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January 11, 2011

2010 YEAR-END SECURITIES LITIGATION UPDATE

In the Second Half of 2010, Federal Courts Wrestled with Numerous Important Issues in a Busy Year for Securities Litigation and SEC Enforcement, as New Case Filings Rebounded, and Settlements Reached Historic Highs

To Our Clients and Friends:

We reported in Gibson Dunn's 2010 Mid-Year Securities Litigation Update that the first half of 2010 was a busy one for securities litigation. That has remained so in the second half of the year. The securities litigation landscape has featured ongoing battles in the trial courts regarding the scope and application of the Supreme Court's decision in *Morrison* holding that purchasers on foreign exchanges cannot bring an action under Section 10(b) of the 1934 Act. As we discuss more fully below, Plaintiffs are employing various strategies in their attempts to bring actions on behalf of foreign purchasers in U.S. courts despite the Supreme Court's explicit rejection of U.S. federal court jurisdiction for such claims, including initiating claims in state court, under state law, and even under foreign law, as well as arguing that a transaction is domestic when the investment decision is made in the U.S. To date, none of these strategies has been successful. We expect these disputes to continue in the district courts and to eventually make their way up to the courts of appeal.

Several other important securities cases are pending before the Supreme Court, or likely to be taken up by the Court in the current term. In *Janus Capital Group Inc. v. First Derivative Traders*, which was argued before the Supreme Court on December 7, 2010, the Court will revisit once again the extent to which a private plaintiff can bring an action under Section 10(b) of the 1934 Act against secondary actors. The case involves the question of whether a service provider (here, an investment adviser) that assisted in the drafting and issuance of another company's prospectuses can be held liable for securities fraud, based upon the service provider's alleged role in preparing the other company's statements. The *Siracusano* case, discussed in our Mid-Year Update, involving materiality and whether there must be statistically significant information suggesting that a product is unsafe, is pending before the Court with oral arguments scheduled on January 11, 2011. As well, the Court recently granted a petition for writ of *certiorari* regarding the Fifth Circuit's holding in *Archdiocese of Milwaukee Supporting Fund Inc. v. Halliburton Co.* (now captioned *Erica P. John Fund, Inc. v. Halliburton Co.*), the latest in a line of Fifth Circuit cases, beginning with *Oscar Private Equity*, requiring a showing of loss causation to obtain the benefit of the fraud-on-the-market presumption of reliance at the class certification stage. A circuit split has developed over the issue, with the Seventh Circuit in *Schleicher v. Wendt* explicitly rejecting *Oscar* and its progeny. The Supreme Court in *Halliburton* is likely to resolve the split.

With respect to filing and settlement trends, new securities class action filings have picked up significantly and the number of filings this year is on track to exceed last year's total, according to statistics compiled by NERA Consulting. Settlement values continue to set new records, demonstrating the enduring risks that securities litigation poses to companies, officers and directors, and their insurers. Although the pace of new securities litigation filings related to the "credit crisis" continued to decline in 2010, there were nevertheless many significant cases in this area in the second half of 2010, some of which demonstrated an increasingly high bar being set by courts on plaintiffs to establish actionable misstatements and scienter at the pleading stage. Plaintiffs nevertheless secured some favorable results in 2010, including the first ever jury verdict in a credit crisis case.

Finally, in the world of SEC Enforcement, the Ninth Circuit's reversal of a criminal conviction of a public company's CFO in *Goyal*; the Fifth Circuit's reversal of the dismissal of the SEC's insider trading enforcement action against Dallas Mavericks owner Mark Cuban; the recent highly-publicized raids of hedge fund's offices in an SEC and DOJ insider trading investigation; and the SEC's award of a $1 million bounty to a whistleblower in an insider trading action, all demonstrate the increasing strength of SEC Enforcement investigations and proceedings, which we believe will continue in 2011.

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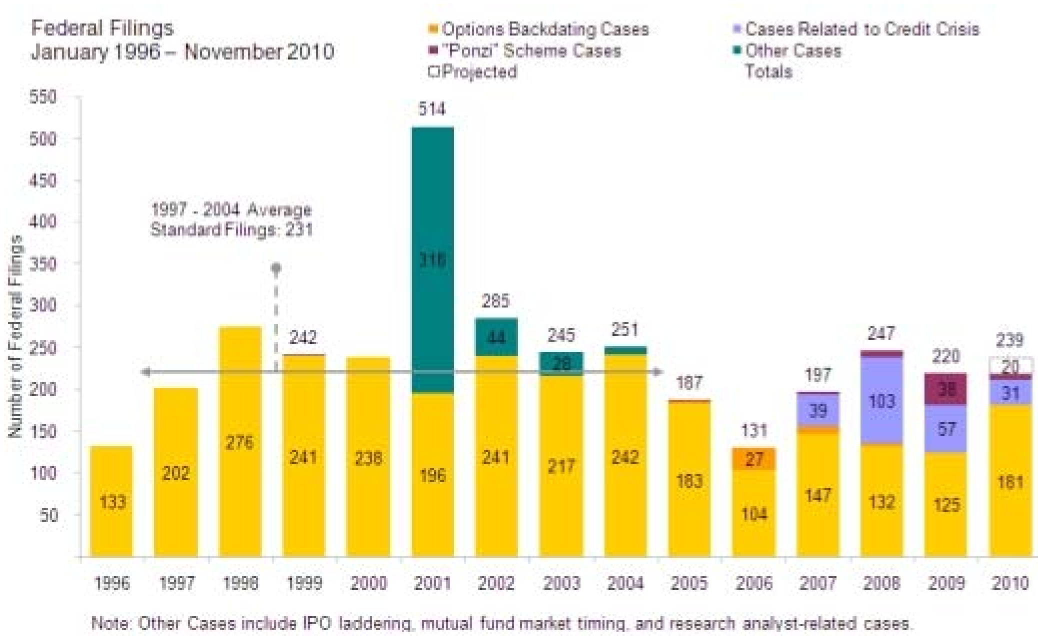
Filing & Settlement Trends

Filing Trends

As noted in Gibson Dunn's [Mid-Year Update](#), the pace of securities class action filings had declined steadily from 2008 through the first half of this year. In the second half of 2010, however, NERA Economic Consulting is reporting that filings have picked up significantly and that the number of filings this year is on track to exceed last year's total.

In particular, there have been 123 filings in the five months from July 1 through November 30, 2010, which already exceeds the 101 filings from January 1 through June 30, 2010. In all, NERA projects 239 filings in 2010, which would represent an increase from last year's 220 filings.



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NERA reports that the drop-off in filings related to the global financial crisis continued notwithstanding the overall uptick in filings--just 31 cases so far this year--compared to a high of 103 such cases in 2008. Nevertheless, securities class actions filed against financial firms still led the way with more filings than any other industry sector, although a majority of such suits were found by NERA to be unrelated to the global financial crisis.

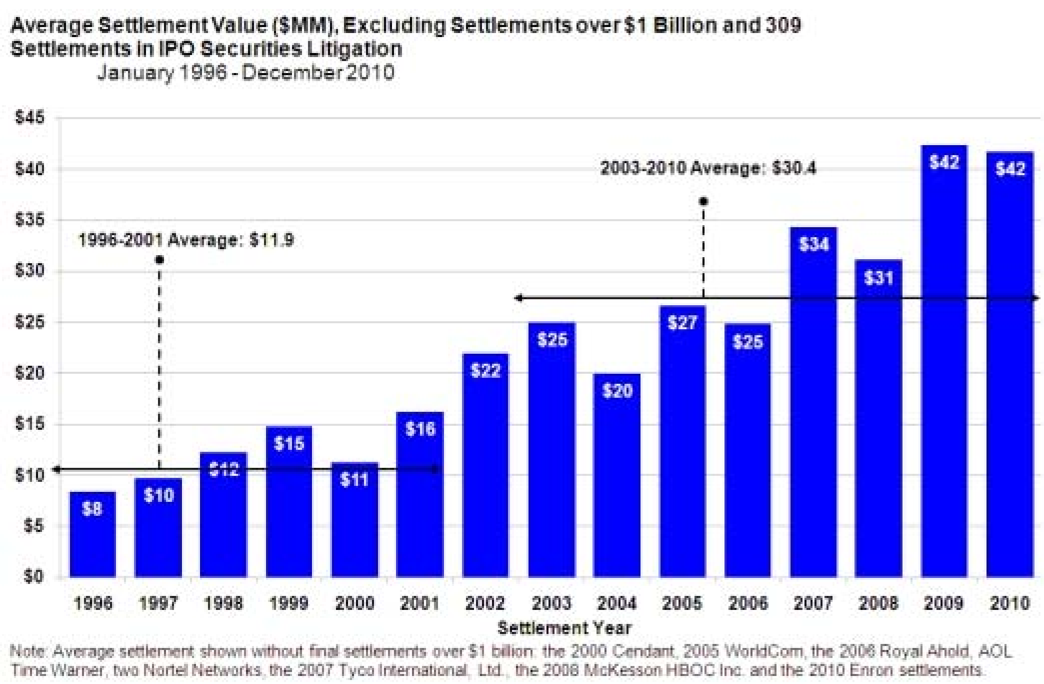
NERA also finds that the increase in total filings in 2010 appears to stem from an increasing number of "standard" filings, which excludes filings related to the credit crisis, Ponzi schemes, and certain other special categories. 2010 also marked a large increase in the number of securities class actions filed against technology firms. Indeed, the amount of filings against electronic technology, technology services, and non-energy minerals firms doubled in 2010 over the prior year.

NERA also reports that 2010 will be the first year since 2005 that the Second Circuit does not lead the country in the number of securities class actions filed. Through the end of November, the Ninth Circuit had 62 filings and the Second Circuit had 49.

Settlement Trends

Although down from the first-half average of $209 million, NERA reports that the average settlement of securities class actions was still a record $109 million, exceeding the previous record of $80 million in 2006. NERA noted that the February 2010, $7.2 billion Enron settlement had a substantial impact on the average settlement in 2010.

When what NERA terms as "outliers" are removed, the average settlement this year was equal to last year, coming in at a record $42 million, as reflected in the chart below.



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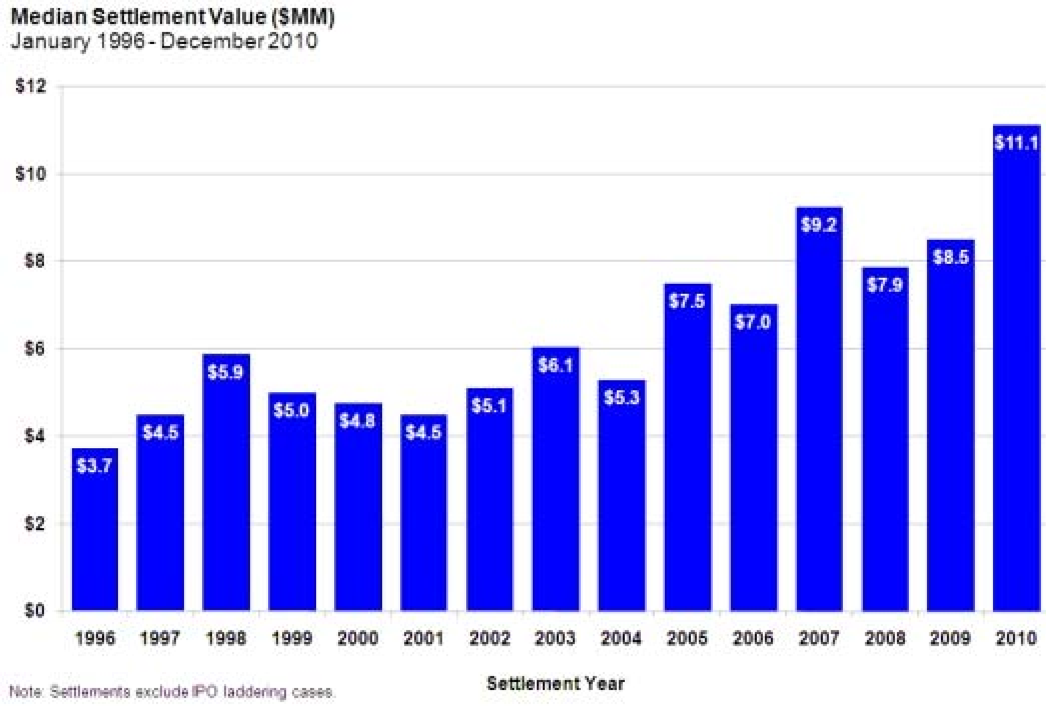
In the chart below, NERA reports that the median securities class action settlement was also a record high of $11.1 million, representing a significant increase over last year's median of $8.5 million.



