore*, 691 F. Supp. 2d 198 (D.D.C. 2010)

The SEC entered into a consent to entry of judgment with defendants by which defendants agreed that the court would order, and defendants would pay, disgorgement of ill-gotten gains, pre-judgment interest, and civil penalties resulting from defendants' fraudulent stock sales. Defendants contested the amount of disgorgement argued for by plaintiffs, asserting that the amount did not "offset" the value of the stock shares prior to the fraud, and that plaintiffs failed to offer evidence that defendants had not paid this "pre-fraud" amount. In refusing to grant defendants' offset, the court relied on longstanding precedent establishing that, where defendants have exercised their Fifth Amendment rights in a civil proceeding, the court may draw an adverse inference. The court also noted that such a finding is appropriate where the relevant evidence is "peculiarly in control of the Defendants."

4. Primary Liability

a. *SEC v. Brown*, No. 09-1423 (GK), 2010 WL 3786563 (D.D.C. Sept. 27, 2010)

The SEC brought suit against defendants, corporate officers, alleging that they omitted material information in filings with the SEC and in proxy statements in violation of the Securities Act, the Exchange Act, and related SEC Rules. Defendants moved to dismiss on the grounds that the claims against them were barred by the statute of limitations, failed to state a claim under Rule 12(b)(6), and failed to allege primary liability. The court deferred consideration of the statute of limitations defense, finding that while the civil penalties sought by the SEC were subject to the statute, it needed a more complete factual record to evaluate the SEC's claim that the limitations period should be tolled under the "continuing violations" doctrine. The court granted the defendants' 12(b)(6) motion with respect to the SEC's Section 17(a) claim on the basis that the complaint was devoid of any allegation that an offer or sale of securities ever occurred. Finally, the court rejected the argument that the complaint failed to allege primary liability for violations of the securities laws. Though the D.C. Circuit has not yet adopted a test for primary liability, the court found that the allegations were sufficient to establish liability under any circuit's test for primary liability.

XIV. DELAWARE COURTS

A. SUMMARY OF DEVELOPMENTS IN 2010

The Delaware Chancery court issued several noteworthy decisions in 2010. In *King v. VeriFone Holdings, Inc*., the court held that a plaintiff who has instituted a derivative action does not have a proper purpose in seeking books and records related to the allegations of the complaint; thus, the court denied the books and records request. In *London v. Tyrrell*, the court denied a motion to dismiss made by a special litigation committee established to evaluate a derivative suit, finding that even though the special committee had hired legal counsel and financial advisors, questions of fact remained about the independence of the committee and whether the committee conducted a good-faith investigation. In *In re CNX Gas Corp. Shareholders Litigation*, the court denied a motion brought by minority shareholders seeking to enjoin a controlling shareholder tender offer to be followed by a merger. The court held that the minority shareholders effectively challenged the tender offer but found that any damages could be remedied through a post-closing action, eliminating the need to issue the preliminary injunction. In a so-called "double derivative" suit, *Lambrecht v. O'Neal*, the Delaware Supreme Court held that former stockholders of Merrill Lynch had standing to bring derivative claims against Bank of America because a post-merger double derivative suit only requires a plaintiff to have owned stock in the acquired corporation at the time of the alleged wrongdoing and continuously until the merger, together with continuous ownership of stock in the acquiring corporation since the merger.

B. NOTEWORTHY CASES IN 2010

1. Fiduciary and *Revlon* Duties

a. *Pfeiffer v. Toll*, 989 A.2d 683 (Del. Ch. 2010)

A stockholder plaintiff brought a derivative action on behalf of the corporation against certain current and former directors and officers alleging that the individual defendants breached their fiduciary duties by engaging in insider trading. The derivative suit was a companion to a class action alleging that the corporation's growth projections from 2003-2005 were materially false or misleading. Defendants argued that plaintiffs had not adequately alleged that demand was futile or pled their breach of fiduciary duty claims with particularity. The court concluded that denial of the motion to dismiss in the related class action sufficiently demonstrated demand futility and that claims for breach of fiduciary duty based on insider trading were not subject to the heightened pleading standard of Rule 9(b).

b. *Robotti & Co., LLC v. Liddell*, C.A. No. 3128-VCN, 2010 WL 157474 (Del. Ch. Jan. 14, 2010)

The defendant corporation conducted a rights offering where the exercise value of the rights was lower than the market price for the company's stock. This below-market price offering triggered anti-dilution provisions contained in agreements governing the options and warrants held by directors and officers, which lowered the respective strike prices of those options and warrants. The court held that the rights offering at a below-market price was not a breach of the board's duty of loyalty because plaintiff failed to demonstrate that the directors knowingly conducted the offering to increase their holdings through the anti-dilution trigger.

c. *Nemec v. Shrader*, 991 A.2d 1120 (Del. 2010)

Plaintiffs, former officers and shareholders of consulting company, owned stock rights that were convertible into common shares of the company. In April 2008, while finalizing an agreement to sell its government unit, the company redeemed plaintiffs' shares at their pre-transaction book value. This redemption prevented plaintiffs from participating in the merger, which would have increased the value of their shares by nearly $60 million. The Delaware Supreme Court affirmed a dismissal of all claims, concluding that claims for breach of the implied covenant of good faith and fair dealing cannot be based on conduct expressly authorized by the agreement.

d. *In re Cogent, Inc. S'holder Litig.*, 7 A.3d 487 (Del. Ch. 2010)

Plaintiffs sought to preliminarily enjoin a transaction by which Cogent would be sold to a purchaser. Cogent had previously had discussions with another potential acquirer that had provided a nonbinding indication of interest at a price in excess of that offered by purchaser. Plaintiffs challenged the decision of the Cogent board to agree to an acquisition by purchaser and further challenged the deal protection measures agreed to by Cogent in connection with that acquisition. The court rejected plaintiffs' arguments, concluding that the actions of the Cogent directors and the deal protections to which they agreed, including a "top-up option," were reasonable under the circumstances.

e. *Lonergan v. EPE Holdings LLC et al.*, C.A. No. 5856-VCL, 2010 WL 3960598 (Del. Ch. Oct. 11, 2010)

A partnership sought to eliminate certain incentive distribution rights that increased its cost of equity capital by acquiring the sole owner of its general partner, a holding company. The Limited Partnership Agreement between the two entities purported to expressly eliminate any duties or liabilities, including fiduciary duties, of the holding company, and replaced them with alternative contractual standards of conduct. In response to a lawsuit challenging the proposed transaction, the court rejected plaintiff's motion for expedited discovery, concluding that the Limited Partnership Agreement effectively eliminated all fiduciary duties, meaning plaintiffs' claims for breach of those duties—including as to alleged deficiencies in disclosure—were not colorable.

f. *In re Atlas Energy Resources, LLC, Unitholder Litig.*, C.A. No. 4589-VCN, 2010 WL 4273122 (Del. Ch. Oct. 28, 2010)

The Court of Chancery dismissed plaintiffs' claims that individual defendant directors of target breached their fiduciary duties by approving a merger at a miniscule premium because the LLC Operating Agreement of target effectively eliminated all fiduciary duties of such individual directors. The Court of Chancery denied defendant's motion to dismiss breach of fiduciary duty claims against the controlling unitholder, however, because the LLC Operating Agreement did not specifically address the scope of fiduciary duties for controlling unitholders and therefore common law defaults applied.

