Weil

The 10b-5 Guide

A Survey of 2010-2011 Securities Fraud Litigation

Robert F. Carangelo, Esq.
Paul A. Ferrillo, Esq.
David J. Schwartz, Esq.
Matthew D. Altemeier, Esq.

Weil, Gotshal & Manges LLP

September 2012

BY

Weil, Gotshal & Manges LLP

Robert F. Carangelo, Esq.

Paul A. Ferrillo, Esq.

David J. Schwartz, Esq.

Matthew D. Altemeier, Esq.

767 Fifth Avenue
New York, New York 10153
Phone 212.310.8000 • Fax 212.310.8007
www.weil.com

Table of Contents

FOREWORD iii

INTRODUCTION v

CHAPTER 1: SECURITIES LITIGATION BASICS 1

GENERAL PRINCIPLES OF SECURITIES LAW 1

EXTRATERRITORIALITY UNDER MORRISON 2

CHAPTER 2: PLEADING STANDARDS AND SCIENTER 11

PLEADING STANDARDS 11

Federal Rule of Civil Procedure 9(b) 11

The PSLRA's Statutory Pleading Requirements 12

SCIENTER 19

Methods of Pleading Scienter: Motive and Opportunity, Conscious Misbehavior, and Recklessness 25

PLEADING SCIENTER THROUGH MOTIVE AND OPPORTUNITY 32

PLEADING SCIENTER THROUGH ALLEGATIONS OF CONSCIOUS MISBEHAVIOR OR RECKLESSNESS 44

CORPORATE SCIENTER 59

GROUP PLEADING 66

THE CORE OPERATIONS DOCTRINE 71

PLEADING ACCOUNTING FRAUD 74

PLEADING ALLEGATIONS BASED ON CONFIDENTIAL SOURCES OF INFORMATION 79

CHAPTER 3: MATERIALITY, SAFE HARBOR, AND LOSS CAUSATION 87

PLEADING MATERIALITY 87

FALSITY DISTINGUISHED 102

THE PSLRA'S SAFE HARBOR FOR FORWARD LOOKING STATEMENTS 107

The Bespeaks Caution Doctrine 116

LOSS CAUSATION 119

CHAPTER 4: LIABILITY ISSUES 135

LIABILITY OF SECONDARY ACTORS IN SECURITIES MARKETS 135

CONTROL PERSON LIABILITY 150

CHAPTER 5: CLASS ACTION PROCEDURAL MECHANISMS 157

THE LEAD PLAINTIFF PROVISIONS OF THE PSLRA 157

Largest Financial Stake/Greatest Economic Loss 158

Substitution of Lead Plaintiffs 159
CLASS CERTIFICATION REQUIREMENTS UNDER RULE 23 161
Rule 23(a) Requirements 161
Rule 23(b) Requirements 168
LOOKING BEYOND THE PLEADINGS 181
CHAPTER 6: OTHER PROCEDURAL ISSUES 183
STATUTE OF LIMITATIONS 183
EXPERT TESTIMONY AND DAUBERT MOTIONS 188
STANDING 190
DAMAGES 193
STAY OF DISCOVERY 194
IMPOSITION OF RULE 11 SANCTIONS 197
MOTIONS TO COMPEL DISCLOSURE OF CONFIDENTIAL WITNESSES DURING DISCOVERY 200
ABOUT WEIL, GOTSHAL & MANGES LLP 203
ROBERT F. CARANGELO 205
PAUL A. FERRILLO 207
DAVID J. SCHWARTZ 209
MATTHEW D. ALTEMEIER 211
TABLE OF AUTHORITIES 213

Foreword

Years from now, when historians write the history of the Roberts Court, perhaps they will be able to explain why, in the second half of the first dozen years of the 21st Century, the Supreme Court suddenly became so interested in taking up cases under the federal securities laws. But whatever the reason, in recent years the Court has agreed to consider a cluster of securities cases, and the Court's decisions have had and will have a far-reaching impact on securities litigation—particularly securities class action litigation.

Among all of the litigation risks a company faces, the risk of a securities class action lawsuit may be among the most serious. These cases are complex, time-consuming and expensive to defend. As if that were not enough, the applicable law is constantly evolving, especially now with the Supreme Court's new-found interest in securities cases. These factors also make litigation arising under the securities laws, particularly under Section 10(b) of the Securities Exchange Act of 1934, so interesting—which of course is cold consolation for the companies involved, but it does mean that securities cases reliably provide particularly rich blog fodder.

Because the securities litigation landscape is so complex and rapidly changing, it is critically important—for in-house counsel, prognosticators, and historians alike—to have a reliable reference source. In their readable, interesting, and concise book, The 10b-5 Guide, Messrs. Carangelo, Ferrillo, Schwartz and Altemeier of Weil, Gotshal & Manges have again done a terrific job erecting useful structure around this complex topic, and identifying and explicating the most recent developments in this area of the law. Their book provides just the comprehensive guide that the topic requires. We can all be grateful for their work.

Kevin M. LaCroix
Author, The D&O Diary

Introduction[1]

Perhaps there is something in the water on First Street. A review of the trends in private Section 10(b) and Rule 10b-5 cases reveals that during the last two years, the United States Supreme Court has issued more precedential opinions than were decided in the previous eighteen.[2] The question remains whether Supreme Court jurisprudence over the last two years will significantly alter the 10b-5 landscape at the district and circuit court levels.

In Merck & Co. v. Reynolds, 130 S. Ct. 1784, 1790 (2010), plaintiff investors brought a 10b-5 action against Merck & Co., alleging that it had "knowingly misrepresented the risks of heart attacks accompanying the use of Merck's pain-killing drug, Vioxx (leading to economic losses when the risks later became apparent)." The applicable statute of limitations, 28 U.S.C. § 1658(b), states that a cause of action may be brought no later than the earlier of two years after discovery of the facts constituting the violation or five years after the violation itself. Merck argued that the plaintiffs knew or should have known of facts constituting the violation more than two years prior to filing their complaint.[3] The district court agreed and dismissed the complaint, and the Third Circuit reversed.[4]

Merck argued before the Supreme Court that the statute of limitations began to run when the plaintiffs were on "inquiry notice," which it defined as the point when a plaintiff possesses information "sufficiently suggestive of wrongdoing that he should conduct a further inquiry."[5] Merck contended that a number of public disclosures concerning the

[1] The authors would like to thank Michael Horowitz, Amanda Burns, Daniel Martin, Alana Montas, Joanne Pedone, Heather Shea, Cliff Silverman, and Amy Suehnholz, associates in the Securities Litigation practice group of Weil, Gotshal & Manges LLP, as well as summer associates Lenny Sandler and Caroline Toole for their invaluable assistance in the preparation of The 10b-5 Guide. We also appreciate the diligent paralegal assistance of Gina Casoria, Daniel Decker, Shelley Fortune, Jeff Hausman, Crystal McCray, Angela Oliva, Toby Saviano, and Sandra Wong.

[2] Compare Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 2541 (2011) (although Wal-Mart does not specifically mention Section 10(b) or Rule 10b-5, it is relevant to the class certification stage of securities litigation); Janus Capital Grp., Inc. v. First Deriv. Traders, 131 S. Ct. 2296 (2011); Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179 (2011); Matrixx Initiatives, Inc. v. Siracusano, 131 S. Ct. 1309 (2011); Morrison v. Nat'l Austl. Bank Ltd., 130 S. Ct. 2869 (2010); and Merck & Co. v. Reynolds, 130 S. Ct. 1784 (2010); with Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148 (2008); Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308 (2007); Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71 (2006); Dura Pharm., Inc. v. Broudo, 544 U.S. 336 (2005); and Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164 (1994).

[3] Merck, 130 S. Ct. at 1792.

[4] Id. at 1792-93.

[5] Id. at 1797 (internal quotation marks omitted).

risks associated with Vioxx put the plaintiffs on inquiry notice more than two years before they filed suit, making their claim untimely.[6]

In a unanimous opinion, the Supreme Court rejected Merck's proposed inquiry notice standard, holding that the limitations period for a 10b-5 claim "begins to run once the plaintiff did discover *or a reasonably diligent plaintiff would have 'discover[ed]* the facts constituting the violation'—whichever comes first."[7] Among the facts a reasonably diligent plaintiff must discover to trigger the statute of limitations, the Court continued, are facts showing scienter—"an important and necessary element" of the claim.[8]

Applying these standards, the Court reasoned that an FDA warning letter and products-liability complaints filed against Merck did not contain enough specific information concerning the defendants' states of mind to trigger the limitations period.[9] Because no facts in evidence suggested scienter on the part of Merck more than two years prior to the filing of the complaint, the Court affirmed the Third Circuit's judgment and held the complaint timely.[10]

In Morrison v. Nat'l Austl. Bank Ltd., 130 S. Ct. 2869 (2010), the plaintiffs sought to represent a class of foreign stock purchasers against National Australia Bank Limited ("National"), HomeSide Lending, Inc. ("HomeSide"), and HomeSide executives for violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. In February 1998, National, an Australian bank with ordinary shares listed on a foreign securities exchange, purchased HomeSide, a Florida-based mortgage services company.[11] Plaintiffs alleged that HomeSide manipulated financial models in its public disclosures by underestimating refinancing rates, which inflated the value of their mortgage business.[12] The district court granted the defendants' motion to dismiss for lack of subject matter jurisdiction because the alleged fraudulent scheme occurred abroad.[13] The Second Circuit affirmed.[14]

---

[6] Id.

[7] Id. at 1798 (emphasis added).

[8] Id.

[9] Id. at 1798-99.

[10] Id. at 1799.

[11] Morrison, 130 S. Ct. at 2875.

[12] Id. at 2876.

[13] Id.

[14] Id. at 2876.