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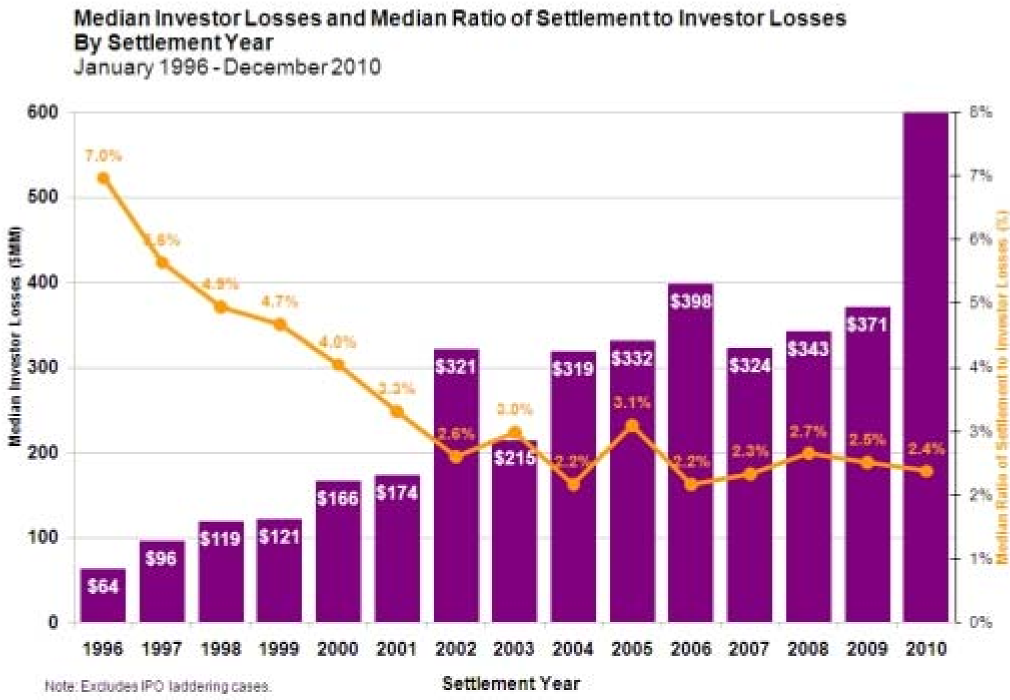
In the chart below, NERA reports record-high median investor losses in 2010 of $604 million. Importantly, however, NERA also reports that the median settlement amount as a percentage of median investor losses has continued to decline from the five-year high water mark set in 2008, and is well below levels from the 1990s. In 2010, the ratio of median settlement amounts to median investor losses was just 2.4%. (NERA calculated investor losses by comparing the return on the defendant company's stock to the return on the S&P 500 over the class period, and by using a proportional decay trading model to estimate the number of affected shares of common stock.)



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Supreme Court Developments

As we reported in our Mid Year Update, the Supreme Court issued several significant securities opinions in its 2009-2010 Term. Several cases in the 2010-2011 Term promise to be similarly important.

Janus Capital Group Inc. v. First Derivative Traders

On December 7, 2010, the United States Supreme Court heard oral arguments in *Janus Capital Group Inc. v. First Derivative Traders*, U.S. No. 09-525, to resolve whether a secondary actor--a service provider (here, an investment adviser) that assisted in the drafting and issuance of another company's (here, mutual funds') prospectuses--could be held liable for securities fraud, based upon the service provider's alleged role in preparing the other company's statements. Petitioner Janus Capital Management LLC (JCM), a subsidiary of petitioner Janus Capital Group Inc. (JCG), is a registered investment adviser that advises and handles the day-to-day operations of the Janus family of mutual funds. A purported class of JCG shareholders alleged that Janus Funds' prospectuses contained misrepresentations regarding market timing, and that JCM is liable for allegedly participating in the preparation of those prospectuses.

In oral argument before the Supreme Court, Janus, represented by Gibson Dunn, argued that JCM should not be liable because it made no statements--the prospectuses were approved and "adopted" by the Funds' board of trustees, and therefore the issuer "made" the statements, not the service provider (JCM). Janus argued that extending liability to

JCM in such circumstances would run contrary to both *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), which held that private plaintiffs could not bring a securities fraud suit against secondary actors (such as service providers) that allegedly assisted in the fraudulent behavior, and also *Stoneridge Investment Partners, LLC v. Scientific-Atlantic, Inc.*, 552 U.S. 148 (2008), in which the Court rejected a private right of action for aiding and abetting securities fraud. Respondent countered that entities like JCM must be held liable when they engage in intentionally fraudulent conduct; otherwise, advisers and other mutual fund service providers could freely engage in fraud through shell parent companies. Respondent also urged a broad interpretation of the word "make," arguing that a defendant "makes" a false or misleading statement if it is involved in creating or composing the statement. The United States also appeared and argued, siding with First Derivative Traders.

At least two justices seemed to agree with Janus. Justice Scalia observed that JCM "didn't make the statements" and the prospectuses "didn't go out under their name." He described JCM's role as "just like writing a speech for somebody." Similarly, Justice Kennedy said that he saw "nothing . . . in the record that would justify" attributing the alleged misstatements to JCM. Justice Sotomayor, however, voiced concerns over whether a party in JCM's situation would be able to avoid liability even though it intentionally engaged in fraudulent conduct. Other justices, including Justices Alito and Kagan, expressed concern about the possibility that if entities like JCM could not be liable in these circumstances, it is possible that victims of fraud might not have redress.

Siracusano v. Matrixx Initiatives, Inc.

In our Mid-Year Update, we reported on the Supreme Court's granting of a writ of *certiorari* to review the Ninth Circuit's decision in *Siracusano v. Matrixx Initiatives, Inc.*, 585 F.3d 1167 (9th Cir. 2009). In *Siracusano*, the district court held that information in adverse event reports regarding the safety of a pharmaceutical product is not material unless such reports provide reliable statistically significant information that a drug is unsafe, and it found that 12 user complaints was not statistically significant. The Ninth Circuit reversed, rejecting the statistical significance standard and holding that an omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important and noting the Supreme Court's rejection of a bright-line materiality standard in *Basic, Inc. v. Levinson.* The Ninth Circuit's decision created a split of authority with the First, Second, and Third Circuits, which have held that drug companies have no duty to disclose adverse event reports until those reports provide statistically significant evidence that the adverse events may be caused by, and are not simply randomly associated with, a drug's use. The Supreme Court granted *certiorari* on June 14, 2010.

The SEC and Solicitor General's office submitted an *amicus* brief in November arguing that the statistical significance standard conflicts with *Basic* because other evidence can suggest a causal link between use of a drug and an adverse effect, and a reasonable investor may consider that information important even if it does not prove that the drug causes the effect (for example, it can affect the product's commercial viability). Additionally, the brief argues that the Supreme Court in *Basic* and *TSC v. Northway* rejected bright-line tests regarding materiality at the motion to dismiss stage in favor of a more flexible approach allowing the consideration of a number of factors. Oral arguments before the Supreme Court are scheduled on January 11, 2011.

Erica P. John Fund, Inc. v. Halliburton Co.

As noted in Gibson Dunn's Mid-Year Update, the Fifth Circuit confirmed that to certify a Rule 23 class for a Section 10(b) claim based on the fraud-on-the-market presumption, the plaintiff must establish loss causation. *See Archdiocese of Milwaukee Supporting Fund Inc. v. Halliburton Co.*, 597 F.3d 330 (5th Cir. 2010) (reaffirming *Oscar Private Equity Investments v. Allegiance Telecom, Inc.*, 487 F.3d 261 (5th Cir. 2007)). On May 13, 2010, 2010, plaintiffs in *Halliburton*, now known as Erica P. John Fund, Inc., filed a petition for writ of *certiorari* with the Supreme Court and in December--at the request of the Court--the SEC and DOJ filed an *amicus* brief, encouraging the Court to take up the case. The government argued that the Fifth Circuit's approach improperly considers the merits at the class certification stage without any reason to do so under Rule 23, and that *certiorari* should be granted to resolve a split between the approach of the Fifth Circuit, the Seventh Circuit (which rejected *Oscar* outright in *Schleicher v. Wendt*, 618 F.3d 679 (7th Cir. 2010)), and the Second Circuit (which allows some consideration of the merits at the class certification but does not require the putative class representative to prove loss causation, *see In re Saloman Analyst Metromedia Litig.*, 544 F.3d 474, 479, 483 (2d Cir. 2008)).

The Supreme Court granted *certiorari* on January 7, 2011, and the case is likely to be argued in the Spring.

Extraterritoriality of U.S. Securities Laws

One of the most significant developments in 2010 was the Supreme Court's holding in *Morrison v. National Australia Bank*, --- U.S. ---, 130 S. Ct. 2869 (2010), that Section 10(b) of the 1934 Securities Exchange Act does not extend to purchases of securities on foreign exchanges, regardless of whether there was a domestic connection to the alleged fraudulent statements. The Supreme Court established a "transactional" rule, holding that Section 10(b) applies only to "the purchase or sale of a security listed on an American stock exchange, and the purchase or sale of any other security in the United States." *Id.* at 2884. The Supreme Court rejected the Second Circuit's "conduct and effects" test, which had construed Section 10(b) to apply to claims on foreign-traded securities if there was a sufficient domestic nexus--either when wrongful conduct (such as the dissemination of misstatements) occurred in the United States, or the conduct's effects were felt here. *Id.* at 2879. The Supreme Court held that the Second Circuit's formulation ignored the "presumption against extraterritoriality," which provides that absent a clear intent of Congress that a statute apply to overseas conduct, the statute should be construed not to do so. The Supreme Court found that nothing in Section 10(b) suggests it applies abroad. *Id.* at 2882.

Judicial Response to Morrison

Following *Morrison*, plaintiffs have asserted a number of arguments that purchases on foreign exchanges should still be subject to Section 10(b) claims -- all of which, to date, the lower courts have rejected.

First, Plaintiffs in several cases have argued that *Morrison*'s requirement of a "domestic transaction" is satisfied where the plaintiffs are domestic and make their investment decisions in the U.S. The courts have unanimously rejected this construction.

- *Plumbers' Union Local No. 12 Pension Fund v. Swiss Reinsurance Co.*, No. 08 Civ. 1958 (JGK), 2010 WL 3860397 at *10-16 (S.D.N.Y. Oct. 4, 2010) ("[A]s a general matter, a purchase order in the United States for a security that is sold on a foreign exchange is insufficient to subject the purchase to the coverage of section 10(b) of the Exchange Act. There may be unique circumstances in which an issuer's conduct takes a sale or purchase outside this rule, but the mere act of electronically transmitting a purchase order from within the United States is not such a circumstance.").

- *In re Société Generale Sec. Litig.*, No. 08 Civ. 2495, 2010 WL 3910286, at *9-10 (S.D.N.Y. Sept. 29, 2010) ("By asking the Court to look to the location of 'the act of placing a buy order,' and to . . . 'the place of the wrong,' Plaintiffs are asking the Court to apply the conduct test specifically rejected in *Morrison*."). The court also *sua sponte* dismissed claims based on American Depository Receipts traded over-the-counter in the U.S., reasoning that a trade in ADRs was a "predominantly foreign securities transaction." Id., 2010 WL 3910286, at *6.

- *Cornwell v. Credit Suisse Group*, No. 08 Civ. 3758, 2010 WL 3291800, at *1 (S.D.N.Y. Aug. 11, 2010) (Section 10(b) does not apply "to any claims related to foreign securities trades executed on foreign exchanges even if purchased by American investors").

- *Stackhouse v. Toyota Motor Co.*, No. CV 10-0922, 2010 WL 3377409, at *1 (C.D. Cal. July 16, 2010) ("`[D]omestic transactions' or 'purchase[s] or sale[s] . . . in the United States' means purchases and sales of securities explicitly solicited by the issuer within the United States rather than transactions in foreign-traded securities where the ultimate purchaser or seller has physically remained in the United States. . . . [B]ecause the actual transaction takes place on the foreign exchange, the purchaser or seller has figuratively traveled to that foreign exchange -- presumably via a foreign broker -- to complete the transaction.").