2. Books and Records Inspection

a. *King v. VeriFone Holdings, Inc*., C994 A.2d 354 (Del. Ch. May 12, 2010)

Immediately following an announcement that an issuer would restate certain earnings, a shareholder filed a derivative suit alleging that directors and officers breached their fiduciary duties. That complaint was dismissed for failure to plead demand futility, but dismissed with leave to amend. Plaintiff thereafter made a demand for inspection of books and records pursuant to 8 Del. C. Section 220. The issuer refused the demand on the grounds that plaintiff's inspection was not for a proper purpose because plaintiff had already filed the derivative action. The court agreed that a plaintiff who has instituted a derivative action does not have a proper purpose in seeking books and records related to the allegations in its complaint.

b. *City of Westland Police v. Axcelis Technologies, Inc.*, 1 A.3d 281 (Del. 2010)

Defendant company initially rebuffed acquisition offers from one of its competitors, which ultimately led to three incumbent directors receiving less than a majority vote in support of their continuing as directors at the next annual meeting of stockholders. In accordance with company policy, those directors tendered their resignations, but the board refused to accept them. Shortly thereafter, company agreed to be acquired by its competitor, but at a lower price. Shareholders sought books and records from company relating to the acquisition discussions and the refused resignations of the directors. After trial, the Court of Chancery granted judgment in favor of the defendant company and dismissed the suit seeking to compel inspection of books and records, holding that plaintiffs had failed to meet their burden to demonstrate a "credible basis" of wrongdoing.

3. Special Litigation Committee

a. *London v. Tyrrell*, C.A. No. 3321-CC, 2010 Del. Ch. LEXIS 54 (Del. Ch. Mar. 11, 2010)

Plaintiffs alleged that six director and officer defendants breached their fiduciary duties by: (1) providing incomplete and inaccurate information to the financial advisor hired to value the company for purposes of certain option grants; and (2) granting options in February and May 2007 based on a report valuing the corporation as of July 2006, despite a provision in the equity incentive plan requiring the exercise price to be set with a value of at least 100 percent of the fair market value of the company's stock on the date of the grant. After the court denied a motion to dismiss for failure to make a demand, the board voted to form a two-member Special Litigation Committee (SLC) to consider whether pursuing the derivative claims was in the company's best interests. The SLC engaged independent legal and financial advisors and conducted a three-month investigation that included interviewing 12 witnesses and reviewing relevant documentation. The SLC issued its formal report on August 5, 2009, which concluded that the suit was not in the best interests of the company and recommended that the suit be dismissed. The court denied the SLC's motion to dismiss because material issues of fact remained as to

(1) whether the SLC members were independent, and (2) whether the SLC conducted a good-faith investigation of reasonable scope into the fairness of the alleged corporate wrongdoing.

b. *Sutherland v. Sutherland*, C.A. No. 2399-VCN, 2010 Del. Ch. LEXIS 88 (Del. Ch. May 3, 2010)

After inspecting books and records, a shareholder brought a derivative suit seeking to vindicate alleged breaches of fiduciary duties by the corporation's directors. In response to the derivative action, the board appointed a single member of the board as a Special Litigation Committee ("SLC"), which thereafter sought to terminate the derivative suit. The Court denied the SLC's motion to terminate, concluding that the appointment of an SLC creates a presumption of interestedness at the pleading stage, but does not concede interestedness as a substantive matter. After the pleading stage, if defendants present evidence negating the accusation of interestedness, the "responsibility would then fall on [the plaintiff] to present evidence of self-dealing by the defendant."

4. Business Judgment Rule / Entire Fairness

a. *In re CNX Gas Corp. S'holders Litig.*, C.A. No. 5377-VCL, 2010 Del. Ch. LEXIS 119 (Del. Ch. May 25, 2010)

A controlling shareholder of the target company sought to acquire the remaining 16.5 percent of the stock of the target that it did not already own. Plaintiff investors challenged the proposed transaction as unfair and moved for a preliminary injunction. Criticizing the test established by *In re Siliconix Inc. S'holders Litig.*, Civ. No. 18700, 2001 WL 716787 (Del. Ch. June 19, 2001), the court refused to apply it on the basis that it did not apply to a freeze-out tender offer made by a controlling shareholder. The court then held that the tender offer did not satisfy the test set forth in *In re Cox Commc'ns, Inc. S'holders Litig.*, 879 A.2d 604 (Del. Ch. 2005), as the special committee set up by the target board did not affirmatively recommend the transaction and was not given authority to negotiate at arms' length. Therefore, the transaction would be subject to review for entire fairness rather than evaluated under the business judgment rule. However, although plaintiffs had demonstrated a probability of success on the merits of their claim that the transaction was unfair, they could not demonstrate a threat of irreparable harm because the transaction was not coercive, their unfair price claims could be redressed through monetary damages and their disclosure claims lacked merit.

b. *Monroe County Employees' Ret. Sys. v. Carlson*, C.A. No. 4587-CC, 2010 Del. Ch. LEXIS 132 (Del. Ch. June 7, 2010)

Plaintiff brought suit challenging a series of transactions between a corporation and its controlling stockholder. Defendants moved to dismiss the breach of fiduciary duty claims, arguing that even though the rigorous "entire fairness" standard applied, plaintiffs had failed to allege facts suggesting that an unfair price was obtained by the corporation from the controlling stockholder in the transactions. The court granted the defendants' motion to dismiss, holding that a "plaintiff must make factual allegations about the transaction in the complaint that demonstrate the absence of fairness," and that such allegations were absent.

5. Poison Pill & Other Defensive Measures

a. *Selectica, Inc. v. Versata Enters., Inc.*, Case No. 4241-VCN, 2010 Del. Ch. LEXIS 39 (Del. Ch. Feb. 26, 2010)

The court validated a poison pill designed to protect a company with substantial net operating loss carryforwards (NOLs), holding that preservation of NOLs is a valid corporate objective and a 4.99 percent trigger of the pill was a reasonable and proportionate response to the perceived threat to the company's NOLs and did not render the pill preclusive to a successful proxy contest.

b. *Versata Enterprises, Inc. v. Selectica, Inc.*, 5 A.3d 586 (Del. 2010)

After several years of sustaining a net loss, company's net operating loss carryforwards ("NOLs") were valued around $160 million and presented a significant tax benefit for future years if protected. Given the company's dire economic prospects, the NOLs were one of its most valuable assets. The company instituted a shareholder rights plan ("poison pill") to protect its NOLs by preventing a hostile takeover. Affirming the lower court, the Delaware Supreme Court held that the protection of the NOLs was an appropriate policy that justified defensive actions, and that the poison pill adopted by the company was reasonable under the circumstances and neither preclusive nor coercive.

c. *Yucaipa Am. Alliance Fund II, L.P. v. Riggio*, C.A. No. 5465-VCS, 2010 WL 3170806 (Del. Ch. Aug. 12, 2010)

Plaintiffs, an investor's funds, challenged defendant corporation's shareholder rights plan ("poison pill"), instituted in response to the acquisition of coproation stock by plaintiffs. After trial, the court found in favor of the corporation and its board of directors, rejecting plaintiff's argument that the strict "compelling justification" standard applied to the board's decision to implement the poison pill because the board's motivation was to protect the corporation, and not to thwart the exercise of a stockholder vote. The court also found that the use of the pill met the reasonableness and proportionality standard because: (1) the board had reasonable grounds for believing that a danger to the corporation existed; and (2) because the poison pill was a reasonable response to that threat.

d. *eBay Domestic Holdings, Inc. v. Craig Newmark and James Buckmaster*, C.A. No. 3705-CC, 2010 WL 3516473 (Del. Ch. Sept. 9, 2010)

Minority stockholder challenged the implementation of a staggered board, the adoption of a stockholder rights plan, and an issuance of new stock in exchange for a right of first refusal. The Court of Chancery upheld the implementation of a staggered board as a valid exercise of the board's business judgment, rescinded the adoption of the rights plan as an improper punitive measure, and rescinded the issuance of new stock as not entirely fair because the transaction diminished the economic value of the minority stockholder's holdings while increasing the value of the holdings of the two majority stockholders.