To determine whether Section 10(b) should apply extraterritorially, the Supreme Court began with the presumption against extraterritorial effect requiring Congress to give clear indication of extraterritorial application.[15] After acknowledging that the Second Circuit had given extraterritorial effect to Section 10(b) for nearly fifty years through "judge-made rules," Justice Antonin Scalia proclaimed them judicial fantasy.[16] Using textual analysis, Justice Scalia determined that there was no affirmative indication of extraterritorial application in Section 10(b).[17]

The Court then proceeded to create its own "'transactional test,'" which applies Section 10(b) to "the purchase or sale of a security listed on an American stock exchange" *or* the "purchase or sale of any other security in the United States."[18] Unfortunately, this test has raised more questions than answers. While interpretation of the first prong of the transactional test—"a security listed on an American stock exchange"—is clear, lower courts continue to struggle with application of the second prong.[19]

In Matrixx Initiatives, Inc. v. Siracusano, 131 S. Ct. 1309 (2011), the Supreme Court, in the tradition of Basic and Tellabs, refused to adopt a bright-line rule as to materiality and scienter. The plaintiffs alleged that Matrixx and three executive officers failed to disclose reports that one of its core products, Zicam, a nasal spray which accounted for 70 percent of Matrixx's sales, was linked to anosmia (loss of smell) in users.[20] The district court granted Matrixx's motion to dismiss, holding that the plaintiffs had not alleged any reports showing a "statistically significant correlation between the use of Zicam and anosmia . . . ."[21] The Ninth Circuit reversed, finding that an allegation of "statistical significance" was not required to establish materiality.[22]

In a unanimous decision, the Supreme Court affirmed the Ninth Circuit. Relying on Basic, Justice Sonia Sotomayor rejected a bright-line rule to determine materiality, noting that any approach that "'designates a single fact or occurrence as always determinative of an inherently fact-specific finding such as materiality, must necessarily be

[15] Id. at 2877-78.

[16] Id. at 2881.

[17] Id. at 2881-83.

[18] Id. at 2888.

[19] See, e.g., Absolute Activist Value Master Fund Ltd. v. Ficeto, 677 F.3d 60 (2d Cir. 2012).

[20] Matrixx, 131 S. Ct. at 1314.

[21] Id. at 1317 (citation omitted).

[22] Id.

overinclusive or underinclusive.'"[23] The Court stated that there were several facts alleged in the complaint (including product-related complaints and the institution of four products liability lawsuits) that raised "'a reasonable expectation that discovery will reveal evidence' satisfying the materiality requirement."[24] The Court also concluded that the plaintiffs did not need to allege knowledge of a statistically significant relationship between Zicam and anosmia to successfully plead scienter because the complaint contained numerous other allegations from which recklessness could be inferred.[25]

The questions remain whether Matrixx's review of materiality and scienter will significantly alter how pharmaceutical and biotechnology companies report information to investors and the public at large, and whether this decision will spill over into business sectors beyond the drug and health industry.

In Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179 (2011), the Erica P. John Fund ("EPJ Fund") alleged that Halliburton Co. made various misrepresentations designed to inflate its stock price in violation of Section 10(b) and Rule 10b-5. The alleged false statements concerned the scope of potential liability in asbestos litigation, expected revenue from construction contracts, and the benefits of a merger.[26] The district court denied class certification, stating that the EPJ Fund failed to prove loss causation.[27] The Fifth Circuit affirmed, following the precedent set in Oscar Private Equity Invs. v. Allegiance Telecom, Inc., 487 F.3d 261, 269 (5th Cir. 2007) (requiring proof of loss causation at the class certification stage).

The Supreme Court reversed the Fifth Circuit's decision, holding that the plaintiffs did not have to prove loss causation at the class certification stage to invoke the classwide presumption of reliance promulgated in Basic.[28] In a unanimous decision for the Court, Chief Justice Roberts held that the elements of reliance and loss causation are wholly independent elements of a Section 10(b) claim.[29] Relying on Basic, Chief Justice Roberts noted that the fraud-on-the-market theory underpinning the presumption of reliance focuses on material misrepresentations that permeate an efficient market and thereby affect all purchasers and sellers.[30] "Loss causation, by contrast, requires a plaintiff to show that a

[23] Id. at 1318 (citation omitted).

[24] Id. at 1322 (citation omitted).

[25] Id. at 1324.

[26] Halliburton, 131 S. Ct. at 2183.

[27] Id. at 2183-84.

[28] Id. at 2183.

[29] Id. at 2185-86.

[30] Id.

misrepresentation that affected the integrity of the market price *also* caused a subsequent economic loss."[31] Thus, the Court reasoned, to invoke the Basic presumption a plaintiff need only demonstrate that "the alleged misrepresentations were publicly known . . . that the stock traded in an efficient market," and that the transaction took place "'between the time the misrepresentations were made and the time the truth was revealed.'"[32]

Though Halliburton has removed loss causation as a viable merits inquiry at class certification, expect the fraud-on-the-market presumption to remain a fervent battleground until the Supreme Court readdresses the issue in Amgen later this year.[33]

In Janus Capital Grp., Inc. v. First Deriv. Traders, 131 S. Ct. 2296 (2011), lead plaintiff First Derivative Traders, representing a class of purchasers of Janus Capital Group, Inc. ("JCG") stock, asserted claims against JCG and Janus Capital Management LLC ("JCM"), an investment adviser and wholly owned subsidiary of JCG, for violations of Section 10(b) and Rule 10b-5.[34] JCG ran a family of mutual funds organized as a Massachusetts business trust, the Janus Investment Fund ("JIF").[35] Although JIF was started by JCG, JIF is a separate legal entity and retained JCM as its investment adviser.[36] Through its business, JIF issued prospectuses stating that Janus funds were not suitable for market timing.[37] First Derivative alleged that JCM and JCG mislead the investing public concerning implementation of measures to curb market timing in response to a September 2003 complaint filed by New York's Attorney General.[38]

Despite allegations that JCM was "significantly involved in preparing the prospectuses [of JIF]," and that all of the officers of JIF were also officers of JCM, the Supreme Court ultimately determined that JCM could not be liable because "[a]lthough JCM, like a speechwriter, may have assisted [JIF] with crafting what [JIF] said in the prospectuses, JCM itself did not 'make' those statements for purposes of Rule 10b-5."[39] The Court ultimately held that "[f]or purposes of Rule 10b-5, the maker of a statement is

---

[31] Id. at 2186.

[32] Id. at 2185 (citation omitted).

[33] See Conn. Ret. Plans & Trust Funds v. Amgen Inc., 660 F.3d 1170 (9th Cir. 2011), cert. granted, 132 S. Ct. 2742 (U.S. 2012), discussed further below.

[34] Janus, 131 S. Ct. at 2299.

[35] Id.

[36] Id.

[37] Id. at 2300.

[38] Id.

[39] Id. at 2305.

the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it. Without control, a person or entity can merely suggest what to say, not 'make' a statement in its own right."[40] Because JIF and JCM are separate legal entities and there was nothing on the face of the prospectuses to indicate attribution to JCM, the Court reversed the Fourth Circuit.[41] The judicial distinction between one who "assists" in preparation of public statements and one who "controls" the ultimate outcome of a public statement could have profound implications for secondary and related actors in 10b-5 actions, as will be discussed herein.

Although Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 2541 (2011), does not mention Rule 10b-5, it has the potential to impact future 10b-5 cases. In Wal-Mart, three named plaintiffs representing 1.5 million class members, each a current or former female employee of the company, asserted sexual discrimination in violation of Title VII of the 1964 Civil Rights Act.[42] Specifically, the plaintiffs alleged that local managers' discretion over pay and promotions was exercised disproportionately in favor of men, leading to an unlawful disparate impact on female employees.[43] The district court and Ninth Circuit each approved certification of the class.[44]

Reversing the Ninth Circuit, Justice Scalia, in a 5-4 decision, determined that the central issue in the case was Rule 23(a)(2)'s commonality requirement.[45] Justice Scalia determined that plaintiffs could not satisfy Rule 23(a)(2) because they failed to allege any uniform employment practice and the allegations centered on local managers enacting local decisions.[46] The Court emphasized that commonality does not merely require '"the raising of common "questions"—even in droves—but, rather the capacity of a classwide proceeding to generate common *answers* apt to drive the resolution of the litigation'" and the ability to "resolve an issue that is central to the validity of each one of the claims in one stroke."[47] The Court ruled that the evidence presented could not generate such common answers because the plaintiffs could not demonstrate a common method of exercising

---

[40] Id. at 2302.

[41] Id. at 2304-05.

[42] Wal-Mart, 131 S. Ct. at 2547.

[43] Id. at 2548.

[44] Id. at 2549-50.

[45] Id. at 2550-51.

[46] Id. at 2554.

[47] Id. at 2551 (citation omitted).

discretion that permeated the company.[48] Following Wal-Mart, circuit and district courts have struggled with several questions—namely, does this language generally set a stricter commonality standard under Rule 23(a) and, if so, is that standard applicable to 10b-5 securities class actions?

Though primarily concerned with Rule 23 class certification requirements, Justice Scalia's opinion in Wal-Mart also touched upon whether class certification expert witnesses should be subjected to Daubert scrutiny—a frequently-litigated issue.[49] In Wal-Mart, the district court determined that courts need not "apply the full Daubert 'gatekeeper' standard" to expert testimony at class certification, holding instead that "a lower Daubert standard should be employed . . . ."[50] The Ninth Circuit, sitting en banc, affirmed this determination.[51] The Supreme Court, however, characterized the district court's decision as finding that "Daubert did not apply to expert testimony at the certification stage . . . ."[52] After stating that "[w]e doubt that is so," the Supreme Court went on to explain that "even if properly considered, [the expert] testimony does nothing to advance [the plaintiffs'] case" because it failed to address the dispositive question at issue.[53] Thus, while the Court's expressed "doubt" is dicta, it nonetheless signals a preference for full Daubert scrutiny at the class certification stage.[54]

Looking ahead, in the fall of 2012, in addition to Comcast, the Supreme Court will hear arguments in Amgen, addressing a circuit split regarding whether plaintiffs must prove materiality to invoke the fraud-on-the-market theory's classwide presumption of reliance at the class certification stage.[55]

---

[48] Id. at 2554-55.

[49] See generally Daubert v. Merrell Dow Pharm., Inc., 509 U.S. 579 (1993).

[50] Dukes v. Wal-Mart, Inc., 222 F.R.D. 189, 191 (N.D. Cal. 2004) (citations omitted).

[51] Dukes v. Wal-Mart Stores, Inc., 603 F.3d 571, 602-03 (9th Cir. 2010) (en banc).

[52] Wal-Mart, 131 S. Ct. at 2553-54.

[53] Id. at 2554.

[54] Indeed, the admissibility of expert evidence at the class certification phase will be addressed by the Supreme Court this fall. The Court recently granted *certiorari* in Comcast Corp. v. Behrend to answer the question of "[w]hether a district court may certify a class action without resolving whether the plaintiff class has introduced admissible evidence, *including expert testimony*, to show that the case is susceptible to awarding damages on a classwide basis." 2012 WL 113090 (U.S. June 25, 2012) (emphasis added). Resolution of this question implicates not only the admissibility of expert testimony specifically, but also the extent to which courts consider merits issues at class certification generally—topics highly relevant to any securities fraud class action.

[55] See Conn. Ret. Plans & Trust Funds v. Amgen Inc., 660 F.3d 1170 (9th Cir. 2011), cert. granted, 132 S. Ct. 2742 (U.S. 2012).