- *Quail Cruises Ship Mgmt. Ltd. v. Agencia de Viagens CVC Tur Limitada*, No. 09-23248-CIV, 2010 WL 3119908, at *3 (S.D. Fla. Aug. 6, 2010) (*Morrison* bars parties from contractually selecting federal law for a securities transaction that otherwise has no relationship to the U.S.).

Second, plaintiffs in several cases have argued that *Morrison* is satisfied so long as the issuer lists some ordinary shares on a U.S. exchange, even if the particular shares that class members purchased on foreign exchanges. This "listing" argument has not yet succeeded in any case.

- *In re Alstom SA Sec. Litig*., No. 03 Civ. 6595 (VM), 2010 WL 3718863 at *2-3 (S.D.N.Y. Sept. 14, 2010) ("[This] argument presents a selective and overly-technical reading of *Morrison* that ignores the larger point of the decision. Though isolated clauses of the opinion may be read as requiring only that a security be 'listed" on a domestic exchange for its purchase anywhere in the world to be cognizable under the federal securities laws, those excerpts read in total context compel the opposite result.").

- *Sgalambo v. McKenzie*, No. 09 Civ. 10087, 2010 WL 3119349, at *17 (S.D.N.Y. Aug. 6, 2010) (although the Canadian issuer's common stock was traded on both U.S. and Canadian exchanges, plaintiffs conceded that *Morrison* "forecloses any potential class members who purchased . . . on a foreign exchange . . . from recovering in this action," and the court agreed.).

- *In re Celestica Inc. Secs. Litig.*, No. 07 CV 312 (GBD), 2010 WL 4159587, at *1 n.1 (S.D.N.Y. Oct. 14, 2010) (where issuer's common stock traded on both domestic and foreign exchanges; claims dismissed as to purchases on foreign exchanges).

Third, plaintiffs in some cases have attempted to assert claims under foreign law in U.S. federal courts.

- *In re Alstom SA Securities Litig*., No. 03 Civ. 6595 (VM), 2010 WL 3718863, at *2 (S.D.N.Y. Sept. 14, 2010) (the court dismissed French law claims by a discretionary denial of supplemental jurisdiction under 28 U.S.C. § 1367(c), saying that inserting French claims following *Morrison* would effectively restart a seven-year old litigation and require application of complex French law).

- In *In re Toyota Motor Corp. Securities Litigation*, No. 10-922 DSF (MANx) (C.D. Cal.), (plaintiff purchasers of Toyota's foreign-traded common stock have asserted statutory claims under Japanese law, claiming jurisdiction under the Class Action Fairness Act as well as supplemental jurisdiction under Section 1367. Toyota is expected to file a motion to dismiss in January 2011.).

Finally, at the very end of the year, Judge Baer in the Southern District of New York held that swap agreements traded domestically but referencing underlying securities traded on a foreign exchange do not fall within *Morrison*'s second prong--*i.e.*, the "purchase or sale of any other security in the United States"--because the "economic reality" is that the swaps were transactions in foreign securities. *Elliott Associates v. Porsche Automobil Holding SE*, No. 10-cv-04155-HB (S.D.N.Y. Dec. 30, 2010). In *Elliott*, the plaintiffs entered swap agreements with unknown third parties that were tied to the performance of foreign-traded stock in Volkswagen. Although Section 10(b) can apply to swap agreements, and plaintiffs entered these swap agreements domestically, the court held that plaintiffs could not bring a claim under Section 10(b) because the referenced shares were traded on a foreign exchange.

The court stated that "[s]ince the economic value of securities-based swap agreements is intrinsically tied to the value of the reference security, the nature of the reference security must play a role in determining whether a transnational swap agreement may be afforded the protection of § 10(b). Here, Plaintiffs' swaps were the functional equivalent of trading the underlying VW shares on a German exchange. Accordingly, the economic reality is that Plaintiffs' swap agreements are essentially 'transactions conducted upon foreign exchanges and markets,' and not 'domestic transactions' that merit the protection of § 10(b)." The court also emphasized that the swap agreements did not involve the issuer, and stated that it was "loathe to create a rule that would make foreign issuers with little relationship to the U.S. subject to suits here simply because a private party in this country entered into a derivatives contract that references the foreign issuer's stock."

It remains to be seen whether the "economic reality" test articulated in *Elliott Associates v. Porsche* will affect the analysis for cases outside the swap context.

Legislative Response to Morrison

The Dodd-Frank Act attempted to revive extraterritorial application of the securities laws' anti-fraud provisions in SEC and DOJ enforcement actions. Section 929O of Dodd-Frank amends the 1933 Act, the 1934 Act and the Investment Company Act of 1940 to provide federal court jurisdiction in any action brought by the SEC or the U.S. Attorney involving (1) conduct within the United States that constitutes "significant steps" in furtherance of the violation, even if the transaction occurs outside of the United States and involves only foreign investors or foreign advisers, or (2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States. These provisions were drafted before the Supreme Court issued its decision in *Morrison* and were enacted into law after the opinion. Interestingly, they are phrased in terms of federal courts' "jurisdiction." *Morrison* made clear, however, that the extraterritorial scope of Section 10(b) is a matter of statutory interpretation, not jurisdiction. Consequently, Dodd-Frank appears to have created jurisdiction for hypothetical enforcement actions that are not currently authorized by the 1934 Act.

Secondary Liability

Outside of *Janus Capital v. First Derivative Traders*, there were a handful of decisions touching on secondary liability. In *King County, Washington v. IKB Deutsche Bank Industriebank AG*, No. 09-Civ-8387, 2010 WL 4366191 (S.D.N.Y. Oct. 29, 2010), the court denied a service provider's motion to dismiss a claim for common law fraud, and held that alleged misstatements could be attributed to it under the "group pleading" doctrine. The court held that plaintiffs sufficiently alleged that defendant Morgan Stanley was directly responsible for the creation, structure, and maintenance of the investment vehicle at issue; made allegedly false and misleading statements about ratings that were later communicated to investors; and was directly involved in creating the core deal documents disseminated to private investors. Morgan Stanley argued that it could not be liable because another entity, not Morgan Stanley, actually made and issued the alleged misstatements and therefore plaintiffs had pled, at most, that Morgan Stanley was merely a secondary actor of the primary fraud. Morgan Stanley relied on *Pacific Investment Management Co. LLC v. Mayer Brown LLP*, 603 F.3d 144 (2d Cir. 2010), which as we explained in our Mid-Year update, had held the law firm Mayer Brown could not be liable for securities fraud where it was not alleged to have made any false statements attributed to it at the time of dissemination. But the *King County* court disagreed, and held that Morgan Stanley's alleged role in this case "far exceeded" merely providing or distributing the alleged misstatements, and instead that Morgan Stanley could be considered an "insider" according to the group pleading doctrine. The court opined that neither the PSLRA nor *Central Bank* "preclude[s] group pleading or require[s] that each individual defendant actually make the representation," although the court did note that there is "some tension" between the group pleading doctrine and *Central Bank*.

Safe Harbor For Forward-Looking Statements

In our Mid-Year Update, we reported on the Ninth Circuit's decision in *In re Cutera Sec. Litig.*, -610 F.3d 1103 (9th Cir. June 30, 2010) (holding that forward looking statements accompanied by meaningful cautionary language are encompassed by the Private Securities Litigation Reform Act ("PSLRA") safe harbor regardless of the state of mind of the person making the statement) and the Second Circuit's decision in *Slayton v. American Express Co.*, 604 F.3d 758 (2d Cir. 2010) (holding that that defendants were not entitled to protection under the meaningful cautionary language prong because their cautionary language was too vague, but affirming dismissal under the actual knowledge prong because plaintiffs failed to plead facts supporting a strong inference that the statement was made with actual knowledge that it was false or misleading). In the second half of 2010, the Third Circuit and a number of district courts rendered decisions interpreting the meaning of "forward-looking statement."

- In *In re Aetna, Inc. Securities Litigation*, 617 F.3d 272 (3d Cir. 2010), the Third Circuit affirmed dismissal of a Section 10(b) claim against an insurance company based on allegedly misleading statements about underwriting practices and premium pricing. It held that the statements came within the safe harbor because they were forward-looking and were accompanied by meaningful cautionary statements. The statements "were partly historical and partly present-tense," and the court acknowledged that mixed present/future statements are "not entitled to the safe harbor with respect to the statement[s] that refer[] to the present." The present-tense portions at issue were indistinguishable, however, from the statements' assertions about the future. "[T]o the extent [they] said anything about current price of premiums, [the statements] did so in the form of a projection . . . . Statements about future profitability and assumptions underlying management's expectations about the future fall squarely within the definition of forward-looking statements." *Id.* at 281. Having found that the statements were forward-looking, the court determined that they were accompanied by meaningful cautionary statements, and alternatively, were immaterial. Because no reasonable investor could have relied on the statements and the statements could not have meaningfully altered the total mix of information available to the investing public, the court found the safe harbor would apply even if the cautionary language had been inadequate.

- In *Gissin v. Endres*, --- F.Supp.2d ---, 2010 WL 3468508 (S.D.N.Y. Sept. 1, 2010), the defendant predicted that because the company had sufficient capital on hand, "we think working capital *will* stay about where it was for the *balance* of the year." 2010 WL 3468508, at *8 & n.106. The court determined that statements describing existing capital were present facts, but their veracity was not disputed. As to the allegedly false portions, the court found that terms such as "expectation" and "we feel we will" sufficiently designated the statements as forward-looking. The court reasoned that "defendants' statements in the instant case refer to present circumstances only as a basis for forecasting future performance, not as a guarantee of the status quo." *Id.* & n.108. The court concluded that those statements were accompanied by sufficient cautionary language and dismissed the suit.

- In *In re Bare Escentuals, Inc.*, --- F. Supp. 2d ---, 2010 WL 3893622 (N.D. Cal. Sept. 30, 2010), the court found that "future projections with regard to the Company's financial guidance and/or general future expenditures" contained in various press releases "easily" met the definition of forward-looking statements. *Id.* at *24. The court also held that the statements were accompanied by meaningful cautionary language, in part because the press releases incorporated by reference cautionary language contained in the company's Form 10-Ks. *Id.* at *15.

- In *In re Accuracy, Inc. Sec. Litig.*, 21010 WL 3447588 (N.D. Cal. Aug. 31, 2010), the court held that statements were forward-looking because they were prefaced with terms of belief and probability. The court found that defendants' prediction that there was a "substantially high probability" of converting certain contingent contracts in backlog into future revenue was forward-looking, even though it was based on present facts about the backlogged contracts. *Id.* at 9. Defendant's emphasis on contingency factors potentially affecting the prediction led the court to conclude that the statements were forward-looking and protected under safe harbor. *Id.*

- In *Sgalambo v. McKenzie*, --- F. Supp. 2d ---, 2010 WL 3119349 (S.D.N.Y. Aug. 6, 2010), by contrast, the court held that defendants' statements predicting the future production value of natural gas wells were not forward-looking. Defendants had reported "positive test results" indicating the wells would be economically productive, but allegedly failed to also include negative information that would have undermined their predictions. *Id.* at 9. The court found that statements reporting test results from the wells and predicting future well performance based on those results "incorporate[d] forward-looking aspects into statements of present fact." Based on that conclusion, the court held that the safe harbor was inapplicable. *Id.* at 11 & n.150 (characterizing as non-forward-looking the statement that, based on recently completed tests, "[t]he 'Victory' well has an estimated flowing rate of over 100 mmscf/d of natural gas and is condensate rich"). The *Sgalambo* case illustrates the somewhat pliable nature of the question whether a statement is truly "forward looking." The court may have been influenced by allegations that defendants intentionally omitted the contrary data undermining their predictions, and therefore strained to construe the predictions as statements of present fact so as to avoid the safe harbor.

- In *Sawant v. Ramsey*, 2010 WL 3937403 (D. Conn. Sept. 28, 2010), the court found that the safe harbor was inapplicable because the statements at issue could reasonably be interpreted as misstatements of present fact. *Id.* at *14. This was because the statements at issue, which were couched as predictions of a contract's impact, implied that such a contract existed, when it did not. *Id.* Moreover, the court found that a "boilerplate safe harbor provision" included in the press release at issue would not have constituted meaningful cautionary language, as it referred only to risks associated with generalized market conditions, and did not alert the reader to the "nascence of the touted agreement." *Id.* at *15.