6. Misstatements and Omissions

a. *Maric Capital Master Fund, Ltd. v. PLATO Learning, Inc. et al.*, C.A. No. 5402-VCS, 2010 Del. Ch. LEXIS 115 (Del Ch. May 13, 2010)

Shareholders brought suit challenging the acquisition of a corporation. Plaintiffs sought to preliminarily enjoin a stockholder vote on the acquisition, arguing that the corporation had not adequately disclosed its internal projections and that other disclosures were materially misleading. The Court granted the preliminary injunction, finding that the proxy statement's description of how the discount rate used in a discounted cash flow analysis was determined was misleading, that a disclosure of management projections which omitted projected cash flows without explaining such omission was materially misleading, and that a disclosure that no compensation "negotiations" had taken place when compensation had been discussed, and the likely nature of such compensation had been explained to management by the acquirer, was materially misleading.

7. Other

a. *Saliba v. William Penn P'ship*, C.A. No. 111-CC, 2010 WL 1641139 (Del. Ch. Apr. 12, 2010)

Attorneys' fees. Plaintiffs successfully challenged certain transactions as self-dealing and unfair to the corporation and thereafter sought an award of attorneys' fees. In a very terse letter opinion, the court awarded attorneys' fees and court costs to plaintiffs because the court concluded that, in light of the defendants' breach of their fiduciary duties, it would be "unfair and inequitable to require plaintiffs to shoulder the costs incurred in demonstrating the unfairness of the sale process."

b. *Dubroff v. Wren Holdings, Inc.*, C.A. No. 3940-VCN, 2010 WL 3294219 (Del. Ch. Aug. 20, 2010)

Class certification. Plaintiff minority shareholders alleged breach of fiduciary duty by interested majority of board members—also constituting majority of company shareholders—after company sent allegedly inadequate notice of a recapitalization converting preferred debt into preferred stock to non-consenting minority shareholders. The court denied plaintiffs' motion for class certification, holding that plaintiffs would be required to prove reliance, causation and damages, and that those individualized issues defeated commonality.

c. *Lambrecht v. O'Neal*, 3 A.3d 277 (Del. Aug. 27, 2010)

Standing for double derivative suit. Plaintiffs, former stockholders of a corporation, asserted derivative claims on behalf of corporation before its acquisition in a stock-for-stock merger. Defendants moved to dismiss, arguing that plaintiffs lacked standing because they did not own stock in the acquiring corporation pre-merger, and because the acquirer did not own stock in the acquired corporation before the merger. The Delaware Supreme Court rejected those requirements, holding that standing to bring a post-merger double derivative suit only requires a plaintiff to have owned stock in the acquired corporation at the time of the alleged wrongdoing and continuously until the merger, together with continuous ownership of stock in the acquiring corporation since the merger.

d. *Hamilton Partners, L.P. v. Englard*, C.A. No. 4476-VCL, 2010 WL 5233010 (Del. Ch. Dec. 15, 2010)

Pleading requirements for double derivative suits. Shareholder brought a derivative action on behalf of a New York parent corporation and a double derivative action on behalf of its wholly-owned subsidiary, a Delaware corporation, for breach fiduciary duty by three of their directors. The Court of Chancery dismissed the derivative action on behalf of the New York parent company for lack of personal jurisdiction. The court, however, denied Plaintiff's motion to dismiss the double derivative action for lack of personal jurisdiction, holding that the New York parent company was not an indispensable party because the subsidiary owned the claims being asserted derivatively. Further, the court held that in a double derivative action involving a parent company and its wholly-owned subsidiary, (i) a plaintiff only needs to show demand futility with respect to the *parent* company and (ii) a plaintiff adequately pleads breach of fiduciary duty by showing that the subsidiary's directors were disloyal to the *parent* company and its shareholders.

e. *Airgas, Inc. v. Air Products and Chemicals, Inc.*, 8 A.3d 1182, 2010 WL 4734305 (Del. Nov. 23, 2010)

Validity of bylaws affecting annual meeting. Corporation appealed a denial of declaratory judgment that a bylaw proposed by an interloper-stockholder and approved by a bare majority of corporation stockholders which accelerated the annual meeting date by about seven months (four months after the previous annual meeting) was invalid. The Delaware Supreme Court found the bylaw was invalid because it was inconsistent with the charter's requirement that directors serve three year terms.

f. *CML V, LLC v. Bax*, No. 5373-VCL, 2010 WL 4347927 (Del. Ch. Nov. 3, 2010)

Creditor standing. Creditor brought derivative suit on behalf of an LLC against its managers alleging breaches of fiduciary duty. The Court of Chancery dismissed the action, holding that under the plain language of Delaware's LLC Act, creditors of LLCs do not have standing to bring derivative claims on behalf of the LLC.

XV. SECURITIES AND EXCHANGE COMMISSION ENFORCEMENT CASES

A. SUMMARY OF DEVELOPMENTS IN 2010

The SEC brought numerous enforcement cases of note in 2010. In *SEC v. Gerald H. Levine*, the District Court for the District of Columbia held individual defendants liable for violations of the Exchange Act committed by several sham corporations under the "alter ego" theory of liability, despite neither defendant having served as a named director or officer of the corporations. In addition, in *In re Reserve Fund Securities and Derivatives Litigation,* the SEC alleged that a money market fund and its investment advisors had made false statements regarding the net asset value of the fund in the wake of the collapse of Lehman Brothers. The Southern District of New York denied defendants' motion to dismiss, holding that the SEC's allegations regarding defendants' personal stakes in the fund met Rule 9(b)'s pleading requirements for scienter and that the PSLRA's heightened pleading requirements did not apply to the SEC. The Southern District of New York also approved a settlement between Bank of America and the SEC resolving the SEC's allegations that the bank failed to disclose bonus payments made by Merrill Lynch to its employees prior to its acquisition by Bank of America. In addition, the SEC brought claims in the District of Nebraska for securities fraud against an international marketing company, its former CEO, CFOs and the chairman of the audit committee arising from the former CEO's undisclosed compensation and related-party transactions. Most of those claims were settled. Finally, the 5th Circuit in *SEC v. Cuban* reversed the district court's dismissal of the allegations that Mark Cuban had misappropriated confidential information and engaged in insider trading, finding that Cuban's statements following his receipt of confidential information could be read as an implicit agreement not to trade on the information. The Court of Appeals remanded to the district court to determine the exact nature of the parties' understanding.