In Amgen, the plaintiffs brought a putative class action under Rule 10b-5, alleging that Amgen and several of its directors and officers misstated and failed to disclose safety information about two of Amgen's pharmaceutical products.[56]

In determining whether the plaintiffs must prove materiality to gain the benefit of the fraud-on-the-market presumption, the Ninth Circuit identified a circuit split on the issue originating from divergent interpretations of a footnote in Basic.[57] Ultimately, the Ninth Circuit agreed with the Seventh Circuit[58] that Basic only envisioned materiality as an essential element of the fraud-on-the-market presumption *on the merits*, and therefore ruled that plaintiffs "must plausibly allege—but need not *prove* at this juncture—that the claimed misrepresentations were material."[59] For the same reason, the Ninth Circuit also did not allow the defendants to rebut the plaintiffs' materiality showing.[60] This approach, however, differs from the Second and Fifth Circuits, which require plaintiffs to prove materiality at the class certification stage to utilize the Basic presumption, and which also allows defendants an opportunity to rebut that showing.[61] The Third Circuit takes a middle-of-the-road approach, which does not require evidence of materiality to invoke the fraud-on-the-market presumption, but does permit defendants an opportunity to rebut the presumption once established.[62] Given the significance of class certification to 10b-5 cases, the outcome of this case could have enormous ramifications for future securities class actions.

Securities Litigation Trends

Federal securities class action filings spiked in 2008, rising over 25% from the previous year to 223 filings.[63] In 2011, 188 securities class actions were filed, up from 176 in 2010.[64] The cases filed in the past two years have moved beyond the financial crisis. In

[56] Amgen, 660 F.3d at 1172.

[57] See Basic Inc. v. Levinson, 485 U.S. 224, 248 n.27 (1988).

[58] See Schleicher v. Wendt, 618 F.3d 679 (7th Cir. 2010).

[59] Amgen, 660 F.3d at 1172.

[60] Id. at 1177.

[61] See In re Salomon Analyst Metromedia Litig., 544 F.3d 474 (2d Cir. 2008); Oscar Private Equity Invs. v. Allegiance Telecom, Inc., 401 F.3d 316 (5th Cir. 2005), abrogated on other grounds by Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179 (2011).

[62] See In re DVI, Inc. Sec. Litig., 639 F.3d 623 (3d Cir. 2011).

[63] See Cornerstone Research, Securities Class Action Filings: 2012 Mid-Year Assessment, at 3 (2012).

[64] Id.

particular, four years ago dockets were plagued with 100 subprime filings in the aftermath of the credit crisis, but only thirteen financial crisis-related cases were filed in 2010, and just three were filed in 2011.[65]

On the settlement front, there were only sixty-five court-approved securities class action settlements in 2011 involving $1.4 billion in total settlement funds—the lowest number of approved settlements and corresponding total settlement dollars in more than ten years.[66] The number of settlements approved in 2011 decreased by almost 25 percent compared with 2010 and was more than 35 percent below the average for the preceding ten years.[67]

The Purpose of The 10b-5 Guide

The 10b-5 Guide summarizes noteworthy cases decided in 2010 and 2011 involving private causes of action based on violations of Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5 promulgated thereunder.[68] These cases address key issues including pleading standards, the elements of a 10b-5 claim, and class certification. Chapter 1 provides an overview of Section 10(b) of the Exchange Act and Rule 10b-5, as well as summaries of recent opinions relating to their extraterritorial application under Morrison. Chapter 2 discusses pleading standards and scienter. Chapter 3 addresses pleading materiality, the PSLRA's Safe Harbor for forward-looking statements, and loss causation. Chapter 4 focuses on liability issues, particularly relating to secondary actors. Chapter 5 sets forth recent case law concerning the PSLRA's lead plaintiff provision, as well as developments in class certification jurisprudence. Finally, Chapter 6 covers additional procedural developments relating to statutes of limitations, expert testimony and Daubert motions, damages, standing, stays of discovery, Rule 11 sanctions, and motions to compel disclosure of confidential witnesses.

---

[65] See Cornerstone Research, Securities Class Action Filings: 2011 Year in Review, at 1 (2011).

[66] See Cornerstone Research, Securities Class Action Settlements: 2011 Review and Analysis, at 1 (2011).

[67] Id.

[68] For background and other informational purposes, cases outside the time period of 2010 through 2011 are occasionally cited.

1 Securities Litigation Basics

General Principles of Securities Law

Rule 10b-5, promulgated by the U.S. Securities and Exchange Commission ("SEC") under Section 10(b) of the Exchange Act, prohibits fraudulent conduct in connection with the purchase or sale of securities. See 15 U.S.C. § 78j. Rule 10b-5 provides that it is unlawful for any person, directly or indirectly:

1. to employ any device, scheme, or artifice to defraud,
2. to make any untrue statement of material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
3. to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5.

In order to plead a claim for securities fraud under Section 10(b) and Rule 10b-5, a plaintiff must plead:

- a misrepresentation or omission of;
- a material fact;
- reliance thereon;
- causation;
- damages; and
- fraudulent conduct (scienter);
- in connection with the purchase or sale of a security.

Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179, 2184 (2011); Matrixx Initiatives, Inc. v. Siracusano, 131 S. Ct. 1309, 1317 (2011); In re DVI, Inc. Sec. Litig., 639 F.3d 623, 630 (3d Cir. 2011); FindWhat Investor Grp. v. FindWhat.com, 658 F.3d 1282, 1295 (11th Cir. 2011); Ashland, Inc. v. Oppenheimer & Co., 648 F.3d 461, 468 (6th Cir. 2011); Katyle v. Penn Nat'l Gaming, Inc., 637 F.3d 462, 480 (4th Cir.) cert. denied, 132 S. Ct. 115 (2011); Desai v. Deutsche Bank Sec. Ltd., 573 F.3d 931, 939 (9th Cir. 2009); Cent. Laborers' Pension Fund v. Integrated Elec. Servs. Inc., 497 F.3d 546, 550 (5th Cir. 2007); Miss. Pub. Emps.' Ret. Sys. v. Bos. Scientific Corp., 649 F.3d 5, 20 (1st Cir. 2011); Cardon v. TestOut! Corp., 244 F. App'x 908, 914-15 (10th Cir. 2007).

Extraterritoriality under Morrison

In Morrison v. Nat'l Austl. Bank Ltd., 130 S. Ct. 2869 (2010), the Supreme Court held that Section 10(b) applies to "the purchase or sale of a security listed on an American stock exchange" *or* the "purchase or sale of any other security in the United States." Id. at 2888. Under subsequent case law, prong one of the Morrison test is satisfied if the transaction *occurs* on a domestic exchange—it is insufficient for the security to merely be listed on a domestic exchange. See In re Alstom SA Sec. Litig., 741 F. Supp. 2d 469, 473 (S.D.N.Y. 2010) ("That the transactions themselves must *occur on a domestic exchange* to trigger the application of § 10(b) reflects the most natural and elementary reading of Morrison.") (emphasis added); In re UBS Sec. Litig., 2011 WL 4059356, at *5 (S.D.N.Y. Sept. 13, 2011) ("[The Supreme] Court makes clear that § 10(b) applies only to 'purchase-and-sale transactions' that are *executed* 'in the United States' and not to all securities that happen to be cross-listed on an American exchange.") (emphasis added).

With regard to prong two, however, the Supreme Court provided "little guidance as to what constitutes a domestic purchase or sale." Absolute Activist Value Master Fund Ltd. v. Ficeto, 677 F.3d 60, 67 (2d Cir. 2012). To compensate for this lack of guidance, courts have examined the facts of individual cases to determine where a transaction took place—the kind of fact-based analysis that the transactional test purported to do away with. See Cascade Fund, LLP v. Absolute Capital Mgmt. Holdings Ltd., 2011 WL 1211511 (D. Colo. Mar. 31, 2011) (examining facts of the transaction to determine where the transaction was completed). Post Morrison, courts in the Second Circuit have decided a number of prong two cases, yet no cohesive rule has developed. See Absolute Activist, 677 F.3d at 62 ("there has been significant ambiguity as to what constitutes a 'domestic transaction in other securities'").

In an attempt to provide some much needed clarity, the Second Circuit held that to properly allege a domestic securities transaction under Morrison, plaintiffs must allege facts suggesting that *either* (1) "irrevocable liability was incurred" or (2) "that title was transferred within the United States." Id. The second part of the Second Circuit test—transfer of title—was adopted from the Eleventh Circuit's decision in Quail Cruises Ship Mgmt. Ltd. v. Agencia de Viagens CVC Tur Limitada, 645 F.3d 1307 (11th Cir. 2011). Although the courts of appeals have begun to clarify the second prong, various tests are likely to emerge in light of this uncertainty.

The Supreme Court

In Morrison, plaintiffs sought to represent a class of foreign stock purchasers against National Australia Bank Limited ("National"), HomeSide Lending, Inc. ("HomeSide"), and HomeSide executives for violations of Sections 10(b) and 20(a) and Rule 10b-5. In February 1998, National, an Australian bank with its ordinary shares listed on a foreign securities exchange, purchased HomeSide, a Florida based mortgage services company. 130 S. Ct. at 2875. Plaintiffs alleged that HomeSide manipulated financial models in its public disclosures by underestimating refinancing rates, which over-inflated the value of its mortgage business. Id. at 2876. The district court granted defendants' motion to dismiss for lack of subject matter jurisdiction, because the alleged fraudulent scheme occurred abroad. Id. The Second Circuit affirmed. Id.

Morrison has been described as a "foreign-cubed" or "f-cubed" case, because (1) foreign plaintiffs were suing (2) a foreign issuer regarding (3) securities purchased on a foreign exchange.[69] To determine whether Section 10(b) should apply extraterritorially, the Court began with the presumption against extraterritorial effect, stating that the U.S. Congress had to give clear indication of such intent. Id. at 2877-78. Although the Second Circuit applied extraterritorial effect to Section 10(b) for nearly 50 years through "judge-made rules," Justice Scalia proclaimed them judicial fantasy. Id. at 2881. Using textual analysis, Justice Scalia determined that there was no affirmative indication of extraterritorial application in Section 10(b). Id. at 2881-83.

The Court then proceeded to create its own "'transactional test'" holding that Section 10(b) applies to "the purchase or sale of a security listed on an American stock exchange" *or* the "purchase or sale of any other security in the United States." Id. at 2888. Yet Morrison's transactional test has raised more questions than answers. Although interpretation of the first prong of the transactional test—"a security listed on an American stock exchange"—is clear, lower courts continue to struggle with the second prong of the transactional test. Id.