- Finally, in *Allstate Life Ins. Co. v. Robert W. Baird & Co., Inc.*, --- F. Supp. 2d ---, 2010 WL 4581242, at *15 (D. Ariz. Nov. 4, 2010), the court held that the safe-harbor did not apply because the issuer was "not subject to the reporting requirements of the Exchange Act.". The court cited 15 U.S.C. 78u-5(a), which limits the safe harbor to an issuer "that at the time that the statement is made, is subject to the reporting requirements of section 78m(a) of this title or section 78o(d) of this title." *Id.* Further, the court stated, the issuer must actually have "properly filed a registration statement with the SEC and must be in compliance with any applicable reporting requirements. *Id.* (citing 15 U.S.C. §§ 78*l* , 78m(a), 78o(d).

PSLRA Discovery Stay

In our Mid-Year Update, we reported on a number of decisions from the first half of the year regarding the PSLRA's automatic stay of discovery. Since that time, courts have issued the following notable decisions.

- In *American Bank v. City of Menasha*, --- F.3d ---, 2010 WL 4812811 (7th Cir. Nov. 29, 2010), the Seventh Circuit addressed the Securities Litigation Uniform Standards Act (SLUSA) provision that amended the Private Securities Litigation Reform Act (PSLRA) to authorize the district court to "stay discovery proceedings in any private action in a State court, as necessary in aid of its jurisdiction, or to protect or effectuate its judgments, in an action subject to a stay of discovery pursuant to [the PSLRA]" *See* 15 U.S.C. § 78u-4(b)(3)(D). The plaintiff bank and other bondholders brought a federal securities class action against the City of Menasha, Wisconsin, which had defaulted on short-term bonds it had issued to convert an electric power plant to a steam-generating plant. The bank submitted a request to the City pursuant to Wisconsin's public records law to inspect a large number of records relating to the conversion project and obtained an order from state court compelling the City to comply with the request. The district court granted the City's motion to stay the order pursuant to the SLUSA amendment to the PSLRA discovery stay. In an opinion authored by Judge Posner, the Seventh Circuit held that public records requests are not "discovery" and the statutes' purpose of preventing "settlement extortion" did not apply because the costs associated with responding to a public records request under Wisconsin law are charged to the requesting party. *See American Bank v. City of Menasha*, 2010 WL 4812811 at *3-*4.

- In *Lindner v. American Express Co.*, No. 10 Civ. 2228, 2010 WL 4537819 (S.D.N.Y. Nov. 9, 2010), the court rejected plaintiffs' argument that the PSLRA stay should be lifted pursuant to the evidence preservation exception. The court reasoned that although the statute provides that the automatic stay can be lifted to preserve evidence, "there must be 'imminent as opposed to merely speculative' risk that evidence will not be preserved." *Id.* at *2 (citing cases). Because plaintiff offered no reasonable basis for the court to conclude that defendants had not complied with their statutory obligation under the PSLRA to preserve evidence, the court denied plaintiff's motion to lift the stay. *Id.*

- In *Anwar v. Fairfield Greenwich Ltd.*, --- F. Supp. 2d. ---, 2010 WL 3431126 (S.D.N.Y. Aug. 20, 2010), the court held that the PSLRA stay does not apply to arbitration proceedings. The plaintiff investment firms were respondents in a AAA arbitration brought by investors whose funds were invested in the Madoff ponzi scheme. Among other things, the investment firms sought an order requiring that discovery be stayed in the arbitration. The court found that neither the PSLRA nor SLUSA contemplates extending the stay to arbitrations. Additionally, the court noted that even if all the motions to dismiss pending in the federal case were granted, it would not bar document production in the arbitration. Accordingly, the court denied the investment firms' motion. *See id.* at *13-*14.

Subprime and "Credit Crisis" Litigation

The pace of new securities litigation filings related to the so-called "credit crisis" continued to decline in 2010, with only 31 such cases filed through November as compared to 57 filed in 2009 and 103 in 2008, according to NERA. Nevertheless, there were many significant cases in this area in the second half of 2010, some of which demonstrated an increasingly high bar being set by courts on plaintiffs to establish actionable misstatements and scienter at the pleading stage. (We reported on several cases decided in the first half of the year in our Mid-Year Update.) Plaintiffs nevertheless secured some favorable results in 2010, including the first ever jury verdict in a credit crisis case.

- Starting with the positive for defendants, in *NECA-IBEW Health & Welfare Fund v. Goldman, Sachs & Co. et al.*, --- F. Supp. 2d ---, No. 08-CV-10783 (MGC), 2010 WL 4054149 (S.D.N.Y Oct. 14, 2010), the court dismissed section 11 claims because plaintiff purchasers of mortgage-backed securities ("MBS") failed to allege any diminution of cash flow payments due under the MBS they purchased, and thus they could not show a cognizable injury. The court rejected plaintiffs' argument that they had been harmed by a decline in the MBS' resale value because the MBS were issued with the express warning that they might not be resalable. The court distinguished *New Jersey Health Fund v. DLJ Mortgage Capital, Inc*., No. 08 Civ. 5653 (PAS), 2010 WL 1473288 (S.D.N.Y. Mar. 29, 2010), which permitted a similar claim to proceed, because in that case there was no express warning that the MBS might not be illiquid.

- Courts continued to reject lead plaintiffs' arguments that they have standing to sue over MBS offerings they did not invest in simply because the securitizations were issued pursuant to shelf registration statements. *See Boilermakers Nat'l Annuity Trust Fund v. WaMu Mortg. Pass Through Certificates, Series AR1*, No. 09-CV-00037 (MJP), 2010 WL 3815796 (W.D. Wash. Sept. 28, 2010); *Maine State Ret. Sys. v. Countrywide Fin. Corp.*, --- F. Supp. 2d. ---, No. 2:10-CV-00302 (MRP), 2010 WL 4452571 (C.D. Cal. Nov. 4, 2010). The court in *Countrywide* explained that because the prospectus supplements contain the descriptions of the unique mortgage pools underlying the MBS, plaintiffs' claims relied on disclosures made in the prospectuses and not a common shelf registration. The *Countrywide* court also noted that every court to address this issue has reached the same conclusion.

- In *Footbridge Ltd. Trust v. Countrywide Home Loans, Inc.*, No. 09-CV-04050 (PKC), 2010 WL 3790810 (S.D.N.Y. Sept. 28, 2010), the court dismissed with prejudice a complaint asserting claims under section 10(b) that challenged disclosures made in connection with two offerings of Countrywide MBS. The court followed the Fifth Circuit's decision in *Lone Star Fund v. (U.S.) L.P. v. Barclays Bank PLC*, 594 F.3d 383, 389-90 (5th Cir. 2010), concluding that the offering documents did not promise unequivocally that loans in the mortgage pool would comply with guidelines, but rather that they either did so or would be cured upon request. The court also found that the plaintiffs' general claims about Countrywide abandoning its underwriting guidelines were not tied to loans in the particular securitizations at issue.

- Claims added by new plaintiffs attempting to cure standing issues have generally been dismissed early on in litigation. This trend continued in *In Re Wells Fargo Mortgage-Backed Certificates Litig.*, No. 09-CV-1376 (LHK), 2010 WL 4117477 (N.D. Cal. Oct. 19, 2010), where the court declined to toll claims asserted by newly added plaintiffs because the original named plaintiffs had no standing to bring the claims in the first place. After the court dismissed Section 11 claims related to MBS offerings in which plaintiffs had not invested, new plaintiffs that had invested in the MBS joined the lawsuit in an attempt to save the claims. The court rejected this tactic, holding that "*American Pipe* and the cases interpreting it support the declination to extend tolling to claims over which the original names Plaintiffs asserted no facts to supporting standing." The court distinguished *In re Flag Telecom Holdings, Ltd. Sec. Litig.*, 352 F. Supp. 2d 429, 455 (S.D.N.Y. 2005), which permitted tolling of claims dismissed for lack of standing because there the original plaintiffs had Section 11 standing, but not Section 12 standing, whereas in

Wells Fargo the original plaintiffs had no standing to assert any claims over the offerings at issue.

- In *Vining v. Oppenheimer Holdings, Inc. et al.*, No. 08 Civ. 4435 (LAP), 2010 WL 3825722 (S.D.N.Y Sept. 29, 2010), the court dismissed for failure to adequately plead scienter plaintiffs' Section 10(b) claims alleging Oppenheimer made misleading statements about the liquidity of its auction rate securities ("ARS"). In weighing competing inferences, the court found it was more probable that Oppenheimer simply did not foresee the "wholly unprecedented collapse" of the ARS market, and thus there was insufficient evidence to find a conscious or reckless intent to defraud. The court also found that general allegations of Oppenheimer's purchases of ARS, without identifying a specific increase in purchases during the relevant time period or the non-public information purportedly used by traders, was insufficient to find the motivation necessary for scienter.

- And in *Woodward v. Raymond James Fin., Inc.*, --- F. Supp. 2d ---, No. 09-CV-5347 (RPP), 2010 WL 3239411 (S.D.N.Y. Aug. 16, 2010), the court similarly dismissed a putative class action complaint alleging defendants made material misrepresentations about the adequacy of the subsidiary's loss reserves and the quality of its loan portfolio because there were insufficient allegations of actionable misstatements or scienter.

- Several defendants were able to knock out substantial parts of lawsuits, but left enough of the case intact to give plaintiffs hope. For example, in *In re Fannie Mae 2008 Sec. Litig.*, --- F. Supp. 2d ---, Nos. 08 Civ. 7831 (PAC), 09 MD 2013 (PAC), 2010 WL 3825713 (S.D.N.Y Sept. 30, 2010), the court dismissed two-thirds of plaintiffs' remaining securities fraud claims. First, the court dismissed claims based on allegations of misleading statements about Fannie Mae's subprime and Alt-A mortgage exposure because public disclosures contained sufficient cautionary language, plaintiffs failed to explain why the purported misstatements were false, and plaintiffs failed to adequately plead scienter. Second, the court dismissed claims based on allegations that Fannie Mae issued materially misleading financial statements because plaintiffs had not pleaded sufficient facts to establish that they were false when issued. The court appeared to rely heavily on the fact that regulators never alleged Fannie Mae violated GAAP or asked the company to restate its financial statements during the class period. Nevertheless, the court allowed claims to proceed based on allegations regarding misrepresentations about the quality of Fannie Mae's internal controls. The court relied heavily on three internal emails where the Chief Risk Officer warned, among other things, that the company "was not even close to hav[ing] control processes for credit, market and operational risk." The court also found that these emails inferred scienter because they demonstrated a conscious and reckless disregard to managing the risks associated with subprime loans.

- Citigroup obtained favorable results on motions to dismiss a putative class action alleging that Citigroup and 14 of its officers and directors made misleading statements regarding its risk exposure and overstated the value of its assets, particularly those associated with the subprime mortgage market. *In re Citigroup Sec. Litig.*, --- F. Supp. 2d ---, No. 07-CV-09901(SHS), 2010 WL 4484650 (S.D.N.Y Nov. 11, 2010). Seven individual defendants were dismissed from the lawsuit; only statements made between February 2007 and April 2008 were held actionable (reducing the class period from five years to a little over one year); and claims regarding disclosures about Citigroup's involvement with several other financial instruments were dismissed. However, the court allowed plaintiffs' Section 10(b) claims concerning disclosures made about the extent, nature and value of Citigroup's collateralized debt obligation ("CDO") holdings to proceed as to Citigroup and seven of the individual defendants. The court found plaintiffs pleaded sufficient facts to establish a strong inference of scienter because the individual defendants attended meetings where CDO risks were discussed: "Although plaintiffs do not allege the matters discussed at the meetings, their mere existence is indicative of scienter." Moreover, the court allowed plaintiffs to use the "group pleading doctrine" to allege the individual defendants were responsible for the misleading statements and omissions in Citigroup's public filings because they were insiders or wielded significant influence.