B. NOTEWORTHY SECURITIES AND EXCHANGE COMMISSION CASES IN 2010

1. Pleading Standards for Securities Fraud

a. *SEC v. Forman,* No. 07-11151-RWZ, 2010 WL 2367372 (D. Mass. June 9, 2010)

The SEC asserted claims of securities fraud under Section 17(a) of the Securities Act and Rule 10b-5, false or misleading statements under SEC Rules 13b2-1 and 13b2-2, and aiding and abetting under Section 13 of the Exchange Act and SEC Rules 12b-20, 13a-1, and 13a-13 against defendant controller for making material misstatements regarding a company's revenue and aiding and abetting the company in falsifying its financial statements. Specifically, the SEC alleged that defendant assisted in the improper recognition of revenue acquired from a prepaid transaction with an original equipment manufacturer agreement ("OEM"), and that defendant had knowingly included these material misstatements in the company's 10-Qs, 10-K, press releases, and earnings report conference calls. The SEC and defendant filed cross motions for summary judgment. The court denied the SEC's motion for summary judgment after finding that there was a genuine issue of material fact regarding whether defendant knew the nature of the transaction that contributed to the improper revenue recognition. Defendant's motion for summary judgment was denied in part and allowed in part. The court granted summary judgment as to part of the Section 17(a) count, specifying that there was no evidence that defendant "obtained money or property" by means of the alleged misstatements. The court denied summary judgment as to the rest of claims. The court also issued four rulings on the securities fraud claims. First, the court found that defendant's role in preparing the publically disseminated financial information was sufficient for primary liability to attach. Second, the court held that the revenue recognition upon the sale to the intermediary was inconsistent with both GAAP and the company's published revenue recognition policy, which dictated that revenue be recognized only upon sale to third parties. Third, the court found that the impact of the revenue misstatements was not immaterial as a matter of law because the misstatements in the filings accounted for approximately 4.5% of total revenue and 7.5% of product license revenue. Finally, the court held that there was sufficient evidence for a jury to conclude that defendant had acted recklessly because he stated he was aware that the transaction at issue was an "exception" to the revenue recognition policy, but he had failed to investigate further the nature of the transaction or to disclose that fact to investors. The court further ruled that allegations of falsifying records, making false statements to accountants and aiding and abetting the company's fraud turned on whether defendant had knowledge of the nature of the transaction at issue, and therefore must be determined by a jury.

b. *SEC v. Cuban*, No. 09-10996, 2010 WL 3633059 (5th Cir. Sept. 21, 2010)

The SEC asserted claims against Mark Cuban, a well-known businessman, under Section 10(b) of the Exchange Act and Rule 10b-5, alleging that Cuban misappropriated confidential information to engage in insider trading. The SEC alleged that Cuban received confidential information from the CEO of a company in which Cuban owned a minority share regarding a pending transaction which would decrease the share price. The SEC further alleged that Cuban's statement to the CEO—"Well, now I'm screwed. I can't sell."—constituted an agreement not to trade on the information and to keep it confidential. Accordingly, when Cuban traded on the information, the SEC contended that he was liable under the misappropriation theory of insider trading. Cuban filed a motion to dismiss, arguing that the complaint did not allege the requisite agreement not to trade. The district court agreed, and the SEC appealed. On appeal from the dismissal of the complaint by the district court, the 5th Circuit vacated the judgment and remanded to the district court for further proceedings. The 5th Circuit reasoned that Cuban's statement, and his subsequent access to the details of the transaction, could plausibly be read as an implicit agreement not to trade. Therefore, it was necessary to remand to the district court to resolve the precise nature of the understanding between the parties.

2. Scienter

a. *In re Reserve Fund Secs. and Derivatives Litig.*, Nos. 09-MD-2011, 09-CIV-4346, 2010 WL 685013 (S.D.N.Y. Feb. 24, 2010)

The SEC alleged that defendant money market fund, its investment advisors, and officers and directors were liable under Section 17(a) of the Securities Act, Sections 10(b) and 20(a) of the Exchange Act, and Sections 206(1), (2) and (4) of the Advisers Act for false statements and omissions made in the wake of Lehman Brothers' bankruptcy filing. When Lehman filed for bankruptcy, the fund, which held $785 million in Lehman debt securities, received a flood of redemption requests, causing the per-share NAV to drop below $1.00. The SEC alleged that defendants made false statements to the investing public regarding the level of redemption requests, the fund's resulting liquidity problems and attempts to obtain a credit support agreement to preserve a $1.00 NAV. The court denied defendants' motion to dismiss, holding that the PSLRA's heightened pleading standard for scienter did not apply to actions brought by the SEC, and the Commission's allegations regarding defendants' personal and reputational stakes in the fund and knowledge of the falsity of their statements were sufficient to satisfy Rule 9(b). Further, the court held that the alleged misstatements and omissions were material and that defendants could be held liable for misstatements and omissions made by their sales staff because defendants had approved those communications.

b. *SEC v. Leslie*, No. C 07-3444, 2010 U.S. Dist. LEXIS 76826 (N.D. Cal. July 29, 2010)

In an SEC enforcement action, the SEC alleged that defendants had made misrepresentations to auditors that led to misstated financial results. Defendants moved for summary judgment, which the court granted in part and denied in part. The court found that there was evidence that each defendant had acted with scienter in making false statements to the company's auditors, which satisfied the required mental state for all of the claims except for the internal controls violations and the aiding and abetting claims. The court also found that defendants' misrepresentations were not immaterial as a matter of law. The court determined, however, that the statute of limitations had expired for civil penalties against two of the defendants, and that a director and officer bar would serve no purpose other than punishment, so it denied this request for relief.

3. Insider Trading

a. *SEC v. Binette*, 679 F. Supp. 2d 153 (D. Mass. 2010)

The District of Massachusetts denied defendants' motion to dismiss an SEC action alleging insider trading in violation of Section 10(b) of the Securities Exchange Act and Rule 10b-5. The SEC alleged that defendant Talbot, while working as vice president at an investment management company, unlawfully shared material non-public information about the company's attempt to acquire another company with defendant Binette, who used the information to make investments. The court held that the SEC had sufficiently alleged materiality because a reasonable investor could plausibly have considered the information Talbot allegedly misappropriated important in deciding whether to buy the stock. The court also held that the SEC's complaint sufficiently alleged Binette's liability, even though he was not a corporate insider, under the "tippee liability" theory because Binette received or misappropriated the nonpublic information and that he knew or should have known that Talbot had breached his fiduciary duty to the company.