The Second Circuit

In Absolute Activist Value Master Fund Ltd. v. Ficeto, 677 F.3d 60 (2d Cir. 2012), the plaintiffs, a group of Cayman Island-registered hedge funds (the "Funds"), sued various corporations and individuals for securities fraud, alleging that the defendants participated in a pump-and-dump scheme that caused the plaintiffs to purchase billions of shares of worthless U.S.-incorporated penny stock companies (the "Penny Stock Companies") pursuant to private placements at artificially inflated prices. Id. at 62-63. The plaintiffs further alleged that the defendants, who owned shares or warrants of the Penny Stock Companies for which they paid "nothing or almost nothing," manipulated and artificially inflated the price of the shares by actively trading the shares between and among the Funds to "generate substantial commissions" for themselves and "to artificially inflate the stock price" so that the defendants could sell their previously untradeable shares

---

[69] See generally Irwin H. Warren and Matthew E.K. Howatt, Transnational Securities Litigation In The U.S. Courts After Morrison v. National Australia Bank: An "F-Cubed" Regression Analysis, The Canadian Institute's 9th Annual Advanced Forum on Securities Litigation & Enforcement (October 2010).

at a profit. Id. at 64. The plaintiffs alleged total losses in excess of $195 million. Id. Certain defendants moved to dismiss the plaintiffs' complaint. Id. at 65. Following the Supreme Court's decision in Morrison, the district court sua sponte dismissed the complaint with prejudice for lack of subject matter jurisdiction. Id. The Second Circuit affirmed in part, reversed in part, and remanded.

On appeal, the Second Circuit held that the district court erred in dismissing the case for lack of subject matter jurisdiction because Morrison "makes clear that whether [Section] 10(b) applies to certain conduct is a 'merits' question." Id. at 67 (citing Morrison, 130 S. Ct. at 2876-77). The Second Circuit then enunciated a new test for determining whether a transaction constitutes a "domestic transaction in other securities" under the second prong of Morrison's "transactional" test, holding that "to sufficiently allege a domestic securities transaction in securities not listed on a domestic exchange . . . a plaintiff must allege facts suggesting that irrevocable liability was incurred or title was transferred within the United States." Id. at 66, 68. The Second Circuit rejected the parties' invitations to adopt tests based on the location of the broker-dealer, the location of the securities' issuance and registration, the identity of a buyer or seller, or the location of the defendants' conduct. Id. at 68-69. Applying its new "domestic transaction" test, the Second Circuit held that the plaintiffs' complaint lacked sufficient allegations to support the claim that the offerings described in the complaint were "*direct* sales by U.S. companies to the Funds." Id. at 68. Given that the plaintiffs drafted their complaint prior to the Supreme Court's decision in Morrison and because amendment would not be futile, the Second Circuit directed the district court to grant the plaintiffs leave to amend their complaint to include additional factual allegations supporting the plaintiffs' claim that the transactions occurred in the United States. Id. at 71.

In Valentini v. Citigroup, Inc., 837 F. Supp. 2d 304 (S.D.N.Y. 2011), the plaintiffs, a businessman and family trust, brought a claim under Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 against the defendants, Citigroup Financial Services and Citi Private Bank. Id. at 312. The plaintiffs purchased structured notes from the defendants, which included securities linked to the value of American Depository Receipts or common stock of U.S. or Brazilian companies traded on the NYSE. Id. at 311. If the value of the assets to which the note was linked fell below a certain percentage of their initial value, the note would then convert to a certain number of shares of the lowest valued asset linked to the note. Id.

The defendants moved to dismiss, arguing that the district court lacked jurisdiction under Morrison because the plaintiffs did not purchase the structured notes in the U.S. and the notes were not listed on a domestic exchange. Id. at 323. The district court adopted the "economic reality" approach suggested by the Supreme Court for determining Section 10(b)'s reach, and held that the transaction did involve a security listed on a domestic exchange as required under Morrison. Id. at 323-24. The district court reasoned that although the notes were not listed on a domestic exchange, they were (1) linked to securities listed on the NYSE and (2) contained a feature that converted the notes into securities listed on the NYSE if the value of the assets to which the note was linked fell below a certain percentage of their initial value. Id. at 323. As such, the district court determined that the plaintiffs purchased not only convertible notes, but also effectively a "put option" in the NYSE-listed securities to which the notes were linked. Id. at 324. Finally, pursuant to its prior holdings that the purchase of an option is equivalent to the purchase of a security for Section 10(b) liability, the Second Circuit ruled that the plaintiffs' transactions involved securities traded on domestic exchanges under Morrison. Id. (citing Caiola v. Citibank, N.A., 295 F.3d 312, 327 (2d Cir. 2002)). Accordingly, the district court denied the defendants' motion to dismiss the claim on jurisdictional grounds. Id.

In In re UBS Sec. Litig., 2011 WL 4059356 (S.D.N.Y. Sept. 13, 2011), the plaintiffs claimed that the defendants violated Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 by making fraudulent statements related to the defendants': (1) positions and losses in the U.S.; (2) positions and losses in auction-rate securities; and (3) compliance with the U.S. tax and securities laws. Id. at *1. The plaintiffs included both foreign and domestic investors who purchased UBS' stock listed on the NYSE, the Swiss Exchange, and the Tokyo Stock Exchange. Id. The defendants moved to dismiss arguing that the district court lacked subject matter jurisdiction. Id.

The district court granted the defendants' motion to dismiss, holding that in light of the Supreme Court's decision in Morrison, the district court lacked subject matter jurisdiction. Id. at *3. The plaintiffs argued that Morrison did not foreclose their claims asserted by foreign investors because although they purchased their securities on a foreign exchange these securities were cross-listed on the NYSE. Id. at *4. The district court struck down plaintiffs' "strained interpretation of Morrison" as ignoring the broader holding that Section 10(b) applies only to transactions executed in the U.S. Id. at *5 (citing Morrison, 130 S. Ct. at 2886). The district court further explained that Morrison "makes clear that its concern was with respect to the location of the securities *transaction* and not the location of an exchange where the security may be dually listed." Id. at *5.

The plaintiffs next argued that claims asserted by U.S. investors who purchased UBS stock on a foreign exchange satisfied Morrison's transactional test because the U.S. investor placed the buy order (and therefore effectuated the purchase) in the U.S. Id. The district court rejected this argument as well, stating that "there is nothing in the text of Morrison to suggest that the Court intended the location of an investor placing a buy order to be determinative of whether such a transaction is 'domestic' for purposes of [Section] 10(b). To the contrary, the Morrison Court 'clearly sought to bar claims based on purchases and sales on foreign exchanges, even though the purchasers were American.'" Id. at *7 (quoting In re Vivendi Universal, S.A. Sec. Litig., 765 F. Supp. 2d 512, 532 (S.D.N.Y. 2011)).

In In re Royal Bank of Scot. Grp. PLC Sec. Litig., 765 F. Supp. 2d 327, 329-30 (S.D.N.Y. 2011), purchasers of both ordinary and preferred shares initiated a consolidated class action against a foreign bank ("RBS"), international underwriters, and various individuals alleging violations of Section 10(b) of the Exchange Act and Rule 10b-5. The plaintiffs' basic allegations asserted that, as a result of certain behavior undertaken by RBS management and underwriters, they suffered losses in shareholder value due to write-downs that affected RBS's subprime portfolio. Id. at 330.

The defendants argued that Exchange Act claims asserted by the plaintiffs must be dismissed on account of the Supreme Court's holding in Morrison that "'10(b) reaches the use of a manipulative or deceptive device or contrivance only in connection with 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 335 (quoting Morrison, 130 S. Ct. at 2888). While the plaintiffs argued that Morrison is satisfied since RBS shares were "listed" on an American stock exchange, this argument failed since "[t]he idea that a foreign company is subject to U.S. Securities laws everywhere it conducts foreign transactions merely because it has 'listed' some securities in the United States is simply contrary to the spirit of Morrison." Id. at 336. Recognizing that no evidence existed that Congress believed it has the power to regulate foreign securities exchanges under established principles of international law, the district court found that the plaintiff's approach, which merely asserted their status as U.S. residents who were in the country during their purchase of RBS shares, did not fulfill the requirements set by Morrison, and plaintiffs' claims with respect to ordinary shares purchased on foreign transactions were dismissed. Id. at 336-38.

In In re Vivendi Universal, S.A. Sec. Litig., 765 F. Supp. 2d 512 (S.D.N.Y. 2011), foreign and domestic shareholders filed a class action asserting derivative claims based on Section 10(b) of the Exchange Act and Rule 10b-5 against a foreign global media corporation and various affiliated individuals. The action was initially brought in 2002 alleging that ordinary shares traded primarily on the Paris Bourse exchange and American Depository Receipts ("ADRs") listed and traded on the New York Stock Exchange ("NYSE") were purchased at artificially inflated prices as a result of material misrepresentations and omissions. Id. at 521. In January 2010, a jury determined that no liability existed with respect to Vivendi's CEO and CFO, but that Vivendi itself had committed securities fraud under Section 10(b). Id. at 524. Thereafter, Vivendi moved for judgment as a matter of law or, in the alternative, a new trial, while plaintiffs moved for entry of judgment and for approval of their proposed class notice and claims administration procedures. Id. at 525. In the wake of the Supreme Court's holding in Morrison that Section 10(b) does not apply extraterritorially, the district court asked the parties to submit supplemental briefs addressing Morrison's impact on their pending motions.

The plaintiffs first argued that the first prong of Morrison's bright-line test that "limits Section 10(b) claims to 'securities listed on domestic exchanges'" was satisfied because ADRs representing ordinary shares traded on the NYSE. Id. at 525 (quoting Morrison, 130 S. Ct. at 2884). Specifically, the plaintiffs noted that, in order to sell ADRs in the U.S. through a public offering, Vivendi was required to register a corresponding number of ordinary shares with the SEC—"albeit not for trading purposes." Id. at 528. However, the district court determined that Morrison adopted a test that turns on the *territorial location* of the transaction in question, holding that "[t]here is no indication that the Morrison majority read Section 10(b) as applying to securities that may be cross-listed on domestic and foreign exchanges, but where the purchase and sale does not arise from the domestic listing, particularly where (as here) the domestic listing is not even for trading purposes." Id. at 531.