- In *Friedus et al., v. ING Group N.V. et al*, --- F. Supp. 2d ---, 2010 WL 3554097, No. 09-CV-01049 (LAK), 2010 WL 3554097 (S.D.N.Y. Sept. 14, 2010) the court dismissed the vast majority of claims asserted by plaintiffs that purchased ING bonds through offerings made in June 2007, September 2007 and June 2008. First, the court held that claims regarding the June 2007 bond offerings were untimely because the September 2007 offering documents contained sufficient "storm warnings" that the value of ING's Alt-A and subprime mortgage holdings were at risk. Because plaintiffs did not file their initial compliant until 2009, the claims were barred by the one-year limitation period. Second, the court found there was insufficient evidence to find that any disclosures regarding the September 2007 offering were incomplete or inaccurate. The court held that plaintiffs could not simply rely on generalized statements about market turmoil, but instead had to allege that ING's specific assets had been effected to show that disclosures about the relatively safety of its holdings were misleading. Finally, the court jettisoned many of plaintiffs' allegations regarding the June 2008 offering. After noting it was a "close call," however, the court let stand allegations that descriptions of ING's mortgage-backed assets as "near prime and of high quality" may have been misleading, finding such allegations "sufficiently link the troubles in the market at large to ING's portfolio to support a plausible inference that ING's assets in 2008 were 'extremely risky.'"

- Not all was positive for defendants in 2010, however. On November 18, 2010, the jury in *In re BankAtlantic Bancorp, Inc. Sec. Litig.*, No. 07-CV-61542 (S.D. Fla.), returned a verdict in plaintiffs' favor, finding the company and two of the five individual defendants made false and misleading statements about the bank's loan portfolio and exposure to loan losses. The jury awarded damages of $2.41 per share, which could amount to as much as $42 million. The jury apparently rejected BankAtlantic's loss causation argument, *i.e.*, that the catastrophic meltdown of the Florida real estate market was responsible for plaintiffs' losses rather than any allegedly misleading statements made by BankAtlantic.

- The court in *In re Am. Int'l Group, Inc. 2008 Sec. Litig.*, --- F. Supp. 2d ---, No. 08-CV-04772 (LTS), 2010 WL 3768146 (S.D.N.Y. Sept. 27, 2010), denied defendants' motion to dismiss a securities fraud lawsuit alleging that defendants materially misstated the extent to which AIG had accumulated exposure to the subprime mortgage market through its securities lending program and its credit default swap portfolio. In particular, the company's statements failed to disclose the CDS' valuation and collateral risk, which would require AIG to quickly come up with collateral for securities that had been devalued or defaulted on, according to plaintiffs. The opinion also contains an interesting standing discussion. The court cited its prior holding in *In re Morgan Stanley Mortg. Pass-Through Certificates Litig.*, No. 09-CV-2137 (LTS), 2010 WL 3239430, at *5 (S.D.N.Y. Aug. 17, 2010), that the structure of MBS offerings requires a different standing analysis than may be appropriate in cases involving ordinary corporate debt securities in which the alleged misstatements are found in common shelf registration statements. The court found that the AIG plaintiffs, who sued on Medium Term Notes, did not rely on the information furnished in the prospectus and pricing supplements unique to each of the 101 offerings, but rather on the alleged material misstatements and omissions located in the common elements of the three different registration statements (that is, the Company's Forms 10-K, 10-Q, and 8-K incorporated therein). The court therefore allowed plaintiffs to sue on all 101 offerings at issue, because purchasers in each of the offerings could trace their injury to the same underlying conduct on the part of the defendants.

- After allowing the class plaintiffs to amend their complaint, the court sustained section 12(a)(2) claims against the Merrill underwriter because plaintiffs specifically alleged they had purchased securities directly from Merrill. *Public Employees' Ret. Sys of Miss. et al. v. Merrill Lynch & Co. Inc, et al.,* No. 08 Civ. 10841 (JSR), 2010 WL 4903619 (S.D.N.Y. Dec. 1, 2010).

- *Defer LP v. Raymond James Fin., Inc. et al.*, No. 08-CV-03449 (LAK), 2010 WL 3452387 (S.D.N.Y. Sept. 2, 2010), was the first auction rate securities ("ARS") case to survive the preliminary motion stage. Although the court dismissed the majority of plaintiffs' securities fraud claims with prejudice for failure to plead actionable misstatements or scienter, it did allow limited claims to proceed against one Raymond James subsidiary ("RJA"), finding allegations that RJA failed to disclose the liquidity risks of ARS in order to unload its surplus inventory were sufficient to meet the "opportunity and motive" prong of the scienter standard in the Second Circuit. The court stated that "given the deterioration of the market . . . and RJA's wish to reduce its own position from November 2007 forward, it is quite reasonable to infer that RJA had a motive to conceal the ARS illiquidity risk from customers." In a potential blow to achieving class certification, however, the court rejected plaintiffs' argument that the alleged misrepresentations were part of a larger scheme to defraud. Instead, the court found that the only actionable misrepresentation had been made to a single plaintiff by one RJA broker.

- In what appears to be an outlier case, the court in *New Jersey Carpenters Health Fund v. Residential Capital, LLC*, No 08 CV 8781 (HB) (S.D.N.Y. Dec. 21, 2010), allowed additional plaintiffs to intervene in an effort to cure standing defects caused by the limited purchases of the initial plaintiffs. The court declined to address whether the new plaintiffs' claims were time-barred, despite recognizing the consensus that the *American Pipe* tolling doctrine does not apply where the class representatives lacked standing to assert their claims. Emphasizing that the claims for which the named plaintiffs lacked standing were nonetheless pleaded in the complaint and thus defendants were on notice of them, the court deferred a decision on the statute of limitations until the class certification stage.

- Finally, several more credit crisis cases settled in the second half of 2010, but no discernible trend has yet to emerge. On November 9, the court in *In re New Century Financial Corp. Sec. Litig.*, No. CV 07-00931-DDP-FMOx (C.D. Cal.) approved a settlement agreement calling for approximately $65 million to be provided on behalf of the directors and officers, the outside auditor to provide approximately $44.7 million, and the underwriters to provide approximately $15 million to settle the respective claims against them. Gibson Dunn represented New Century's independent directors. On October 25, 2010, Toll Brothers, Inc. entered into a stipulation of settlement to resolve a subprime-related class action for $25 million. (*City of Hialeah Employees' Ret. Sys. et al. v. Toll Brothers, Inc. et al.*, No. 07-01513 (E.D. Pa.)). Plaintiffs had alleged that Toll Brothers and its individual officers and directors misrepresented the company's ability to succeed during the nation's housing downturn. On December 15, 2010, Ambac Financial Group announced it reached an agreement in principal to settle two subprime-related securities class action lawsuits against the company and its officers and directors (*In re Ambac Fin. Group, Inc. Sec. Litig.*, No. 08-CV-41 (S.D.N.Y.); *Tolin et al. v. Ambac Fin. Group, Inc. et al.*, 08-CV-11241 (S.D.N.Y). The settlement calls for Ambac to pay a total of $27.1 million, of which $24.6 million will be paid by D&O insurers with the company paying the balance. Of the 230 credit-crisis lawsuits filed so far, Toll Brothers and Ambac represent only the sixteenth and seventeenth settlements, approximately. Both settlement agreements require court approval.

Pleading--Scienter

The scienter element of Section 10(b) claims remains a major hurdle for plaintiffs at both the circuit and district court level. We reported on a number of decisions in the first half of the year in our Mid-Year Update. Courts issued the following noteworthy decisions in the second half of 2010.

- The Sixth Circuit recently issued a notable decision concerning scienter in the context of claims against outside auditors. In *Louisiana School Employees' Retirement System v. Ernst & Young, L.L.P.*, 622 F.3d 471 (6th Cir. 2010), the court upheld the dismissal of a class securities fraud action against Ernst & Young stemming from its audit of Accredo Health, Inc., a pharmaceutical distribution company. The Sixth Circuit reaffirmed that "[t]he standard of recklessness is more stringent when the defendant is an outside auditor." *Id. at 479. Given this strict standard, the Sixth Circuit rejected the plaintiffs' attempt to premise scienter on Ernst & Young's use of "old and stale data" from a previous year to test the allowance attributable to the Company's receivables. Id*. at 481. The court found that "even if Ernst & Young should have included the appropriate data in its audit, its failure to do so does not create an inference that it acted with the requisite scienter." *Id*. at 482. In addition, the court noted that for "a red flag to create a strong inference of scienter in securities fraud claims against an outside auditor, it must consist of an 'egregious refusal to see the obvious, or to investigate the doubtful.'" *Id.* Additionally, the Sixth Circuit followed several district courts in holding that the magnitude of an accounting error does not give rise to an inference of scienter against an auditor, and rejected the plaintiffs' allegation that accounting improprieties in a prior year's financial statement gave rise to an inference of scienter in the audit opinion at issue. *Id*. at 483-484. Further, the court held that the mere receipt of audit fees could not constitute a sufficient motive to indicate scienter. *Id*. at 484.

- In another case concerning competing scienter inferences, the Second Circuit in an unpublished disposition affirmed the dismissal of Section 10(b) claims arising from a failed merger. *First New York Sec., L.L.C. v. United Rentals, Inc.*, 2010 WL 3393757 (2d. Cir. Aug. 30, 2010). Plaintiffs had purchased United Rentals stock following reports of a contemplated merger, and alleged that "URI acted with scienter by deliberately and improperly concealing the risks affecting the deal in order to stabilize the market price of its stock," resulting in damage when the deal fell through. *Id.* at *1. The Second Circuit held that the inference of scienter was not compelling, and that the more plausible inference was that the defendants failed to disclose any risks because they believed "that the deal was going to close." *Id. at *2.*

- In an unpublished disposition, the Ninth Circuit affirmed dismissal of Section 10(b) claims against Jones Soda Company because plaintiffs failed to plead facts sufficient to support any inference of fraudulent intent. *In re Jones Soda Co. Sec. Litig.*, 2010 WL 3394274 (9th Cir. Aug. 30, 2010). Plaintiffs asserted that the company and its former CEO "misled investors by overstating their efforts and accomplishments as Jones Soda entered the carbonated, canned soft drink market, leading to an over-valuation of Jones Soda's stock." *Id. at *1. The Ninth Circuit noted that the plaintiffs attempted to allege scienter from a single fact--sales data defendants received from retailers. Id.* at *2. Noting that the complaint did not say "what sorts of data" were covered in the reports, or which retailers the data covered, the court held that "[t]his single factual allegation [was] not sufficient" to create an inference of scienter. *Id*.

- The Ninth Circuit also provided guidance on the degree to which subjective recklessness is required to establish scienter at summary judgment. In *SEC v. Platforms Wireless International Corp.*, 617 F.3d 1072 (9th Cir. 2010), the court reaffirmed that a showing of subjective recklessness is necessary to prove scienter. *Id*. at 1093 (citing *Gebhart v. SEC*, 595 F.3d 1034, 1042 (9th Cir. 2010)). Nevertheless, the court held that "a defendant ordinarily will not be able to defeat summary judgment by the mere denial of subjective knowledge of the risk that a statement could be misleading." *Id.* at 1094. "When the defendant is aware of the facts that made the statement misleading, he cannot ignore the facts and plead ignorance of the risk." *Id.* In other words, the court held, "if no reasonable person could deny that the statement was materially misleading, a defendant with knowledge of the relevant facts cannot manufacture a genuine issue of material fact merely by denying (or intentionally disregarding) what any reasonable person would have known." *Id. at 1094 (emphasis added). Applying this standard, the Ninth Circuit affirmed summary judgment against the defendants for issuing a press release that claimed a prototype had been built when none existed. Id*. at 1096. Specifically, the court rejected the defendants' argument that the company's former CEO did not act with scienter when he issued the press release because he did not subjectively believe it was misleading. *Id.* at 1095. Instead, the Ninth Circuit found that the CEO acted with scienter because he admitted to knowing that no prototype existed when he authorized the press release. *Id. Indeed, the court held that defendants' admission that they knew the underlying facts meant that "no reasonable juror could credit" their assertion that they did not subjectively believe the contrary statement was misleading. If such "a self-serving assertion could be viewed as controlling, there would never be a successful prosecution or claim for fraud." Id.*

- In another notable decision, *United States v. Goyal*, 2010 WL 5028896, at *1 (9th Cir. Dec. 10, 2010), the Ninth Circuit reversed the conviction of a CFO charged with accounting and securities fraud. The company allegedly used a practice known as "sell-in" accounting, which allowed it to "recognize revenue from . . . deals earlier than it should have and thereby overstated its revenue." *Id*. The government charged the CFO with lying to auditors when he represented the company was compliant with GAAP. The Ninth Circuit held, however, that no reasonable jury could have inferred scienter under the facts. First, the court rejected the argument that intent could be inferred from "Goyal's desire to meet [the company's] revenue targets, and his knowledge of and participation in deals to help make that happen." *Id*. The court held that this was "simply evidence of Goyal doing his job diligently." *Id*. Second, the court held that "Goyal's presumed knowledge of GAAP as a qualified CFO does not make him criminally responsible for his every conceivable mistake." *Id*. As the court noted, "[i]f simply understanding accounting rules or optimizing a company's performance were enough to establish scienter, then any action by a company's chief financial officer that a juror could conclude in hindsight was false or misleading could subject him to fraud liability without regard to intent to deceive. *Id*. Third, the court ruled that the linkage of the CFO's compensation to the company's success was irrelevant. *Id*. "Such a general financial incentive merely reinforces Goyal's preexisting duty to maximize . . . performance, and his seeking to meet expectations cannot be inherently probative of fraud." *Id*. Fourth, the court found no facts to support the argument that the CFO "must have known about various revenue recognition problems because others at the company claimed they were aware of accounting improprieties." *Id*. at *7. Although *Goyal* was a criminal case, the court's discussion of scienter should influence the inferences courts are willing to accept in civil matters as well.