4. Statute of Limitations

a. *S.E.C v. Kearns,* No. 09-3599, 2010 WL 715467 (D.N.J. Feb. 23, 2010)

The SEC brought this securities fraud action against the CFO of a medical transcription provider, alleging that he helped further and conceal the company's fraudulent billing scheme and made omissions that created the misleading impression that the company's financial performance was due to legitimate business practices. Defendant moved to dismiss, arguing that plaintiff's suit was time-barred because the limitations period accrued with the alleged *violation* and plaintiff could not establish equitable tolling of the limitations period because it did not plead affirmative acts of concealment separate from the actual fraud. The court rejected that argument, holding that the statute of limitations in 28 U.S.C. § 2462 is equitably tolled until the date of *discovery* for claims sounding in fraud so long as the plaintiff pursues its claim with diligence. Based on plaintiff's allegations that none of the financial filings prepared by defendant revealed the fraudulent billing scheme and that defendant reassured auditors that the company had no problems with billing, the court concluded that there was no indication on the face of the complaint that plaintiff could have uncovered the fraud before the scheme was revealed. Defendant also argued that none of his statements to shareholders and the public were misleading because his statements that the company's revenues were based on "contract rates" and that increased revenues were due to increased sales were both true. The court, however, held that that the question of whether defendant's statements were accurate raised a disputed issue of fact that could not be decided on a motion to dismiss, although the court did dismiss securities fraud claims based on the company's statements that it followed "disciplined business practices," on the ground that it was apparent on the face of the complaint that such generic statements were not material and did not create an obligation to provide further information.

b. *Riordan v. SEC,* No. 10-1034, 2010 WL 5299662 (D.C. Cir. Dec. 28, 2010)

The SEC brought a civil enforcement action against the defendant, the owner of a brokerage firm, for violation of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5. Specifically, the SEC alleged that the defendant paid kickbacks to New Mexico's treasurer in exchange for state business. An SEC administrative law judge found the defendant liable and imposed sanctions, including civil fines and the disgorgement of profits. Defendant petitioned the D.C. Circuit for review, arguing that the disgorgement order was barred under the five-year statute of limitations contained in 28 U.S.C. § 2462, because the order was based on conduct that occurred outside of the limitations period. The D.C. Circuit denied the defendant's petition, holding that disgorgement orders are not subject to the statute of limitations contained in 28 U.S.C. § 2462, so long as the disgorged amount is causally related to the wrongdoing.

5. Substantial Assistance

a. *S.E.C v. Conaway*, No. 2:05-CV-40263, 2010 WL 318283 (E.D. Mich. Jan. 20, 2010)

Following a three-week trial, a jury determined that the defendant, former CEO of Kmart Corporation, violated Section 10(b) of the Exchange Act, as well as aided and abetted Kmart's violation of Sections 10(b) and 13(b). Defendant filed a motion for judgment as a matter of law or, in the alternative, for a new trial. Other than finding that one alleged misstatement was not supported by sufficient evidence, defendant's motion was denied and the jury's verdict was upheld. The record supported a conclusion that the defendant provided "substantial assistance" to Kmart in the commission of the fraud and that his assistance "was knowingly rendered" because defendant was at the center of Kmart's response to the liquidity crisis, he approved the vast program of delaying payments to Kmart's vendors in a manner that would appear to have invoices "hung up in processing," and he approved a cover story and used it repeatedly to mislead Kmart's Board of Directors, employees and the investing public about the true source of vendor payment delays. Based on this evidence, the jury could conclude that defendant was the driving force behind the fraud and therefore knowingly and substantially participated in violations of Section 10(b) and 13(a). In addition, because of defendant's personal statements on a conference call and his involvement in Kmart's response to the liquidity crisis, including the misrepresentations made by him and others with his knowledge or approval, there was sufficient evidence to uphold the jury's finding of his primary liability.

b. *SEC v. Brown*, No. 09-1423 (GK), 2010 WL 3786563 (D.D.C. Sept. 27, 2010)

The SEC brought suit against defendants, corporate officers, alleging that they omitted material information in filings with the SEC and in proxy statements in violation of Section 17 of the Securities Act, Sections 10 and 14(a) of the Exchange Act, and Exchange Act Rules 10b-5, 13a-14 and Rule 14a-9. Defendants moved to dismiss on the grounds that the claims against them were barred by the statute of limitations, failed to state a claim under Rule 12(b)(6), and failed to allege primary liability. The court deferred consideration of the statute of limitations defense, finding that while the civil penalties sought by the SEC were subject to the statute, it needed a more complete factual record to evaluate the SEC's claim that the limitations period should be tolled under the "continuing violations" doctrine. The court granted the defendants' 12(b)(6) motion with respect to the SEC's Section 17(a) claim on the basis that the complaint was devoid of any allegation that an offer or sale of securities ever occurred. Finally, the court rejected the argument that the complaint failed to allege primary liability for violations of the securities laws. Though the D.C. Circuit has not yet adopted a test for primary liability, the court found that the allegations were sufficient to establish liability under any circuit's test for primary liability.

6. Other

a. *SEC v. Bank of America Corp.*, No. 09 Civ. 6829, No. 10 Civ. 0215, 2010 U.S. Dist. LEXIS 15460 (S.D.N.Y. Feb. 22, 2010)

In an effort to resolve two cases alleging that defendant bank violated Section 14(a) of the Exchange Act based on a failure to disclose large bonuses paid to executives and significant losses suffered by target bank in proxy materials, plaintiff SEC and defendant submitted a proposed consent judgment for court approval. The court approved the proposed settlement because the law required judicial deference to decisions made by the SEC.

b. *SEC v. Whittemore*, 691 F. Supp. 2d 198 (D.D.C. Mar. 9, 2010)

The SEC entered into a consent to entry of judgment with defendants by which defendants agreed that the court would order, and defendants would pay, disgorgement of ill-gotten gains, pre-judgment interest, and civil penalties resulting from defendants' fraudulent stock sales. Defendants contested the amount of disgorgement argued for by plaintiffs, asserting that the amount did not "offset" the value of the stock shares prior to the fraud, and that plaintiffs failed to offer evidence that defendants had not paid this "pre-fraud" amount. In refusing to grant defendants' offset, the court relied on longstanding precedent establishing that, where defendants have exercised their Fifth Amendment rights in a civil proceeding, the court may draw an adverse inference. The court also noted that such a finding is appropriate where the relevant evidence is "peculiarly in control of the Defendants."

XVI. SEC RULES AND GUIDANCE

A. SUMMARY OF DEVELOPMENTS IN 2010

The SEC issued several noteworthy rules in 2010, including Rule 201, which restricts short selling on a stock once the price of the stock has dropped more than 10 percent from the prior day's closing price. The SEC also adopted new rules governing money market funds, including a rule that requires a minimum percentage of money market funds' assets to consist of highly liquid securities. Other significant rules adopted by the SEC in 2010 include rules prohibiting investment advisors from engaging in "pay to play" practices with government entities, requiring increased disclosures and monitoring of the underlying assets from issuers of asset-backed securities, and requiring companies to hold non-binding shareholder votes on executive pay packages.

B. NOTEWORTHY RULES AND GUIDANCE ISSUED BY THE SEC IN 2010

1. SEC Adopts New Restrictions on Short Selling

The SEC adopted Rule 201, known as the alternative uptick rule, on February 24, 2010, to restrict short selling from further driving down the price of a stock that has dropped more than 10 percent from the prior day's closing price. The rule enables long sellers to sell their shares before any short sellers for the remainder of the day once the 10 percent threshold is triggered. The rule applies to all equity securities, including those traded on an exchange or in the over-the-counter market, and requires trading centers to establish, maintain and enforce written policies and procedures that are reasonably designed to prevent the execution or display of a prohibited short sale.