In the alternative, the plaintiffs argued that the claims of Americans who purchased ordinary shares traded on foreign exchanges should be allowed to go forward under the "domestic transactions in other securities" prong of Morrison's transactional test. Id. at 525. Although the Supreme Court did not specifically define the term "domestic transaction," the district court determined that "there can be little doubt that the phrase was intended to be a reference to the location *of the transaction*, not to the location of the purchaser and that the Supreme Court clearly sought to bar claims based on purchases and sales of foreign securities on foreign exchanges, even though the purchasers were American." Id. at 532. As such, the district court determined that, after Morrison, American purchasers of shares sold on foreign exchanges may not bring Section 10(b) claims. Id.

In Plumbers' Union Local No. 12 Pension Fund v. Swiss Reinsurance Co., 753 F. Supp. 2d 166, 170 (S.D.N.Y. 2010), the putative class action plaintiffs brought claims under Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 against Swiss Reinsurance Company ("Swiss Re") and two of its senior officers. The plaintiffs alleged that the defendants made false and misleading statements regarding Swiss Re's risk management and exposure to mortgage-related securities. Id. The defendants moved to dismiss the plaintiffs' claims, contending that they were barred by Morrison because the plaintiffs had purchased Swiss Re common shares on the "virt-x" trading platform (a subsidiary of the SWX Swiss Exchange based in London) and that the complaint failed to satisfy the pleading requirements of Rule 9(b) and the PSLRA. Id. at 170-72. The district court granted the defendants' motion to dismiss on both grounds.

The district court first considered whether the plaintiffs' Exchange Act claims were precluded by Morrison. Id. at 175-79. The lead plaintiff argued that, because it placed its orders to purchase Swiss Re shares with traders in Chicago and those orders were entered electronically in Chicago, they had "purchased" Swiss Re common shares in the United States. Id. at 177. Interpreting "what it means for a purchase or sale to be 'made in the United States'" in light of Morrison, the district court reasoned that the term "purchase" "c[ould not] bear the expansive construction plaintiffs propose[d]" because the "plaintiffs' construction would require a fact-bound, case-by-case inquiry into when exactly an investor's purchase order became irrevocable." Id. at 176-78 (citation omitted). Although the lead plaintiff was a U.S. investor who had placed a buy order in the U.S., the district court determined that the plaintiff had "purchased its shares on a foreign exchange," since the transactions were "executed, cleared, and settled" on a Swiss Exchange. Id. at 178.

In Cornwell v. Credit Suisse Grp., 729 F. Supp. 2d 620, 621 (S.D.N.Y.), mot. to certify denied, 270 F.R.D. 145 (S.D.N.Y. 2010), investors brought a putative class action against Credit Suisse Global ("CSG") and four of its officers, alleging that the defendants violated Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The plaintiffs sought to represent all investors who purchased CSG securities either on the Swiss Stock Exchange ("SWX") or as American Depositary Shares ("ADSs") on the NYSE during a specific time period. Id. Following Morrison, the defendants moved to dismiss those plaintiffs who had purchased CSG shares on the SWX. Id. at 622-624.

The plaintiffs argued that Morrison did not foreclose their claims because, unlike the "'foreign cubed'" plaintiffs in Morrison, they were United States residents who made an investment decision in the United States to purchase CSG stock and took the CSG stock into their United States-based accounts. Id. at 622. The district court roundly rejected this argument as ignoring "the multiple concerns that moved the Supreme Court to prescribe a new test clarifying the application of [Section] 10(b) in transnational securities trading. In that restructuring of United States securities law, the Second Circuit's conduct and effect doctrine took a great fall. And neither the Plaintiffs' law horses nor this Court's pen can put the pieces together again." Id. at 627. Accordingly, the district court dismissed the claims of those plaintiffs and potential class members who purchased CSG stock on the SWX. Id.

In In re Alstom SA Sec. Litig., 741 F. Supp. 2d 469 (S.D.N.Y. 2010), investors who had purchased Alstom SA ("Alstom") securities on the Euronext, directly from Alstom, or in the form of American Depository Receipts ("ADRs") on the NYSE, brought a securities fraud class action against Alstom, its subsidiaries and some of its officers for violation of Sections 10(b) and 20(a) of the Exchange Act. The district court directed the plaintiffs to show cause why the claims of those plaintiffs who purchased securities on the Euronext should not be dismissed. Id. at 471. The plaintiffs argued, inter alia, that because Alstom's "common shares were registered and listed on the NYSE, though not actually purchased there, these Euronext transactions fulfill[ed] the letter of Morrison's rule that the federal securities fraud laws apply to transactions in securities 'listed on a domestic exchange.'" Id. at 471-72 (citing Morrison, 130 S. Ct. at 2886). The district court disagreed, finding plaintiffs' argument "a selective and overly-technical reading of Morrison that ignores the larger point of the decision." Id. at 472. "That the transactions themselves must occur on a domestic exchange to trigger application of § 10(b) reflects the most natural and elementary reading of Morrison." Id. at 473. The district court therefore dismissed the claims of those plaintiffs who had purchased Alstom securities on the Euronext. Id.

In Elliott Assocs. v. Porsche Auto. Holding SE, 759 F. Supp. 2d 469, 471 (S.D.N.Y. 2010), plaintiffs were hedge fund investors who entered into security-based swap agreements that would generate gains for plaintiffs as the price of Volkswagen ("VW") shares decreased (and corresponding losses as those shares increased in price). Defendant Porsche was a public company with shares that traded in Germany and an American Depositary Receipt ("ADR") that traded in the U.S. Id. at 471-72. Porsche, VW's largest shareholder, allegedly made false and misleading statements in which it denied its desire to take over VW. Id. at 472. However, in October 2008, Porsche announced its acquisition of a roughly 75% stake in VW, driving the price of VW shares up and forcing plaintiffs to cover their short positions. Id. at 472-73. Porsche moved to dismiss plaintiffs' allegations that it had violated Section 10(b) of the Exchange Act.

Pursuant to Morrison's holding that Section 10(b) applies only to "'transactions in securities listed on domestic exchanges, and domestic transactions in other securities,'" Id. at 473 (quoting Morrison, 130 S. Ct. at 2884), the district court determined that Morrison's second prong was not satisfied because the "economic reality" was that the swaps, although executed in the U.S., were transactions in foreign securities. Id. at 475-76. Since the value of swap agreements were intrinsically tied to the value of a reference security which traded on a foreign exchange, the district court reasoned that Plaintiffs' swap agreements were essentially "'transactions conducted upon foreign exchanges and markets,' and not 'domestic transactions' that merit the protection of Section 10(b)." Id. at 476. As such, defendants' motions to dismiss with respect to plaintiffs Section 10(b) allegations were granted. Id. at 477.

The Ninth Circuit

In re Toyota Motor Corp. Sec. Litig., 2011 WL 2675395 (C.D. Cal. July 7, 2011), the district court granted the defendants' motion to dismiss because it did not have original jurisdiction over the claim. Id. at *7.

The plaintiffs, investors in the defendant's company, brought a class action complaint alleging a Rule 10b-5 violation and claims based on Japanese securities law against Toyota Motor Corporation ("Toyota"), arguing that the district court had original jurisdiction over the Japanese law claims under the Class Action Fairness Act ("CAFA") as well as supplemental jurisdiction under 28 U.S.C. § 1367(c). Id. at *1, *6. The vast majority of the investors purchased their stock on foreign exchanges. Id. at *6. The district court found that the claims related to "'covered securities'" because they were listed on the NYSE and were therefore exempted from the CAFA. Id. at *6 (citation omitted). The district court recognized that it also had supplemental jurisdiction over the Japanese law claims, but declined to exercise that jurisdiction because it found the Japanese law claims substantially predominated over the American law claims. Id. The district court stated that the "clear underlying rationale of the Supreme Court's decision in [Morrison] is that foreign governments have the right to decide how to regulate their own securities markets," and that "[t]his respect for foreign law would be completely subverted if foreign claims were allowed to be piggybacked into virtually every American securities fraud case, imposing American procedures, requirements, and interpretations likely never contemplated by the drafters of the foreign law." Id. at *7. The district court did not foreclose the possibility of exercising supplemental jurisdiction over foreign securities law claims in the future, but stated that "any reasonable reading of Morrison suggests that those instances will be rare." Id.

The Tenth Circuit

In Cascade Fund, LLP v. Absolute Capital Mgmt. Holdings Ltd., 2011 WL 1211511 (D. Colo. Mar. 31, 2011), the Cascade Fund, LLP ("Cascade"), an investment fund based in the U.S., brought a 10b-5 claim against Absolute Capital Management Holdings, Ltd ("ACM"), a company that managed and sold shares in investment funds organized under the laws of the Cayman Islands. Id. at *1. None of the funds were listed on any U.S. stock exchange. Id. Cascade alleged that ACM's failure to disclose material facts made its offering memoranda materially misleading. Id. at *1-2. ACM moved to dismiss, arguing that the transactions at issue were not covered by the Exchange Act based on the Supreme Court's decision in Morrison. Id. at *3-4.

Cascade argued that application of Morrison should be limited to "'F-cubed transactions'" and that its suit should be allowed to proceed because it was a U.S.-based entity. Id. at *5-6. The district court disagreed, stating that, under Morrison, 10b-5 claims "are cognizable only when they involve 'a security listed on a domestic exchange' or where 'th[e] purchase or sale [of the security] is made in the United States.'" Id. at *7 (quoting Morrison, 130 S. Ct. at 2886). Cascade also argued that its investment was a domestic transaction because:

> (i) the [o]ffering [m]emoranda and other investment materials were disseminated to Cascade in the United States; (ii) [one of ACM's directors] and other ACM executives traveled to the United States to solicit American investors; (iii) Cascade made its decision to invest while in the United States; and (iv) the money for the purchase was wired to a bank in New York.

Id. at *7. The district court rejected Cascade's argument, noting that the first three facts concerned the location of the solicitation of the transaction rather than the transaction itself, and that the fourth fact was merely "one step by Cascade to comply with ACM's designated process for applying to invest in the funds . . . [that] was not sufficient to complete the transaction." Id. The district court found that the transaction was not completed until ACM accepted an application (which it presumed occurred at ACM's Cayman Islands offices), thus it was not a domestic transaction covered by the Exchange Act. Id.

The Eleventh Circuit

In Quail Cruises Ship Mgmt. Ltd. v. Agencia de Viagens CVC Tur Limitada, 645 F.3d 1307, 1310-11 (11th Cir. 2011), the Eleventh Circuit vacated and remanded the district court's dismissal of a suit brought under Section 10(b) of the Exchange Act because the plaintiffs had alleged sufficient facts to establish subject matter jurisdiction under Morrison. The Eleventh Circuit reiterated that, after Morrison, Section 10(b) applies only where the security at issue is: (1) listed on a domestic stock exchange; or (2) where its purchase or sale was made in the United States. Id. at 1310. Although the stock at issue was not listed on a domestic stock exchange, the Eleventh Circuit concluded that the plaintiff properly alleged that the relevant transactions "closed" in Miami, Florida—clearly within the United States. Id. The Eleventh Circuit reasoned that the closing constituted a "sale" because it entailed a transfer of property or title for a price. Id.