- In *Vining v. Oppenheimer Holdings, Inc.*, 2010 WL 3825722 (S.D.N.Y. Sept. 29, 2010), the court dismissed securities fraud claims arising from the purchase of Auction Rate Securities (which are long-term or perpetual instruments that pay interest or dividends at rates set by periodic auctions). The plaintiffs claimed that the defendants failed to disclose material facts about the nature and condition of the ARS market, and in particular that they suggested the market was more liquid than it was before its eventual collapse. *Id. at *4. The district court held that plaintiffs failed to adequately plead scienter. Though the plaintiffs claimed Oppenheimer must have known that the market was illiquid and fragile, the court reasoned that the plaintiffs' own allegations made clear that the ARS market collapse was an unprecedented event, which yielded a competing--and more compelling--inference that the collapse was also unforeseen. Id*. at *14. Moreover, the court held that purported red flags in the form of prior ARS illiquidity were limited to a "narrow segment" of the market, and that the most compelling inference was that "executives did not believe the [prior] failures represented a threat to the remainder of the market." *Id*. The court emphasized that this "competing inference appears even stronger when considered in light of the lack of specificity that Plaintiffs provide regarding Oppenheimer's alleged uniform management directives" regarding what statements to make about the ARS market. *Id*.

- Similarly, in *Footbridge Limited Trust v. Countrywide Home Loans, Inc.*, 2010 WL 3790810, at *1 (S.D.N.Y. Sept. 28, 2010), the court dismissed claims stemming from mortgage-backed securities, where the plaintiffs alleged "that a 'corrupt culture' at Countrywide, combined with defendants' 'lust for high yields and high profits' motivated defendants to make fraudulent misrepresentations to plaintiffs in order to induce them to invest in the Securities." *Id*. at *4. Specifically, the plaintiffs claimed that Countrywide "made material misrepresentations and omissions regarding the quality of the underlying loans and, more specifically the underwriting guidelines used in the origination process . . . ." *Id. The court found, however, that express warnings in the offering documents about the risks involved in these investments, as well as the flexible nature of the underwriting guidelines, undermined plaintiffs' claim that the defendants acted with scienter. Id. at *20. The court also emphasized the failure to connect any of the alleged misstatements with loans in the securitizations at issue. Id.*

- A court found that plaintiffs adequately pleaded scienter against Fannie Mae for misstatements involving Fannie Mae's internal risk management and controls. *In re Fannie Mae 2008 Sec. Litig.*, 2010 WL 3825713 (S.D.N.Y. Sept. 30, 2010). Plaintiffs alleged that "Fannie did not have the risk and control management infrastructure necessary to properly assess the risks of subprime and Alt-A mortgages, but misinformed the market that they had such safeguards in place." *Id.* at *13. The court found that emails written by the Chief Risk Officer "suggest that Fannie was conscious of its internal inability to manage the risks associated with subprime loans. Proceeding headlong into an unfamiliar market and telling investors that risk controls are in place while working . . . without the internal ability to analyze the risks associated with that market is certainly enough . . . to show an inference of scienter and therefore survive a motion to dismiss. *Id.* at *15.

- Similarly, in *In re CIT Group, Inc. Sec. Lit.*, 2010 WL 2365846 (S.D.N.Y. June 10, 2010), the court found that plaintiffs satisfied the scienter requirement because the complaint alleged particularized facts demonstrating that "Defendants (1) knew about CIT's lowered lending standards--and, in some cases, affirmatively approved them--while publicly touting the company's 'conservative' and 'disciplined' approach to subprime lending; and (2) learned of the deterioration of CIT's home loan and student loan profiles, while making public statements indicating that CIT was outperforming the market and would suffer only minimal losses." *Id. at *4. Plaintiffs supported these inferences with allegations that "Defendants made written and oral statements indicating that CIT had 'disciplined lending standards' and was 'much more conservative' than other lenders and that CIT 'had 'tightened home lending underwriting, . . . [and] raised minimum FICA requirements." Id*. at *2. As to misstatements concerning the performance of CIT's student loan portfolio, the plaintiffs offered evidence that the defendants had received Management Process Reports "which included information on the concentration of private, non-guaranteed students loans at Silver State, Silver State's abnormally high delinquency rate and low graduation rate, and CIT's failed attempt to the sell the Silver State loan portfolio." *Id*. at *3. The court agreed with the plaintiffs and concluded that "[t]he information gleaned from the Management Process Reports, and from monitoring the Silver State portfolio, tended to contradict Defendants' reassuring statements regarding the student loan portfolio as a whole. *Id*.

- In *In re Rackable Systems, Inc. Securities. Litigation*, 2010 WL 3447857 (N.D. Cal. Aug. 27, 2010), the court dismissed a securities fraud class action where plaintiffs alleged that scienter could be inferred from statements made by the company's former Executive President of Operations during a conference call, in which he admitted that the company should have realized various issues at an earlier time. *Id.* at *10. The court found that "[t]hese statements do not show that Defendants possessed contemporaneous knowledge" of any facts contradicting an earlier statement, and instead "merely acknowledge[ed] that the company could have been run better in the past." *Id.*

- The absence of allegations demonstrating contemporaneous knowledge of falsity was similarly fatal in *Zang v. Alliance Financial Services*, 2010 WL 3842366 (N.D. Ill. Sept. 27, 2010). There, plaintiff claimed that defendants knew at the time they took his investment that they would foil the financial deals they promised to enter on his behalf, and that they would not return his investment even though they had promised him that it was refundable. *Id. at *16. The court found, however, that the complaint "does not allege facts showing the defendants knew when they took money from him that the deals would not be completed and the money would not be returned." Id. at *17.*

Pleading--Confidential Witnesses

In our Mid-Year Update we reported on *Campo v. Sears Holding Corp.*, No. 09-3589-cv, 2010 WL 1292329 (2d Cir. Apr. 6, 2010), in which the Second Circuit ruled a district court was within its discretion to permit depositions of confidential witnesses to aid in resolving a motion to dismiss. Since that time, we are not aware of any courts that have followed *Campo* and allowed such depositions. One court outside the Second Circuit, however, has refused to follow *Campo*, and has strongly criticized it. *See In re Cell Therapeutics, Inc.*, No. C10-414MJP, 2010 WL 4791808 (W.D. Wash. Nov. 18, 2010). In rejecting defendants' request to depose confidential witnesses, that court opined that "the 2nd Circuit's language favoring the practice is *dicta*"; no other court has followed *Campo*; many courts have refused to allow such depositions; and "neither the Federal Rules nor the [PSLRA] supports the practice." We will continue to follow and report on other courts' treatment of *Campo* in 2011.

Courts in the second half of 2010 continued to apply a strict standard to allegations based on confidential witnesses, dismissing complaints for failure to particularly plead facts supporting confidential witnesses' purported knowledge. *See In re NVIDIA Corp. Sec. Litig.*, No. 08-CV-04260-RS, 2010 WL 4117561 (N.D. Cal. Oct. 19, 2010) (dismissing complaint based on eight confidential witnesses where two "were never employed by NVIDIA, making it unlikely that they have personal knowledge," and the others were too remotely placed within the company); *Local No. 38 IBEW Pension Fund v. American Express Co.*, No. 09-Civ-3016, 2010 WL 2834226 (S.D.N.Y. July 19, 2010) (rejecting confidential witness allegations that amounted to "anecdotes and conclusory statements of belief" and where many of the confidential witnesses were rank-and-file employees or outside contractors who were not in contact with individual defendants and did not have access to relevant information).

Pleading--Standing

In our Mid-Year Update, we reported on a number of decisions in which courts dismissed cases at the pleading stage for lack of standing. Standing continued to play significant role in the second half of the year, with courts in particular distinguishing between ordinary corporate securities offerings and those involving mortgage-backed securities. *See, e.g., Boilermakers National Annuity Trust Fund v. WaMu Mortg. Pass Through Certificates, Series AR1*, 2010 WL 3815796 (W.D. Wash. Sept. 28, 2010), *Katz v. Gerardi*, 2010 WL

3034358 (D. Colo. Aug. 3, 2010), *In re Citigroup Inc. Bond Litigation*, --- F.Supp.2d ---, 2010 WL 2772439 (S.D.N.Y. July 12, 2010), *Maine State Retirement System v. Countrywide Financial Corp.*, --- F.Supp.2d ---, 2010 WL 4452571 (C.D. Cal. Nov. 4, 2010), *Hoff v. Popular, Inc.*, --- F.Supp.2d ---, 2010 WL 3001710 (D. Puerto Rico Aug. 2, 2010), *Local 295/Local 851 IBT Employer Group Pension Trust and Welfare Fund v. Fifth Third Bancorp*, --- F.Supp.2d ---, 2010 WL 3221813 (S.D. Ohio Aug. 10, 2010).

- For example, in *Maine State Retirement System*, *supra*, the named plaintiffs sought to represent all purchasers of certificates issued in 427 separate MBS offerings, arguing that they had standing with respect to any offering issued pursuant to a common registration statement, including offerings in which they did not actually purchase securities. The court rejected that argument, emphasizing that each MBS certificate was described in a unique accompanying prospectus. Even where there was a common shelf registration, the plaintiffs' claims relied on separate disclosures or omissions made in individual prospectuses. 2010 WL 4452571, at *4. Although the court granted leave to amend to reflect only the securities in which plaintiffs actually invested, it suggested that it would evaluate standing at the tranche level, as it required plaintiffs to specify the tranches in which they had invested as well. *Id.* Gibson Dunn represents the underwriter defendants in this case.

- Similarly, a court in the Southern District of New York dismissed putative class claims involving MBS because the named plaintiffs had not purchased most of the securities at issue. *In re Morgan Stanley Mortgage Pass-Through Certificates Litig.*, 2010 WL 3239430 (S.D.N.Y. Aug. 17, 2010). Plaintiffs alleged that shelf registrations common to each offering contained material misstatements and omissions. *Id.* The court found, however, that the suit relied on allegations associated with individual certificates, such as service and ratings issues, as well as allegedly false disclosures in individual certificate prospectuses. Because of the differences between the different certificates, the court concluded that the plaintiffs lacked standing to pursue claims concerning any certificates other than the ones they purchased. *Id.*

- In a recent case involving medium-term notes, the same court distinguished *In re Morgan Stanley*, holding that plaintiffs had standing to raise Securities Act claims on behalf of all note purchasers whose offerings relied on the same allegedly misleading shelf registrations. *In re American International Group, Inc. 2008 Securities Litig.*, 2010 WL 3768146 (S.D.N.Y. Sept. 27, 2010). Plaintiffs purchased securities from some of 101 separate offerings that were made pursuant to three shelf registrations, each having incorporated by reference SEC filings allegedly containing material misstatements and omissions. *Id.* at 21-22. Unlike in *Morgan Stanley*, where the relevant misstatements and omissions occurred in unique prospectuses, the *AIG* plaintiffs could "trace the injury of the purchasers in each of the 101 offerings to the same underlying conduct on the part of the defendants." *Id.* at 22. The court concluded that plaintiffs could assert claims based on all 101 offerings, including those in which they did not participate.