2. SEC Adopts New Rules for Money Market Funds

On February 22, 2010, the SEC adopted new rules designed to strengthen the regulatory requirements governing money market funds. The new rules require a minimum percentage of money market funds' assets to be in highly liquid securities. Specifically, 10 percent of assets must be in securities that can be converted to cash within one day, and 30 percent of assets must be in securities that can be converted to cash within one week. The rules redefine "illiquid security" as any security that cannot be disposed of within seven days at carrying value and restricts money market funds from purchasing illiquid securities if, after the purchase, more than 5 percent of the fund's portfolio becomes illiquid. The new rules also require funds to hold sufficiently liquid securities to meet foreseeable redemptions, and collateral must be cash items or government securities.

In addition, while the new rules continue to limit the funds' investments to securities rated in the top two rating categories of the NRSRO conducting the rating, funds must now also perform an independent credit analysis of every security purchased. Money market funds also must post their portfolio holdings on their websites and report detailed portfolio schedules to the SEC. The new rules also allow funds and administrators to process purchases and redemptions electronically at a price other than one dollar per share. Further, funds are now authorized to suspend redemptions if the fund is in danger of "breaking the buck," but the fund must notify the Commission prior to doing so.

3. SEC Imposes Pretrade Verification Rules

On November 15, 2010, the SEC announced the adoption of a rule that requires brokers to verify all automated trades to ensure the trades are compliant with securities laws and regulations before the trades hit the open market. The rule will be effective 60 days after November 15, 2010 and brokers must comply with the new rule within six months. SEC Rule 15c3-5 ends "naked access" where clients can trade online using a broker's "market participant identifier" without the broker reviewing the trades. Currently, naked access accounts for at least 38 percent of the daily trade volume. The new rule requires traders to set up systems to review all trades to prevent erroneous trades. Brokers will be required to keep a record of verification procedures and must review these procedures once a year to make sure they continue to comply with SEC regulations.

4. SEC Adopts Rule to Prohibit "Pay to Play" Practices

On June 30, 2010, the SEC approved Rule 206(4)-5, which imposes limitations on investment advisers with regards to solicitation of capital commitments from US government entities. The new rule also prohibits political contributions or gifts to US government entities by investment advisers who provide or seek to provide investment advisory services to such US government entities. These investment companies are also prohibited from providing payments to third parties to solicit a state or local government entity on behalf of itself unless the third party is also a registered investment adviser with the SEC and subject to this rule or similar "pay to play" rules. If an investment adviser contributes to an official or government entity, that investment adviser is prohibited from receiving compensation from that official or government entity with respect to any investment advisory services it provides within two years of the contribution. The investment adviser is also prohibited from soliciting any person or political action committee to make a political contribution to a government entity for which the investment adviser is providing investment advisory services. Prohibited payments are broadly defined to include any direct or indirect payment. Thus, any indirect act, which, if made directly, would violate the rule, is also prohibited. The rule became effective September 13, 2010.

5. SEC, in Split Vote, Adopts "Say on Pay" Rule

The SEC adopted new regulations to require companies to hold nonbinding shareholder votes on executive-pay packages. The regulations require companies to hold nonbinding shareholder votes on executive pay packages at least once every three years beginning at the first annual shareholder meeting to occur on or after January 21, 2011. The new rules also require companies to disclose "golden parachutes" for departing executives in their merger proxy statements and to hold advisory votes on the proposed compensation. These rules implement a mandate derived from the Dodd-Frank Act requiring companies to hold advisory votes at least once every six years, in order to allow shareholders to say how frequently they want to hold the "Say on Pay" votes. For the next two years, companies that have less than $75 million outstanding shares available for trading in the public markets and that also file proxy statements are exempt from the new regulations. The two year exemption given to the smaller companies does not apply to the golden parachute rules. The companies are not bound by the advisory votes, but companies will have to disclose whether and how they considered the voting results.

6. SEC OKs Disclosure Rules for Asset-Backed Securities

The SEC approved two sets of rules directed at reducing risks surrounding asset-backed securities. The first set of rules requires asset-backed securities issuers to file with the SEC a three-year repurchase history, as well as requests they have received for their outstanding asset-backed securities. The first filing would be due February 12, 2012. Every quarter, issuers will be required to update the repurchase histories and fulfilled and unfulfilled repurchase requests. Investors will have full access to repurchase histories dating back for the last three years, and issuers' representations, warranties and enforcement mechanisms will fall under new scrutiny from Nationally Recognized Statistical Rating Organizations.

The second set of rules requires registered issuers to review the assets underlying the asset-backed securities to ensure the information in the prospectus disclosures is accurate. Third parties may conduct the review if they are named in the registration statements and constitute experts under securities law. Under the new rules, issuers must also explain why loans that fell short of underwriting criteria were included in a pool and disclose information about the nature of those loans and the entity that cleared them for inclusion in the pool. All asset-backed securities offerings commencing after December 31, 2010 must comply with the two new sets of rules.

7. A Review of SEC Proxy Access Rules for Public Companies

On August 25, 2010 the SEC adopted proxy access rules with two components: (1) establishing a federal proxy access right pursuant to Rule 14a-11, and (2) amending Rule 14a-8 to permit shareholder proposals that would establish additional, more flexible proxy access procedures.

Rule 14a-11 requires companies to provide information about the ability to vote for a shareholder's nominees for director in proxy materials. Companies will now be required to include in their proxy materials nominees for directors submitted by shareholders that hold a significant, long-term interest in the company and have provided timely notice and disclosure concerning themselves and their nominees. Eligible shareholders must beneficially own at least 3 percent of the total voting power and have held such minimum amount for at least three years as of the date of the filing. Companies cannot "opt out" of Rule 14a-11, even if the company does not have a provision in its governing documents providing for or prohibiting the inclusion of shareholder nominees in its proxy materials. Under the new rules, nominating shareholders will not lose their eligibility to file abbreviated beneficial ownership reports as passive investors under Schedule 13G.

The SEC also amended Rule 14a-8(i)(8). Previously, the rule allowed companies to exclude from their proxy statements a shareholder proposal that relates to a nomination or election for membership on the company's board of directors or procedures for such nomination or election. Under the new amendment, companies would no longer be able to rely on this rule to exclude a proxy access shareholder proposal. The amendment only applies if the proposals do not conflict with or limit Rule 14a-11 and are not otherwise excludable under Rule 14a-8.

XVII. DEVELOPMENTS WITH THE PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD IN 2010

A. SUMMARY OF DEVELOPMENTS IN 2010

The Public Company Accounting Oversight Board ("PCAOB" or "Board") issued several notable releases and concluded several disciplinary proceedings in 2010. The PCAOB announced, for example, that it had approved Auditing Standard No. 7, Engagement Quality Review, which requires that a quality review be completed for each audit engagement. The PCAOB also proposed for comment an auditing standard for communications with audit committees, which requires that the auditor establish mutually agreeable terms of the audit engagement with the committee and document that understanding in an engagement letter. In addition, the PCAOB issued Staff Audit Practice Alert No. 5, which compiles existing requirements from PCAOB auditing standards regarding significant unusual transactions, to remind auditors of their responsibilities to assess the risk of misstatement related to significant unusual transactions. The PCAOB also announced a staff guidance update related to the registration process for applicants from non-US jurisdictions in which the PCAOB is prevented from inspecting PCAOB-registered firms. The PCAOB also issued a statement summarizing the Supreme Court's decision in *Free Enterprise v. PCAOB*, 130 S.Ct. 3138 (2010), which held that the Sarbanes-Oxley Act's provisions making PCAOB Board members removable by the SEC only for good cause were inconsistent with the U.S. Constitution's separation of powers. The statement recognized that as a consequence of the decision, PCAOB Board members will be removable by the SEC at will, rather than only for good cause. The PCAOB also approved a proposed audit standard, "Confirmation," for public comment; released a statement regarding the recently signed Dodd-Frank Act; and adopted a suite of eight auditing standards related to an auditor's assessment of, and response to, risk in an audit. Lastly, the Board published an alert prompted by observations that some American firms were issuing audit reports based upon work performed by persons outside the United States who were not properly applying PCAOB standards, and another alert reminding auditors of public companies about their responsibilities when auditing loss contingencies, disclosures, and related items.