2 Pleading Standards and Scienter

Pleading Standards

Special pleading standards set forth in the PSLRA govern complaints brought pursuant to Section 10(b) of the Exchange Act and Rule 10b-5. These standards are unique to securities cases and were adopted in an attempt to curb abuses in securities fraud litigation. See, e.g., Elam v. Neidorff, 544 F.3d 921, 927 (8th Cir. 2008); Winer Family Trust v. Queen, 503 F.3d 319, 326 (3d Cir. 2007). To survive a motion to dismiss, a plaintiff must plead sufficient facts "to raise a right to relief above the speculative level," Bell Atl. Corp. v. Twombly, 550 U.S. 544, 555 (2007) (citation omitted); see also ACA Fin. Guarantee Corp. v. Advest, Inc., 512 F.3d 46, 58 (1st Cir. 2008) ("The Supreme Court [in Bell Atlantic] has recently altered the Rule 12(b)(6) standard in a manner which gives it more heft. In order to survive a motion to dismiss, a complaint must allege a 'plausible entitlement to relief.'") (citations omitted).

Federal Rule of Civil Procedure 9(b)

Prior to the enactment of the PSLRA in 1995, courts evaluated securities fraud pleadings under Federal Rule of Civil Procedure 9(b) ("Rule 9(b)"). Rule 9(b) requires that "[i]n alleging fraud or mistake, a party must state with particularity" the circumstances constituting that fraud or mistake. However, "[m]alice, intent, knowledge, and other conditions of a person's mind may be alleged generally." Fed. R. Civ. P. 9(b). Pleading circumstances constituting fraud with particularity requires that a plaintiff identify the speaker, state where and when the statements were made, specify the statements alleged to be fraudulent, and explain why the statements were fraudulent. See generally, e.g., Reese v. BP Exploration (Alaska) Inc., 643 F.3d 681, 690 (9th Cir. 2011). This "who, what, when, where and how" test is a well-settled and widely accepted standard. See, e.g., Lustgraaf v. Behrens, 619 F.3d 867, 874 (8th Cir. 2010) (citation omitted); In re 2007 Novastar Fin. Inc., Sec. Litig., 579 F.3d 878, 882 (8th Cir. 2009) (citation omitted). The Rule 9(b) standard does not tolerate mere boilerplate and conclusory allegations; rather, a plaintiff must allege facts that plausibly support the asserted legal theories within the complaint. See Chemtech Int'l, Inc. v. Chem. Injection Techs., Inc., 247 F. App'x 403, 405 (3d Cir. 2007) (citation omitted); In re Cybershop.com Sec. Litig., 189 F. Supp. 2d 214, 226 (D.N.J. 2002) (citation omitted). The purpose of Rule 9(b)'s heightened pleading requirement is to give defendants notice of the claims against them and to reduce the number of frivolous suits brought solely to extract settlements. See, e.g., In re Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1418 (3d Cir. 1997) (citation omitted).

Many courts now recognize that the PSLRA supersedes, but essentially incorporates, the particularity requirements of Rule 9(b). See, e.g., Rolin v. Spartan Mullen Et Cie, S.A., 2011 WL 5920931, at *4 (S.D.N.Y. Nov. 23, 2011) (noting that the PSLRA has "essentially codified 9(b)").

The PSLRA's Statutory Pleading Requirements

The PSLRA contains two heightened pleading requirements in securities fraud cases. A securities fraud complaint must:

1. specify each statement alleged to have been misleading, and the reason or reasons why the statement is misleading; and
2. state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.

15 U.S.C. 78u-4(b). The PSLRA requires a court to dismiss the complaint if these requirements are not met. See 15 U.S.C. 78u-4(b)(3). Importantly, however, the PSLRA does not require courts to dismiss complaints failing these requirements *with prejudice*. See Belizan v. Hershon, 434 F.3d 579, 583–84 (D.C. Cir. 2006) (vacating district court's dismissal of a Rule 10b-5 claim with prejudice for failure to allege scienter with particularity, because the PSLRA did not mandate dismissal with prejudice and because fact issues remained concerning whether the plaintiffs could cure the complaint).

The First Circuit

In Ambert v. Caribe Equity Grp., Inc., 2011 WL 4626012 (D.P.R. Sept. 30, 2011), investors in a public offering of Caribe, a Puerto Rico holding company, brought suit under Section 10(b) of the Exchange Act and Rule 10b-5, alleging that the defendants omitted material facts and made false representations to investors, causing the total loss of their investments with Caribe. Id. at *1. The plaintiffs alleged that the defendants solicited meetings with them, encouraging them to invest with the defendants, who would use the investment to create and operate a new health maintenance organization ("HMO"). Id. However, instead of creating a new HMO, the defendants bought an existing HMO with troubled finances, and the plaintiffs lost their investment. The defendants moved to dismiss.

The district court denied the defendants' motion to dismiss, finding that the plaintiffs successfully pleaded material misrepresentation, scienter, reliance, and loss causation under Rule 9(b) and the PSLRA. The district court began by noting that, "because their complaint sounds in fraud, [the p]laintiffs must . . . plead with particularity the circumstances constituting [the] fraud." Id. at *4 (internal quotation marks and citations omitted) (second alteration in original). Explaining that "Rule 9(b) seeks to provide a defendant with fair notice of a plaintiff's claim, to safeguard defendants' reputations, and to protect defendants from the institution of a strike suit," the district court found that the plaintiffs alleged the time, place, and content of the misrepresentations with specificity, and detailed the "context in which the misrepresentations and omissions were made." Id.

The Second Circuit

In Footbridge Ltd. v. Countrywide Home Loans, Inc., 2010 WL 3790810 (S.D.N.Y. Sept. 28, 2010), two investment funds that had purchased over $43 million of residential mortgage-backed securities ("RMBS") in two public offerings sued Countrywide-related entities, directors and officers for federal securities fraud and for common law fraud in connection with those securities. Id. at *1-2. The plaintiffs alleged that the defendants violated Section 10(b) of the Exchange Act and Rule 10b-5 because the defendants made material misrepresentations and omissions in the offering documents for the RMBS and in other public statements regarding "the quality of the underlying loans and . . . the underwriting guidelines used in the origination process," which caused the plaintiffs to lose their investments. Id. at *4. The district court noted at the outset that the plaintiffs did not dispute knowing that the RMBS were made up of "credit-blemished, closed-end, fixed-rate loans" secured by second liens on residential properties. Instead, the plaintiffs claimed to be misled because the RMBS were *riskier* than they perceived. Id. The district court granted the defendants' motion to dismiss, holding, inter alia, that the plaintiffs failed to allege material misrepresentations with particularity and failed to raise a strong inference of scienter.

The district court found that the plaintiffs had not met the particularity requirements of Rule 9(b) and the PSLRA in the first instance because they had failed to identify material misstatements or omissions to support a plausible claim of fraud. For example, the plaintiffs alleged that term sheets for the RMBS contained false statements regarding owner occupancy levels of the underlying mortgaged properties. The plaintiffs alleged reliance on sections of the term sheets stating that over 99% of mortgaged properties were owner-occupied when, in fact, the number of owner-occupied properties was known to be lower. Id. at *9. The district court found these pleadings insufficient to meet Rule 9(b) and the PSLRA's heightened pleading requirements. The district court noted that the plaintiffs had "omit[ted] critical language from their citation of the statements in the offering documents," which explained that Countrywide was relying on the representations made by mortgagors in their loan applications. Id. In addition, the district court pointed to the plaintiffs' failure to plead facts suggesting that the percentages reported in the defendants' term sheets were "inaccurate representations of the data received from borrowers," and to "identify any loans that the defendants represented as being related to owner-occupied properties that were not actually occupied by the owners." Id. at *9-10.

Similarly, the district court determined that the plaintiffs' allegation that the defendants omitted material facts regarding Countrywide's Reduced-Documentation

Programs did not meet pleading standards under Rule 9(b) and the PSLRA. The plaintiffs alleged that Countrywide represented in the RMBS prospectuses that it verified borrowers' employment and income in "most cases," when in fact, Countrywide failed to verify this information "at a far greater rate than it represented." Id. at *14. The plaintiffs, however, had not alleged necessary facts to support this allegation, "such as the 'rate' Countrywide represented exceptions [to income or employment verification procedures] would be granted or the 'rate' at which exceptions were actually granted." Id. Under the PSLRA, the district court reasoned, the "plaintiffs must 'do more' than allege that, on information and belief that exceptions were granted 'at a greater rate than it represented.'" Id. (citation omitted). The plaintiffs also claimed that Countrywide failed to disclose the results of studies showing that low documentation loans were more likely to default. The district court determined that this was not an actionable "omission" under the PSLRA because the plaintiffs had not identified any fiduciary duty obligating the defendants to disclose such information. Furthermore, the RMBS offering documents contained a general disclosure that the underlying mortgages would "experience higher rates of delinquency and loss." Id. at *15.

In Plumbers' Union Local No. 12 Pension Fund v. Swiss Reinsurance Co., 753 F. Supp. 2d 166 (S.D.N.Y. 2010), putative class action plaintiffs brought claims under Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 against Swiss Reinsurance Company ("Swiss Re") and two of its senior officers. The plaintiffs alleged that the defendants made false and misleading statements regarding Swiss Re's risk management and exposure to mortgage-related securities. Id. at 170. The defendants moved to dismiss the plaintiffs' claims, contending that the claims were barred by Morrison because the plaintiffs had purchased Swiss Re common shares on the "virt-x" trading platform (a subsidiary of the SWX Swiss Exchange based in London) and that the complaint failed to satisfy the pleading requirements of Rule 9(b) and the PSLRA. Id. at 170-71. The district court granted the defendants' motion to dismiss on both grounds.