- Similarly, another court in the Southern District of New York found that plaintiffs had standing to bring Section 11 claims arising from a series of bond offerings that relied on common shelf registrations, but lacked standing to raise claims pursuant to Section 12. *In re CitiGroup Bond Litig.*, --- F.Supp.2d ---, 2010 WL 2772439, at *14 (S.D.N.Y. July 12, 2010). The court found that "where a plaintiff alleges untrue statements in the shelf registration statement or the documents incorporated therein--as opposed to an alleged untrue statement in a supplemental prospectus unique to a specific offering--then that plaintiff has standing to raise [Section 11] claims on behalf of all purchasers from the shelf." *Id.* Plaintiffs lacked standing, however, to bring Section 12 claims--which require a direct purchaser relationship between plaintiff and defendant--because they failed to "identify a particular purchase from a particular defendant pursuant to a particular prospectus that it contends contained a particular false or misleading statement." *Id.* at *12.

Loss Causation

In addition to the circuit split regarding whether plaintiffs must establish loss causation to obtain the fraud on the market presumption at the class certification stage, and the recent grant of *certiorari* by the Supreme Court in the *Halliburton* case out of the Fifth Circuit, which we discussed above, the federal courts of appeals issued several other loss causation decisions.

- The Third Circuit rejected the "fraud-created-the-market" theory of reliance in *Malack v. BDO Seidman, LLP*, 617 F.3d 743, 756 (3d Cir. 2010). Because the plaintiff could not establish class-wide reliance based on a valid presumption, he could not establish the predominance requirement of Rule 23(b)(3). *Id.*

- The Ninth Circuit in *In re Oracle Securities Litigation*, __ F.3d __, No. 09-16502, 2010 U.S. App. LEXIS 23531 at * 29-30 (9th Cir. Nov. 16, 2010), reaffirmed its decision in *Metzler Inv. GMBH v. Corinthian Colleges, Inc.*, 540 F.3d 1049 (9th Cir. 2008), that loss causation is only established if the market learns of a defendant's fraudulent act or practice, and a plaintiff suffers a loss as a result of the market's reaction; it is not enough that the market learns of the "impact" of the alleged fraud. *Oracle* case is a strong companion to *In re Omnicom Group, Inc. Sec. Litig.*, 597 F.3d 501, 512 (2d Cir. 2010), discussed in our Mid-Year Update, in which the Second Circuit held that a plaintiff must show that new facts were disclosed to the market, not just a recharacterization or someone's opinion of previously disclosed facts.

- The court in *In re Imax Securities Litigation*, No. 06 Civ. 6128 (NRB) (S.D.N.Y. Dec. 22, 2010), denied a motion for class certification of Section 10(b) because the lead plaintiff was an in and out trader unable to establish loss causation, as it sold its holdings before any corrective disclosure relating to misstatements on which it could have relied.

- A recent unpublished decision from the Ninth Circuit appears more lenient for plaintiffs, however, as we reported in our Mid-Year Update. In a remarkably short memorandum disposition in *In re Apollo Group Inc. Securities Litigation*, No. 08-16971 (9th Cir. Mar. 3, 2010), the court reversed the district court's grant of judgment as a matter of law in favor of Apollo, which had overturned a jury verdict for plaintiffs. Gibson Dunn represents Apollo in the case. The Ninth Circuit's order stated only that the jury could reasonably have found that analyst reports (that had appeared a significant time after various newspaper articles reporting the same information) were nevertheless "corrective disclosures," because they provided additional or more authoritative information that deflated Apollo's stock price. The court did not address Apollo's argument, which the district court accepted, that the analyst reports could not be "corrective disclosures" because they did not contain any new fraud-revealing information. It remains to be seen whether this more lenient approach will eventually make its way into binding precedent.

Negative Causation

Sections 11(e) and 12 of the 1933 Act provides a defense where a defendant can prove that any damages suffered by the plaintiff was the result of something other than the alleged misstatement. In our Mid-Year Update, we discussed a number of decisions addressing the negative causation defense. The few courts that have examined this defense in the last six months have continued to show reluctance to apply it, at least during pre-trial proceedings.

A court in the District of New Jersey disagreed with the negative causation holding in a case described in our Mid-Year Update, *Blackmoss Investments v. ACA Capital Holding*, *Inc*., 2010 WL 148617 (S.D.N.Y. Jan. 14, 2010). In *Bauer v. Prudential Financial*, *Inc*., 2010 WL 2710443 at *7-8 (D.N.J. June 29, 2010), a case arising out of the collapse of the auction rate securities market, the defendants argued in their motion to dismiss that plaintiffs had not pleaded a compensable loss because, at the time of the motion, the securities at issue were trading above their offering price. The court found that the facts supporting the negative causation defense did not appear on the face of the complaint, as the complaint alleged that the securities were trading at 48% of their offering price at the time the complaint was filed. *Id*. While this presumably would have been sufficient to distinguish the *Blackmoss Investments* decision, the *Bauer* court went on to hold that *Blackmoss* was not persuasive in light of Third Circuit law.

In a different context, a district court refused to decide whether defendants' negative causation defense as to a proposed class representative rendered that plaintiff atypical, holding that negative causation issues need not be addressed at the class certification stage if they involved disputed issues of fact or expert testimony. *In re Washington Mutual*, *Inc. Securities*, *Derivative & ERISA Litig*., 2010 WL 4272567 at *10 (W.D.Wash. Oct. 12, 2010). In this regard, the court's decision cannot be squared with appellate decisions from other Circuits including the *Flag Telecom* decision from the Second Circuit, and the *Halliburton* decision from the Fifth Circuit, both of which held that loss causation or negative causation issues were appropriate factors to be decided under Rule 23.

The Second Circuit reversed in part a negative causation dismissal in *Iowa PERS v. MF Global, Ltd.*, 620 F.3d 137 (2d Cir. 2010). There, the plaintiffs claimed that misrepresentations concerning MF Global's internal controls were revealed when one of its traders incurred massive losses on MF Globab's behalf by overriding certain trading limits. The district court ruled that because the trader's losses were on an MF Global account, and not on a client account, claims based on alleged misrepresentation concerning controls on client accounts were subject to a negative causation defense. The Second Circuit disagreed, noting MF Global had acknowledged that the risk-management deficiencies affected client accounts as well. However, the Second Circuit affirmed dismissal of claims that MF Global had failed to disclose that client accounts could be accessed by the public, as this purported security risk was never the subject of a corrective disclosure and therefore the negative causation defense was apparent on the face of the complaint.

By contrast, the Ninth Circuit in *Miller v. Thane International, Inc.*, 615 F.3d 1095 (9th Cir. 2010), affirmed a judgment on negative causation grounds following a bench trial. In that case, Thane's stock did not, as represented in a prospectus, trade on the NASDAQ National Market System ("NMS"), but on the NASDAQ Over-the-Counter Bulletin Board ("OTCBB"), but the absence of any stock price movement following the revelation of this misstatement meant the plaintiffs' losses were not caused by the misrepresentation. This was true even though the misrepresentation was "material," in the sense that a reasonable investor would have wanted to know the facts. The Ninth Circuit emphasized that the materiality inquiry is hypothetical and objective, while the loss causation inquiry "assess whether a particular misstatement actually resulted in loss." Moreover, the Ninth Circuit held the district court did not err in looking to stock prices even in the absence of a showing that the market was "efficient" as defined in *Cammer v. Bloom*, 711 F. Supp. 1264, 1286-87 (D.N.J. 1989). The *Miller* court held that *Cammer* was "not appropriate" for assessing loss causation.

CAFA Removal

Courts also examined the "securities exception" to removal under the Class Action Fairness Act ("CAFA"). CAFA allows defendants facing class action complaints in state court to remove to federal court under certain circumstances when the parties' citizenship is minimally diverse--*i.e.*, at least one plaintiff is a citizen of a different state than at least one defendant. The "securities exception" to CAFA removal, however, prevents defendants from removing certain securities-related class actions, defined as those "*solely* involv[ing] a claim . . ."

> (A) concerning a covered security as defined under 16(f)(3) of the Securities Act of 1933 (15 U.S.C. 78p (f)(3) [2]) and section 28(f)(5)(E) of the Securities Exchange Act of 1934 (15 U.S.C. 78bb (f)(5)(E));
>
> (B) that relates to the internal affairs or governance of a corporation or other form of business enterprise and that arises under or by virtue of the laws of the State in which such corporation or business enterprise is incorporated or organized; or

> (C) that relates to the rights, duties (including fiduciary duties), and obligations relating to or created by or pursuant to any security (as defined under section 2(a)(1) of the Securities Act of 1933 (15 U.S.C. 77b (a)(1)) and the regulations issued thereunder).

28 U.S.C. § 1332(d)(9) (emphasis added).

In our Mid-Year Update, we reported on the Seventh Circuit's decision in *Lincoln Nat'l Life Ins. Co. v. Besich*, 610 F.3d 448 (7th Cir. 2010), holding that the securities exception to CAFA applied in the case. In another notable decision this year, the Second Circuit dismissed an appeal for review of a remand order based in part on the Section 1332(d)(9)(C) securities exception. *See Greenwich Fin. Servs. Distressed Mortgage Fund LLC v. Countrywide Financial Corporation LP*, 603 F.3d 23 (2d Cir. 2010). Plaintiffs owned certificates in securitized mortgage trusts created by Countrywide, which were administered pursuant to "pooling and servicing agreements" ("PSAs"). They commenced a class action in New York state court seeking declaratory judgments that the defendants were required to perform certain duties under the PSAs, including repurchasing certain mortgage loans. Defendants removed the case to the Southern District of New York, and plaintiffs moved to remand based in part on Section 1332(d). The district court granted the motion, and the defendants appealed.

The Second Circuit began by confirming that not all securities claims are non-removable under the Section 1332(d)(9) exception, else the three prongs in subsections (A), (B), and (C) would be rendered "superfluous." *Id.* at 28. One "limiting principle" is whether a claim is based on the "terms of the instruments that create and define securities . . . [or] based on rights arising from independent sources of state law." *Id.* at 28-29). The key distinction is that claims to enforce the rights of securities "holders as holders" are not removable, while those brought to enforce rights as purchasers are removable. *See id.* at 29 (holding that the *Cardarelli* suit was removable because the plaintiffs asserted that their securities purchase (involving non-"covered" securities not within the subsection (A)) was tainted by fraud). The court concluded that the PSAs defined the defendant's obligation to repurchase loans related to the plaintiffs' certificates. The Section 1332(d)(9)(C) securities exception applied because the plaintiffs were seeking to enforce those terms.

Additionally, the Second Circuit rejected arguments that the suit was not "solely" related to the certificates' terms. Defendants argued the case would involve questions under state *alter ego* law (because one of the defendants was not a party to the PSAs). The court disagreed, stating, "[t]he phrase 'solely involves' cannot be stretched so far as to limit the exception in [Section] 1332(d)(9) . . . to class actions that raise no collateral issues and for which there are no affirmative defenses." *Id.* at 31. "If Congress had intended these provisions to apply only to class actions that involve no legal issues extraneous to the primary claim, [it] would have used language that was more clearly limiting." *Id.* Rather, the phrase "solely involves" ensures that "federal jurisdiction under CAFA cannot be defeated by adding a claim that falls within a § 1332(d)(9) exception to a class action complaint advancing one or more other claims." *Id.* at 32. Consequently, plaintiffs' class action was not removable because it solely involved a single claim grounded in the terms of a document that created and defined a security. *See id.*

Materiality

Gibson Dunn secured an important victory on materiality grounds in *Berks County Employees' Retirement Fund v. First American Corporation*, --- F. Supp. 2d ---, 2010 WL 3430517 (S.D.N.Y. Aug. 31, 2010). There, the court denied plaintiffs' motion for class certification on Section 10(b) claims, finding no evidence that the alleged misrepresentations were material, as is required for a presumption of reliance under either *Affiliated Ute* or the fraud-on-the-market doctrine. The case stemmed from the New York Attorney General's investigation of First American subsidiary eAppraiseIT, which allegedly inflated mortgage appraisals at the best of its client, Washington Mutual. However, the revenue received from WaMu was only .3% of First American's total revenue, and plaintiffs offered no evidence supporting their theory that revelation of the NYAG investigation impugned the integrity of defendants' management or otherwise would have been viewed by a reasonable investor as having significantly alterted the total mix of information made available. Moreover, the court rejected the plaintiffs' attempt to show materiality by resort to stock price movements, as the purported corrective disclosures that preceded those movements "disclosed no new information regarding defendants."