During 2010, the PCAOB also brought disciplinary proceedings against several persons and accounting firms. Such proceedings were brought against two former auditors of e-commerce service business upon finding that the auditors were aware of materially contradictory evidence of certain collection rates and failed to obtain reasonable assurances regarding the actual rates in light of this evidence. The PCAOB also barred two auditors of an Indian IT company from being associated persons of a registered accounting firm as a result of their noncooperation with a Board investigation. Another firm's registration was revoked, and its principal barred, based upon violations of PCAOB rules and auditing standards in connection with the auditing of the 2006, 2007 and 2008 financial statements of an issuer client. In addition, an auditor was barred, and her associated firm's registration revoked, due to violations of PCAOB rules and auditing standards in connection with the auditing of three issuer clients from 2007 to 2009. The registration of another firm was permanently revoked and an auditor barred and fined $75,000 following noncooperation with a Board investigation. Finally, a former auditing company employee was censured following violations of PCAOB rules and auditing standards in connection with the improper removal, addition, and backdating of audit documentation prior to a Board inspection.

B. NOTABLE RELEASES IN 2010

1. PCAOB Auditing Standard on Engagement Quality Review Approved by SEC, Effective for Fiscal Years Beginning December 15, 2009

On January 15, 2010, the PCAOB announced that the SEC had approved Auditing Standard No. 7, Engagement Quality Review. Auditing Standard No. 7 provides that an engagement quality review and concurring approval of issuance are required to be performed for each audit engagement and for each engagement to review interim financial information. The Standard provides a framework for the quality reviewer to evaluate the significant judgments made by an engagement team in forming its overall conclusion about the engagement. The engagement quality reviewer must be a partner, or the equivalent of a partner, of the firm that issues the engagement report or of another registered public accounting firm. The Standard is effective for engagement quality reviews of audits and interim reviews for fiscal years beginning on or after December 15, 2009.

2. PCAOB Proposed Auditing Standard on Communications With Audit Committees, Amendments to PCAOB Interim Standards

On March 29, 2010, the PCAOB proposed for comment an auditing standard on communications with Audit Committees and a series of related amendments to its interim standards. The proposed standard requires that the auditor establish a mutual understanding of the terms of the audit engagement with the audit committee and document that understanding in an engagement letter. The proposal also includes requirements relating to: (1) communication of an overview of the audit strategy, including a discussion of significant risks, the use of the internal audit function, and the roles, responsibilities, and location of firms participating in the audit; (2) communication regarding critical accounting polices, practices, and estimates; (3) communication regarding the auditor's evaluation of a company's ability to continue as a going concern; and (4) evaluation by the auditor of the adequacy of the two-way communications. The proposed auditing standard would supersede PCAOB interim standards AU Section 380, Communication With Audit Committees, and AU Section 310, Appointment of the Independent Auditor, as well as amend several other interim standards.

3. PCAOB Issued Staff Audit Practice Alert No. 5

On April 7, 2010, the PCAOB issued Staff Audit Practice Alert No. 5 to remind auditors of public companies about their responsibilities to assess and respond to the risk of material misstatement of financial statements due to error or fraud posed by significant unusual transactions. Staff Audit Practice Alert No. 5 compiles existing requirements from PCAOB auditing standards regarding significant unusual transactions and groups them into the following categories: (1) identifying and assessing risks of material misstatement; (2) responding to risks of material misstatement; (3) consulting others; (4) evaluating financial statement presentation and disclosure; (5) communicating with audit committees; and (6) reviewing interim financial information.

4. PCAOB Published Updated Staff Guidance Related to Registration Process for Applicants from Certain Non-US Jurisdictions

On June 1, 2010, the PCAOB announced a staff guidance update related to the registration process for applicants from non-US jurisdictions where the PCAOB is prevented from inspecting PCAOB-registered firms. Currently, the affected jurisdictions are the thirty European countries following the European Union's Directive on Statutory Auditors, China, Hong Kong, and Switzerland. The guidance alerts applicants from these jurisdictions that the staff intends to recommend that the Board request certain supplemental information before acting on their applications. It also explains how an applicant can seek to avoid delay by including such information when first submitting an application. The information sought includes facts about public company audits in which the applicant has recently been involved or expects to play any role and information about other PCAOB-registered firms in whose audits the applicant expects to participate in any manner. The Board expects that this information will facilitate a better understanding of the scope and nature of an applicant's activities related to SEC-reporting companies. The new guidance appears in a supplement to the staff’s answers to frequently asked questions on the registration of non-US firms.

5. Statement on Decision in *Free Enterprise Fund v. PCAOB*

On June 28, 2010, the PCAOB released a statement in connection with the decision of the US Supreme Court in *Free Enterprise Fund v. PCAOB*, 130 S.Ct. 3138 (2010). In that decision, the Supreme Court held that the Sarbanes-Oxley Act's provisions making PCAOB Board members removable by the Securities and Exchange Commission (SEC) only for good cause were inconsistent with the U.S. Constitution's separation of powers. As a result, PCAOB Board members will be removable by the SEC at will, rather than only for good cause. Because the Court severed these provisions from the Act, however, no legislation is necessary to bring the Board's structure within constitutional requirements. All other aspects of the SEC's oversight, the structure of the PCAOB and its programs are otherwise unaffected by the Court's decision.

6. PCAOB Issued Staff *Audit* Practice Alert Regarding Requirements When Using Work of Other Auditors or Engaging Outside Assistants

On July 12, 2010, the PCAOB published a Staff Audit Practice Alert prompted by observations that some US-based firms were issuing audit reports based upon work performed by persons or groups outside the United States who were not properly applying PCAOB standards. In recent years, the securities of some companies, particularly those operating in China, have come to trade in the United States due to reverse mergers with US shell entities. For many such companies, the audit report is issued by registered public accounting firms located in the United States, even though the majority of audit procedures are performed by auditing firms or individuals located outside of the United States. The practice alert reminds registered firms of their obligations when using the work of other firms or outside assistants. It describes the circumstances under which the firm issuing the audit report may use the work and reports of another auditor. The alert also notes that auditors who engage assistants from outside the firm are governed by the same planning and supervision standards that apply to auditors supervising work performed by assistants who are employed by the auditor's own firm.

7. PCAOB Statement Upon Signing of the Dodd-Frank Wall Street Reform and Consumer Protection Act

On July 21, 2010, the PCAOB released a statement regarding the recently signed Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). The Dodd-Frank Act allows the PCAOB to share information with foreign auditor oversight authorities under certain circumstances. The Dodd-Frank Act also expands the PCAOB's authority to oversee auditors of brokers and dealers. Under the Sarbanes-Oxley Act, auditors of brokers and dealers were required to register with the Board. The Dodd-Frank Act provides the PCAOB with standard-setting, inspection and disciplinary authority over broker-dealer audits.