The district court held that the plaintiffs failed to plead material misstatements or scienter with particularity. According to the court, the "gist" of plaintiffs' claim regarding Swiss Re's exposure to risky mortgage-related securities was that Swiss Re failed to adequately disclose that it had issued credit default swaps ("CDSs") to insure billions of Swiss Francs ("CHF") worth of assets, including subprime mortgage securities and collateralized debt obligations ("CDOs"). Id. at 180-81. In support of this claim, the plaintiffs pointed to two statements: (1) Swiss Re's August 7, 2007 statement that "CHF 190 billion of invested assets was 'exposed to sub-prime of less than CHF 500 [million],'" and (2) Swiss Re's subsequent announcement that, "[f]or the sake of completeness . . . there are sub-prime risks elsewhere in the balance sheet," including "in the portfolio of CDS business and the Financial Guarantee Re . . . [and] also in swaps . . . ." Id. at 181. The district court found that this second statement sufficiently disclosed the existence of risks related to the subprime mortgage market, reasoning that "[t]here is no obligation for an issuer to identify specifically every type of asset or liability it possesses, so long as its disclosures are 'broad enough to cover' all instruments that are in fact relevant to the value of the issuer's securities." Id. (citing Hunt v. Alliance N. Am. Gov't Income Trust, Inc., 159 F.3d 723, 730 (2d Cir. 1998)). The defendants had made an appropriate disclosure about subprime risks and were not required to make more detailed disclosures. Therefore, the district court held, the plaintiffs had failed to plead material misstatements or omissions. Id.

In In re Citigroup Inc. Sec. Litig., 753 F. Supp. 2d 206 (S.D.N.Y. 2010), the putative class action plaintiffs brought claims against Citigroup Inc. ("Citigroup") and fourteen of its directors and officers, alleging violations of Sections 10(b) and 20(a) of the Exchange Act. The plaintiffs claimed that, at various times from 2006 to 2008, the defendants materially misled investors about the company's financial health by knowingly understating the risks it faced, namely in various financial instruments related to the subprime mortgage industry, and overstating the value of its assets. The plaintiffs alleged that the defendants' misstatements and omissions caused investors to suffer damages when the truth about Citigroup's assets was revealed. Id. at 212.

A number of the plaintiffs' allegations concerned Citigroup's exposure to collateralized debt obligations ("CDOs"). For instance, the plaintiffs alleged that "the defendants failed to give a full and truthful account of the extent of Citigroup's CDO exposure," by revealing only the size of Citigroup's underwriting activities and not the size of Citigroup's CDO holdings. Id. at 217-18. The plaintiffs further claimed that Citigroup's SEC filings "failed to convey the subprime-related risks inherent in its CDO portfolio," because the filings did not distinguish which Citigroup CDOs were backed by subprime mortgages and which were backed by other assets. Id. at 217, 220. The plaintiffs also contended that Citigroup violated accounting rules when valuing Citigroup's CDO holdings in its SEC filings because it failed to "take[] writedowns on its CDO holdings in reaction to precipitous drops in the 'TABX,' a widely used index that tracked the price of mezzanine CDOs." Id. at 217, 223. The defendants moved to dismiss the plaintiffs' claims, arguing that the plaintiffs failed to meet the heightened pleading standards for securities fraud. The district court granted the defendants' motion in part but allowed the plaintiffs to proceed against Citigroup and seven of the individual defendants on the plaintiffs' claims that, between February 2007 and August 2008, the defendants misrepresented the extent of Citigroup's CDO exposure. Id.

With regard to the individual defendants, the district court found that the plaintiffs had not set forth sufficient particularized allegations establishing that seven of the defendants had knowledge of Citigroup's CDO obligations. But, as for the remaining seven, the district court found the plaintiffs' allegation that they attended meetings addressing Citigroup's CDO exposure was sufficient to establish a strong inference of scienter. The district court reasoned that "[a]lthough plaintiffs do not allege with specificity the matters discussed at these meetings, their mere existence is indicative of scienter: That defendants engaged in meetings concerning Citigroup's CDO risks is inconsistent with the company's public statements downplaying or concealing that risk." Id. at 238-39.

The Third Circuit

In Barnard v. Verizon Commc'ns, Inc., 2011 WL 5517326 (3d Cir. Nov. 14, 2011), cert. denied, 132 S. Ct. 2107 (2012), former investors appealed the district court's dismissal of their complaint, which alleged violations of Section 10(b) of the Exchange Act and Rule 10b-5, among others, against Verizon and J.P. Morgan Chase Bank ("JPMC"). Id. at *1. The corporation that the plaintiffs invested in was formed in a spin-off transaction by Verizon and filed for bankruptcy less than three years after its formation. Id. The plaintiffs alleged Exchange Act violations in connection with the spin-off, as they claimed Verizon failed to disclose its true purpose for effecting the spin-off (i.e., to off-load the debt and transfer ownership of the debt to the banks) and misrepresented the corporation's solvency. Id. at *2.

The Third Circuit affirmed the district court's dismissal of the securities fraud claim, as the complaint did not comply with the heightened pleading requirements of the PSLRA. Id. at *3. The Third Circuit found that the pleading did "not provide any facts from which one could ascertain whether either JPMC or Verizon, or both, made any actionable misrepresentations or omissions at all." Id. The complaint referenced both Verizon's 2007 annual statement and the prospectus from the spin-off; however, the Third Circuit noted that the plaintiffs' reference to statements in those documents failed to indicate "how, if at all, the statements could be interpreted as material misrepresentations or omissions." Id.

The Third Circuit also found that the complaint contained no allegations that could establish reliance or economic loss. Id. The complaint did not indicate "how, when, or why" the plaintiffs purchased or sold stock, and as a result, there was "no way to ascertain how any misrepresentation or omission impacted Appellants' decisions to purchase or sell securities." Id.

In Solomon-Shrawder v. CardioNet, Inc., 2010 WL 3168366 (E.D. Pa. Aug. 10, 2010), the plaintiffs brought claims under, inter alia, Section 10(b) of the Exchange Act and Rule 10b-5 against CardioNet and two of its executives. Id. at *1. The plaintiffs contended "that the defendants made overly optimistic statements during the proposed class period regarding the company's general prospects and, more specifically, the reimbursement rate that Medicare and Medicaid would pay for CardioNet's main product, which is a wireless heart monitor." Id. Medicare and Medicaid eventually reduced the rate during the class period, and CardioNet's stock price fell. Id. The defendants moved to dismiss the complaint.

The district court applied the standard of review announced by the Third Circuit in Inst'l Investors Grp. v. Avaya, Inc., 564 F.3d 242 (3d Cir. 2009). In order to state a claim under Rule 10b-5, the Avaya court noted, the plaintiffs "must 'allege defendants made a misstatement or an omission of material fact with scienter in connection with the purchase or sale of a security upon which plaintiffs reasonably relied and plaintiff[s'] reliance was the proximate cause of their injury.'" Id. at 251. The Avaya court also stated that plaintiffs must plead facts "with particularity," which means the complaint must allege "who, what, when, where, and how"—and when the complaint includes allegations made on information and belief, it "must not only state the allegations with factual particularity, but must also describe the sources of information with particularity . . . ." Id. at 253. Avaya further observed that, to adequately plead scienter, the plaintiffs must state "with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind . . . ." Id. at 280. However, Avaya also advised that a defendant "might be culpable as long as what he knew made obvious the risk" of misleading investors. Id. at 270. Finally, Avaya instructed that when plaintiffs attribute information to confidential witnesses, but do not provide details about the sources, information, or corroborating facts, a court must "discount" the allegations from those witnesses "steeply." Id. at 263.

Relying on Avaya, the district court found that the plaintiffs failed to plead both falsity and scienter "with the particularity that the PSLRA demands." Solomon-Shrawder, 2010 WL 3168366, at *20. The district court considered each statement that the plaintiffs alleged to be false and found the allegations failed to show falsity, because: (1) the plaintiffs did not give sufficient information to support why or how confidential witnesses knew the information they provided to the plaintiffs; (2) the plaintiffs failed to connect the reasons they gave for statements being false with the actual statements themselves; (3) the defendants' statements could not be deemed false as a result of information that the defendants did not know and were not privy to; (4) a reasonable mistake by the defendants does not rise to the level of scienter; and (5) there were no facts alleged to show that the defendants had knowledge of the impending rate reduction or that they should have known about it. Id. at *11-17. The district court therefore dismissed the plaintiffs' claims under 10b-5.

The Eleventh Circuit

In Thompson v. RelationServe Media, Inc., 610 F.3d 628 (11th Cir. 2010), the Eleventh Circuit affirmed the district court's dismissal of the plaintiffs' putative class action claims brought under Sections 10(b) and 20(a) of the Exchange Act against an internet marketing firm and eleven of its directors and employees. L. Allen Jacoby led a putative class of all purchasers who bought stock in RelationServe Media, Inc. ("RelationServe") on the open market prior to the company's public disclosure of a pending lawsuit alleging that RelationServe sold securities through unregistered brokers. Id. at 630, 632. Before RelationServe became a publicly-traded company, it hired an independent consulting agency to sell shares through a private offering to investors. Id. at 631. Jacoby claimed that RelationServe did not disclose that a broker was involved in the company's earlier securities sales to hide the fact that RelationServe sold securities through unregistered brokers and to mislead the public regarding the company's worth. Id. at 634.

The Eleventh Circuit held that under the PSLRA's heightened pleading standard for scienter, Section 10(b) and Rule 10b-5 required Jacoby to plead "'with particularity facts giving rise to a strong inference' that the defendants either intended to defraud investors or were severely reckless when they made the allegedly materially false or incomplete statements." Id. (quoting Mizzaro v. Home Depot, Inc., 544 F.3d 1230, 1238 (11th Cir. 2008)). The Eleventh Circuit concluded that Jacoby only made conclusory allegations and failed to state that any of the defendants either knew they were utilizing unregistered brokers or, if they did know, that they also knew RelationServe was required to utilize registered brokers. Id. at 634-35. Jacoby's proposed inference was "not as compelling as the competing inference that the defendants did not disclose its use of unregistered brokers because the brokers were exempt from registration." Id. at 635. Accordingly, the Eleventh Circuit held that Jacoby failed to adequately plead scienter under the PSLRA.

In City of Pontiac Gen. Emps. Ret. Sys. v. Schweitzer-Mauduit Int'l, Inc., 806 F. Supp. 2d 1267 (N.D. Ga. 2011), the district court granted the defendants' motion to dismiss the plaintiffs' putative class action alleging violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The plaintiffs were shareholders in Schweitzer-Maduit International, Inc. ("Schweitzer"), which supplied tobacco products to tobacco companies internationally. Id. at 1270. The plaintiffs alleged that the company and two of its directors and officers engaged in a fraudulent scheme to artificially inflate the company's stock price by misleading the market about (1) Schweitzer's relationship with one of its largest customers, (2) the strength of Schweitzer's intellectual property protections, and (3) pressures Schweitzer faced from European competitors. Id.