Mutual Funds

As we reported in our Mid-Year Update, the Supreme Court in *Jones v. Harris Associates L.P.*, 130 S. Ct. 1418 (2010), clarified the standard for determining whether investment advisory fees are excessive within the meaning of Section 36(b) of the 1940 Act. The Court adopted a standard largely based on the Second Circuit's decision in *Gartenberg v. Merrill Lynch Asset Mgt.*, 694 F.2d 923 (2d Cir. 1982). The *Gartenberg* standard holds that to violate Section 36(b), an adviser "must charge a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's length bargaining." justThe Court did not adopt *Gartenberg* wholesale, though, as it emphasized that a "degree of deference" is due to a board's decision to approve an adviser's fees and it did not "countenance the free-ranging judicial 'fairness' review of fees that *Gartenberg* could be read to authorize." Gibson Dunn submitted an amicus brief in *Jones v. Harris* on behalf of the Independent Directors Council.

In December, a federal district court issued a decision in *Gallus v. Ameriprise Financial, Inc.*, No. 04-cv-04498, 2010 WL 5137419 (D. Minn. Dec. 9, 2010), that has attracted widespread attention as the first implementation of the Supreme Court's decision in *Jones*. In an earlier decision, the district court had rejected the *Gallus* plaintiffs' argument that "the Board followed a flawed process in establishing the advisory fees charged to the funds" because the adviser "failed to provide [the Trustees] with sufficient and reliable information." *Gallus v. Ameriprise Fin., Inc.*, 497 F. Supp. 2d 974, 983 (D. Minn. 2007). The district court reasoned that "while Plaintiffs contend that the information Defendants provided the Board was misleading, Plaintiffs fail to describe how these alleged deficiencies affected the results of the Board's *fee-negotiation* process." *Id.* (emphasis added). Applying the *Gartenberg* standard, the district court held that plaintiffs failed to establish a genuine issue of material fact regarding whether the advisory fees were excessive. *Id.* at 983-84. The Eighth Circuit reversed, concluding that information withheld by the adviser could violate Section 36(b) even in the absence of a *Gartenberg*-based fee challenge. *Gallus v. Ameriprise Fin., Inc.*, 561 F.3d 816, 823-24 (8th Cir. 2009). The Supreme Court vacated that decision and remanded for further consideration in light of *Jones*. *Ameriprise Fin., Inc. v. Gallus*, 130 S. Ct. 2340 (2010) (mem.). On remand, the district court concluded that the Supreme Court's endorsement of the *Gartenberg* standard precluded the *Gallus* plaintiffs' disclosure-based theory, and reconfirmed its previous summary judgment ruling.

Settlement

Courts have also opined on the propriety of settlement agreements. For example, in *Cohen v. Viray*, 622 F.3d 188 (2d Cir. 2010), the Second Circuit vacated a settlement agreement as impermissibly releasing a CEO and CFO from liability arising under the Sarbanes-Oxley Act, in violation of SOX Section 304, 15 U.S.C. § 7243, which grants the SEC the sole authority to exempt persons from Section 304 liability.

The Ninth Circuit in *In re Mercury Interactive Corp. Securities Litigation*, 618 F. 3d 988 (9th Cir. 2010), found that the district court abused its discretion in awarding attorneys fees to a settlement class, because it set the objection deadline for class members on a date before the deadline for lead counsel to file its fee motion. The Ninth Circuit found that this sequencing violated Rule 23(h), which allows class members to object to fee motions, not merely the preliminary notice that such a motion will be filed. Accordingly, the court vacated the fee award and remanded for further proceedings.

SEC and DOJ Actions

As we reported in our Mid-Year Update the First Circuit, sitting *en banc*, held that the SEC could not pursue allegations that two former executives of a mutual fund distributor were primarily liable under Rule 10b-5 for using false or misleading prospectuses to sell fund shares. *SEC v. Tambone*, 597 F.3d 436 (1st Cir. 2010) (*en banc*). According to the court, the SEC's interpretation of Rule 10b-5(b) was overly expansive, as it suggested that one may "make" a statement within the purview of the rule by merely using or disseminating a statement without regard to the authorship of that statement or, in the alternative, that securities professionals who direct the offering and sale of shares on behalf of an underwriter impliedly "make" a statement, covered by the Rule, to the effect that the disclosures in a prospectus are truthful and complete. The court interpreted the word "make" in Rule 10b-5(b) to be narrower, drawing a distinction between the words "use" and "employ" used in Section 10(b). The court also found that the SEC's interpretation of the Rule was "in tension" with the Supreme Court's decision in *Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164 (1994), which carefully circumscribed secondary liability, because the SEC's rule would essentially seek to impose primary liability for a secondary violation of the Rule.

In addition to what we reported in our Mid-Year Update, there have been the following recent significant developments in the area of SEC and DOJ enforcement.

- In *U.S. v. Goyal*, --- F.3d --- (9th Cir., No. 08-10436, Dec. 10, 2010), the Ninth Circuit issued an opinion regarding scienter in a criminal case that should be important in future SEC and DOJ enforcement actions and in private securities litigation. The Ninth Circuit reversed the criminal conviction of the former CFO of Network Associates, remanding the case to the district court for entry of a judgment of acquittal. It held, among other things, that the jury could not have inferred fraudulent intent from the CFO's desire to meet revenue targets and his knowledge of and participation in deals to help meet them, because that was "simply evidence of [the CFO] doing his job diligently." The Court also found that jury could not infer fraudulent intent from the CFO's presumed knowledge of GAAP: "If simply understanding accounting rules or optimizing a company's performance were enough to establish scienter, then any action by a company's [CFO] that a juror could conclude in hindsight was false or misleading could subject him to fraud liability without regard to intent to deceive. That cannot be." The court also held that the jury could not infer fraudulent intent from the fact that the CFO's bonus was largely dependent on achieving corporate performance goals. The Chief Judge of the Ninth Circuit went so far as to file a separate concurrence in which he expressed concern for the CFO and his family, and the hope that "the government will be more cautious in the future."

- The Fifth Circuit breathed new life into the SEC's enforcement action against Dallas Mavericks' owner Mark Cuban by reversing the district court's dismissal of the insider trading claims. *SEC v. Cuban*, 650 F.3d 551 (5th Cir. 2010). The SEC brought its suit against Cuban alleging he violated Section 17(a) of the 1933 Act, Section 10(b) of the 1934 Act, and Rule 10b-5 under the misappropriation theory of liability. The core allegation is that Cuban received confidential information from the CEO of Mamma.com, a Canadian search engine company in which Cuban was a large minority stakeholder, that he agreed to keep the information confidential, and acknowledged he could not trade on the information. According to the SEC, before the CEO told Cuban about a PIPE offering, he informed Cuban that the information was confidential and, according to the CEO, Cuban agreed to keep the information confidential. Cuban was not happy to learn about the offering because he said it would dilute existing shareholders. At the end of their call, Cuban told the CEO he was "screwed" and "can't sell." Taking the CEO up on his offer of more details on the offering, Cuban learned that the offering would be at a discounted price. One minute later, Cuban called his broker and instructed him to sell his shares in the company. When the PIPE offering was announced, Mamma.com's stock price fell significantly, and Cuban avoided $750,000 in losses The district court found that, at most, the complaint alleged an agreement to keep the information confidential, but did not include an agreement not to trade. Finding a simple confidentiality agreement to be insufficient to create a duty to disclose or abstain from trading under the securities laws, the court granted Cuban's motion to dismiss. The Fifth Circuit, in a highly fact-specific opinion, came to a different conclusion, holding that the allegations, taken in their entirety, supported at least an "equally plausible" conclusion that the understanding between the CEO and Cuban was that he was not to trade, and for that reason the complaint should not have been dismissed on a Rule 12(b)(6) motion.

- The Second Circuit vacated a district court's order requiring Galleon Group founder Raj Rajaratnam to turn over wiretap evidence to the SEC that he received from the government in connection with its criminal prosecution. *SEC v. Rajaratnam*, 622 F.3d 159 (2d Cir. 2010). The Second Circuit found that the district court abused its discretion in ordering the disclosure without considering Rajaratnam's privacy interests, and without considering the legality of the wiretaps in the first instance.

- On December 20, the SEC announced the first non-prosecution agreement that it has entered into since the announcement of its new cooperation initiative earlier this year. The non-prosecution agreement was entered into with Carter's, Inc., an Atlanta-based marketer of children's clothing, and relates to alleged wrongdoing by a former executive vice president of Carter's, who is the subject of a complaint filed by the SEC that alleges that the former executive vice president committed fraud that caused material misstatement of Carter's publicly-reported financial statements. In the non-prosecution agreement, the SEC agrees not to bring any enforcement action or proceeding against Carter's in connection with its investigation of this issue, in exchange for Carter's "full, truthful and continuing cooperation" in the investigation and any related enforcement litigation or proceeding.

- The SEC and DOJ are conducting insider trading investigations relating to hedge funds' and other investors' use of third-party research firms (so-called "expert networks"). The research is often paid for with so-called "soft dollars"--*i.e.*, arrangements in which the investment manager directs commissions towards a third party. The investigations have featured raids of hedge funds' offices with high-profile media coverage. The SEC and DOJ are investigating, among other issues, whether the research constitutes inside information, which could trigger criminal or civil insider trading liability for the hedge funds that use the research. They may also be attempting to expand the traditional use of insider trading statutes to third-party research where the recipient was not aware that the research it received was based on material, nonpublic information.

- On August 11, 2010, the SEC amended its rules to make permanent the Enforcement Division's power to issue formal orders of investigation, greatly expanding the Enforcement Division's power to compel the production of documents and testimony. In August, 2009, the five SEC commissioners had delegated their power to issue formal orders of investigation to the Enforcement Division for a one-year trial program. At the time, Robert Khuzami, the Enforcement Director, said that "if defense counsel resist the voluntary production of documents or witnesses, or fail to be complete and timely in responses or engage in dilatory tactics, there will very likely be a subpoena on your desk the next morning."

- On July 23, 2010, the SEC announced that it had awarded a $1 million bounty to an individual who had provided documents and information that had lead to civil penalties in the SEC's insider trading actions against Pequot Capital Management and certain individuals. This bounty was by far the largest that the SEC had ever awarded and amounted to 10% of the penalties that the SEC had collected in the settled charges against Pequot and one of the individuals. It is noteworthy that the Dodd-Frank Act has increased the potential bounty to 30% of the total monetary sanctions collected in resulting actions, as well as increasing protections for whistleblowers. It is clear that this bounty and the recent authority for increased bounties shows the SEC's intent to use these rewards to motivate whistleblowers to come forward. Of course, they will also motivate misplaced, inaccurate, and unfounded complaints, as well.

- Judge Rakoff of the Southern District of New York reluctantly approved a $150 million settlement between Bank of America and the SEC, stemming from BofA's acquisition of Merrill Lynch. SEC v. Bank of America, Nos. 09 Civ. 6829, 10 Civ. 0215 (S.D.N.Y.) The SEC claimed BofA should have disclosed billions of losses Merrill sustained before the merger, as well as bonuses it had authorized Merrill to pay. Judge Rakoff had previously rejected a $33 million dollar settlement in the related cases, and his displeasure over the ultimate settlement--which he criticized as merely transferring loss from one group of shareholders to another--could foreshadow increased judicial oversight of settlements.

For more securities enforcement news, see Gibson Dunn's Securities Enforcement 2010 Year-End Report.

Legislative Update

In the legislation area, we discussed in our Mid-Year Update the sweeping Dodd-Frank Wall Street Reform and Consumer Protection Act. For a more complete and exhaustive analysis of the Dodd-Frank legislation, see Gibson Dunn's prior summaries regarding the provisions regarding SEC enforcement authority, executive compensation and corporate governance, advisers to private funds, and derivatives regulation.

Recently, the SEC published for comment a proposed "whistleblower" rule pursuant Section 922 of the Act, which requires the SEC to pay a reward between 10 to 30 percent of the amount recouped to individuals that provide original information that results in monetary sanctions exceeding $1 million. Among other things, the proposed rule further defines and expands the requirements that the individual "voluntarily" provide the SEC with "original information" that leads to "successful enforcement." The public comment period expired on December 17, 2010.

Conclusion

The past year has been another busy one in securities litigation, with important developments in many different areas. Gibson Dunn will continue to track the latest developments and trends. Look for our updates whenever a major opinion is issued, and watch this summer for our 2011 Mid-Year Securities Litigation Update.

Gibson, Dunn & Crutcher lawyers are available to assist in addressing any questions you may have regarding these issues. Please contact the Gibson Dunn lawyer with whom you work or any of the following members of the Securities Litigation Practice Group Steering Committee:

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