8. PCAOB Adopted New Auditing Standards on Risk Assessment

On August 5, 2010, the PCAOB adopted a suite of eight auditing standards related to an auditor's assessment of, and response to, risk in an audit. These risk assessment standards, Auditing Standards No. 8 through No. 15, set forth requirements aiming to enhance the effectiveness of an auditor's assessment of, and response to, the risks of material misstatement in financial statements. These standards supersede six PCAOB interim standards and related amendments: AU Section 311, *Planning and Supervision*; AU Section 312, *Audit Risk and Materiality in Conducting an Audit*; AU Section 313, *Substantive Tests Prior to the Balance Sheet Date*; AU Section 319, *Consideration of Internal Control in a Financial Statement Audit*; AU Section 326, *Evidential Matter*; and AU Section 431, *Adequacy of Disclosure in Financial Statements*. The standards were approved by the SEC and became effective for audits of fiscal periods beginning on or after December 15, 2010.

9. PCAOB Issued Release on Failure to Supervise

On August 5, 2010 the PCAOB issued a Release discussing Section 105(c)(6) of the Sarbanes-Oxley Act that authorizes the Board to impose sanctions on registered public accounting firms and their supervisory personnel for failing to reasonably supervise associated persons. Part I of the release highlighted the scope of Section 105(c)(6). The PCAOB did not seek public comment because Part I was not a rule or rule proposal. Part II of the Release discussed concepts relating to possible rulemaking or standard setting that, without imposing any new supervisory responsibilities, would require firms to make and document clear assignments of pre-existing supervisory responsibility requirements.

10. PCAOB Published Staff Audit Practice Alert on Auditor Considerations of Litigation and Other Contingencies Arising from Mortgage and Other Loan Activities

On December 20, 2010, the PCAOB published a Staff Audit Practice Alert to inform auditors of public companies about their responsibilities when auditing loss contingencies, disclosures, and related items. The alert advises auditors that mortgage and foreclosure-related activities or exposures could have implications for audits of financial statements or on internal controls over financial reporting. These implications might include accounting for litigation or other loss contingencies and related disclosures.

C. NOTABLE DISCIPLINARY PROCEEDINGS IN 2010

1. *In the Matter of Jennifer Nakao, CPA*, PCAOB Release No. 105-2010-002 (Order Making Findings and Imposing Sanctions) and *In the Matter of Ray O. Westergard, CPA*, PCAOB Release No. 105-2010-003 (Order Making Findings and Imposing Sanctions)

In two related February 17, 2010 orders, the PCAOB barred one respondent auditor from being associated with a registered public accounting firm and suspended another from being associated with a registered public accounting firm for a period of one year. The PCAOB imposed these sanctions on the basis of its findings concerning respondents' violations of PCAOB rules and auditing standards in auditing the 2004 financial statements of an e-commerce services company. Most of the company's FY 2004 revenue came from sales of software licenses to customers who were given 24-month extended payment term arrangements (EPTAs) to finance their purchases. Respondents failed to ensure that the engagement team sufficiently tested management's representations of its historical collection experience for EPTA sales. Moreover, respondents were aware of materially contradictory evidence of the collection rates of the company's EPTAs, but failed to obtain reasonable assurance regarding the actual rates in light of this contradictory evidence. In addition, respondents failed to ensure that sufficient procedures were performed to test or assess the reasonableness of certain EPTA collection rates disclosed by the company in the footnotes to its FY 2004 financial statements and in other SEC filings. Finally, respondents failed to assess the reasonableness of the company's allowance for doubtful accounts.

2. *In the Matter of Siva Prasad Pulavarthi*, PCAOB Release No. 105-2010-004 (Order Instituting Disciplinary Proceedings, Making Findings, and Imposing Sanctions) and *In the Matter of Chintapatla Ravindernath*, PCAOB Release No. 105-2010-005 (Order Instituting Disciplinary Proceedings, Making Findings, and Imposing Sanctions)

In two related March 16, 2010 orders, the PCAOB barred two respondent auditors from being an associated person of a registered accounting firm for noncooperation with a Board investigation by failing to comply with demands for their testimony. PCAOB sent respondents a demand that required their appearance for testimony on March 10, 2009 regarding prior audits performed for an Indian IT company. After the PCAOB made several attempts to accommodate respondents with respect to the dates and location of testimony, including a delay to allow new counsel to become familiar with the matter, respondents informed the PCAOB in January 2010 that they would not comply with the demands.

3. *In the Matter of Robert T. Taylor, CPA and Robert T. Taylor, CPA*, PCAOB Release No. 105-2010-006 (Order Instituting Disciplinary Proceedings, Making Findings, and Imposing Sanctions)

In an April 27, 2010 order, the PCAOB revoked the registration of an auditing firm and barred its proprietor from being an associated person of a registered public accounting firm for violations of PCAOB rules and auditing standards in connection with the auditing of the 2006, 2007 and 2008 financial statements of an issuer client. In each audit year and in significant audit areas, respondents failed to: (1) plan adequately for the audit; (2) perform audit procedures on the issuer's assets and liabilities; (3) consider whether certain assets still existed or were impaired; and (4) prepare and maintain sufficient audit documentation. Additionally, respondents failed to plan for the risk of material error or fraud, failed to consider related-party transactions to be an area of risk and failed to adequately document planning procedures. The respondent auditor stated that he "relied on . . . the previous year's audit figures and made inquiries as to the changes . . . other than that, I did nothing."

4. *In the Matter of Traci Jo Anderson and Traci Jo Anderson, CPA*, PCAOB Release No. 105-2010-007 (Order Instituting Disciplinary Proceedings, Making Findings, and Imposing Sanctions)

In an August 12, 2010 order, the PCAOB revoked the registration of an auditing firm and barred its proprietor from being an associated person of a registered public accounting firm for violations of PCAOB rules and auditing standards in connection with the auditing of three issuer clients from 2007 to 2009. Violations included the failure to perform sufficient procedures related to: (1) the capitalization of software costs; (2) the value of capitalized software; (3) outstanding and future warrants; (4) the value of stock issued for services; and (5) contract revenues. In addition, respondents had failed to prepare audit documentation.

5. *In the Matter of Larry O'Donnell, CPA, P.C. and Larry O'Donnell, CPA*, PCAOB File No. 105-2010-002 (Final Decision)

In an October 19, 2010 decision, the PCAOB permanently revoked the registration of an auditing firm and barred its proprietor from being an associated person of a registered public accounting firm due to noncooperation with a PCAOB investigation. The PCAOB also imposed a civil penalty of $75,000 on the auditor respondent.

6. *In the Matter of Jacqueline A. Higgins, CPA*, PCAOB Release No. 105-2010-008 (Order Instituting Disciplinary Proceedings, Making Findings, and Imposing Sanctions)

In a December 3, 2010 order, the PCAOB censured an auditor for violations of PCAOB rules and auditing standards in connection with the improper removal, addition, and backdating of audit documentation prior to a Board inspection. The auditor was a manager in a regional office of a large registered public accounting firm. The accounting firm removed the censured auditor from its audit engagement team in July 2010, and at that time she ceased participating in issuer audit engagements.