The district court held that the plaintiffs failed to sufficiently plead a false statement or omission of a material fact. Id. at 1293-94. The plaintiffs' complaint "compiled a series of statements—almost all of which contain multiple passages presented in the form of lengthy block quotes—and then paired each series of statements to the same conclusory list of deficiencies." Id. at 1293. The district court derided this type of "puzzle pleading" as placing "the burden on the Court to sort out the alleged misrepresentations and then match them with the corresponding adverse facts." Id. (quoting In re Alcatel Sec. Litig., 382 F. Supp. 2d 513, 534-35 (S.D.N.Y. 2005)) (internal quotation marks omitted). The district court concluded that this pleading method was deficient under the PSLRA, but granted the plaintiffs leave to re-file. Id. at 1293-94.

In Prager v. FMS Bonds, Inc., 2010 WL 2950065 (S.D. Fla. July 26, 2010), the district court denied the defendants' motion to dismiss because the plaintiff pleaded his Rule 10b-5 claim with sufficient particularity under Rule 9(b) and the PSLRA. The defendants brokered a sale of bonds to the plaintiff, a retiree who explained that he wanted to invest in conservative income-producing products for his portfolio. Id. at *5. The defendants allegedly misrepresented that the bonds were guaranteed by the State of Georgia, when they were actually guaranteed by Lehman Brothers Holdings, Inc. ("Lehman Brothers"). Id. at *1. When Lehman Brothers filed for bankruptcy, it failed to honor its guaranty, resulting in the plaintiff suffering a net loss of $112,000 in principal as well as accrued interest. Id.

The defendants moved to dismiss, alleging that the plaintiff failed to satisfy Rule 9(b) and the PSLRA requirements that the plaintiff allege the time and place of the fraudulent statements or omissions. Id. at *3. The district court held that the allegations in the aggregate can obviate the need for such details. Id. at *3-4. Since the plaintiff alleged the identity of the person who made the fraudulent statement, what the statement contained, provided a timeframe of a few weeks during which the defendants solicited the plaintiff, and the plaintiff attached documentation further specifying the transaction from which the fraud originated, the district court held that these allegations collectively put the defendants on notice and satisfied Rule 9(b). Id.

The district court additionally held that the plaintiff satisfied Rule 9(b)'s requirement that the plaintiff provide a description of what was "'obtained as a consequence of the fraud.'" Id. at *5 (quoting Mizzaro v. Home Depot, Inc., 554 F.3d 1230, 1237 (11th Cir. 2008)). However, the district court held that the plaintiff's bare allegations that the defendants were motivated to induce him to purchase the bonds to serve their "'financial interests'" did not satisfy Rule 9(b) because it failed to specify what the defendants actually obtained from the fraud. Id. at *5. Nonetheless, based on allegations that the defendants obtained a broker's fee in connection with the sale, the district court held that the plaintiff sufficiently alleged a claim under Rule 10b-5. Id.

Scienter

The Supreme Court has defined scienter as "a mental state embracing intent to deceive, manipulate, or defraud." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976). Note that this statement leaves open the possibility of whether scienter also includes recklessness. See Matrixx, 131 S. Ct. at 1323 ("We have not decided whether recklessness suffices to fulfill the scienter requirement."). As discussed above, the PSLRA and Rule 9(b) require plaintiffs to plead scienter with particularity. 15 U.S.C. 78u-4(b)(2); Fed. R. Civ. P. 9(b).

In Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 309-10 (2007), the Supreme Court clarified that the "strong inference" of scienter under the PSLRA must be more than merely permissible or even reasonable—it must be "cogent and compelling" when compared to all non-fraudulent inferences. Yet as discussed below, the Supreme Court's decision only laid out the rationale for its standard without providing much guidance on how to apply it.

The Supreme Court

In Tellabs, 551 U.S. at 313-17, shareholders of Tellabs, Inc. filed a class action against the company and its former CEO, alleging that they had engaged in securities fraud in violation of Section 10(b) of the Exchange Act and Rule 10b-5. The plaintiffs asserted, inter alia, that defendants made material and misleading statements about the market demand for new products. Id. at 315. The complaint alleged that the company's CEO knew that the market for the company's product was drying up, but that he continued to make positive statements to financial analysts regarding an increase in customer demand. Id. The district court dismissed the claim, holding that the plaintiffs failed to adequately plead scienter. Id. at 316. The Seventh Circuit reversed the district court in part, holding that the plaintiffs pleaded facts that gave rise to a strong inference of scienter with respect to statements made by the CEO because the plaintiffs provided enough for a reasonable person to infer that the CEO knew his statements were false. Id. at 308-09.

The Supreme Court reversed the Seventh Circuit's decision and held that to qualify as "strong" within the meaning of the PSLRA, the inference of scienter must be more than merely permissible or even reasonable—it must be "cogent and compelling" as compared to all explanations of non-fraudulent intent. Id. at 310. The Court further advised that scienter allegations cannot be evaluated "in a vacuum"—that is, courts cannot simply look at isolated portions of the pleadings to see if, standing alone, they give rise to a strong inference of scienter. Id. at 323-24. Rather, even accepting the pleaded facts as true, a court must "assess all of the allegations" to see if there are "plausible, nonculpable explanations" for the defendant's conduct—and then weigh the competing inferences. Id.

at 310. The Supreme Court held that a securities fraud complaint can only survive a dismissal motion "if a reasonable person would deem the inference of scienter cogent and at least as compelling as any plausible opposing inference one could draw from the facts alleged." Id. at 324.

The Supreme Court set forth the "process" for evaluating a "strong inference" in three parts:

1. On a motion to dismiss a securities fraud complaint under Rule 12(b)(6), lower courts must, "as with any motion to dismiss for failure to plead a claim on which relief can be granted, accept all factual allegations in the complaint as true." Id. at 309.
2. When considering a motion to dismiss, courts can, as they traditionally do, consider documents incorporated by reference into the complaint, and matters of which they can take judicial notice. Courts, however, must evaluate the entire complaint to determine whether "*all* of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard." Id. at 310.
3. The Court then outlined a balancing test requiring lower courts to "take into account plausible opposing inferences" arising from a review of all of the allegations of the complaint:

> The inquiry is inherently comparative: How likely is it that one conclusion, as compared to others, follows from the underlying facts? To determine whether the plaintiff has alleged facts that give rise to the requisite 'strong inference' of scienter, a court must consider plausible, nonculpable explanations for the defendant's conduct, as well as inferences favoring the plaintiff. . . . [T]he inference of scienter [drawn from this inquiry] must be more than merely 'reasonable' or 'permissible'—it must be cogent and compelling, thus strong in light of other explanations. A complaint will survive, we hold, only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged.

Id. at 323-24.

The Supreme Court vacated the judgment of Seventh Circuit and remanded the case for further proceedings consistent with its opinion. On remand, the Seventh Circuit again concluded that the plaintiffs had adequately pleaded scienter in conformity with the PSLRA, and adhered to its prior decision reversing the district court's dismissal. Makor Issues & Rights, Ltd. v. Tellabs Inc., 513 F.3d 702, 712 (7th Cir. 2008).

The Supreme Court's decision in Tellabs laid out the rationale behind its standard, but stopped short of providing guidance to lower courts on how to apply it. Though Matrixx is best known for its comprehensive review of materiality, see infra at 87-88, it also provided helpful guidance in its review of scienter, applying Tellabs' strong inference standard to the operative facts of a pharmaceutical case.

In Matrixx, the plaintiffs alleged that Matrixx Initiatives, Inc. ("Matrixx") and three of its executive officers failed to disclose reports that one of its core products, Zicam, a nasal spray which accounted for 70 percent of Matrixx's sales, was causing anosmia (loss of smell) in users. See Matrixx, 131 S. Ct. at 1314. The district court granted Matrixx's motion to dismiss, holding that the plaintiffs had not alleged any reports showing a "statistically significant correlation between the use of Zicam and anosmia . . . ." Id. at 1317 (citation omitted). The Ninth Circuit reversed, finding that an allegation of "statistical significance" was not required to establish materiality. Id.

In a unanimous decision addressing the elements of scienter and materiality, the Supreme Court in Matrixx affirmed the Ninth Circuit. Acknowledging the precedent set by Tellabs, the Court reiterated its reading of the PSLRA, i.e., that a complaint adequately pleads scienter "'only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged.'" Id. at 1324 (citing Tellabs, 551 U.S. at 324). "In making this determination, the court must review 'all the allegations holistically.'" Id. (citation omitted). Despite Matrixx's arguments that plaintiffs failed to point to statistically significant evidence, the Supreme Court noted that plaintiffs did not need to allege knowledge of statistically significant evidence to successfully plead scienter because the defendant had engaged in numerous activities leading to an inference of recklessness, including hiring a consultant to review Zicam, convening a panel of physicians, and issuing a press release suggesting that studies showed no link between Zicam and anosmia. Id. Rather than adopting a bright-line rule for scienter, the Supreme Court determined that these allegations "'taken collectively'" gave rise to inference of scienter. Id.

The Second Circuit

In Russo v. Bruce, 777 F. Supp. 2d 505, 510 (S.D.N.Y. 2011), shareholder plaintiffs filed a complaint alleging violations of Section 10(b) of the Exchange Act against defendant, a gold-mining company and its individual officers. Plaintiffs contended that, despite defendants' "dwindling or nonexistent prospects for success" in securing the environmental permit required to mine for gold, the alleged fraud induced plaintiffs to purchase stock at artificially inflated prices. Id. at 511. When the permit was eventually denied, the defendant company's share price declined by 45%. Id. The district court considered defendants' motion to dismiss.

In support of its decision to grant defendants' motion, the district court pointed out that "allegations that defendants behaved recklessly [are] weakened by their voluntary disclosure of certain financial problems prior to the deadline to file financial statements." Id. at 526-27 (citing Rombach v. Chang, 355 F.3d 164, 176 (2d Cir. 2009)). The district court noted that the defendants publically disclosed many of the potential difficulties in the permit application process upon which the plaintiffs' complaint rested—a candidness that "undermines an inference of fraudulent intent." Id. at 526 (citation omitted). The district court also distinguished itself from Matrixx, observing that a blatantly false representation did not exist in Russo and that "the most compelling inference is that defendants' optimism about the receipt of the Final Permit was not reckless given the progress they made and the assurances they received throughout . . . ." Id. at 527. As such, defendants' motion to dismiss was granted. Id.

The Third Circuit

In Inst'l Investors Grp. v. Avaya, Inc., 564 F.3d 242 (3d Cir. 2009), the Third Circuit provided a framework for examining securities fraud claims post-Tellabs, and emphasized that courts must look to the complaint as a whole, not just particular allegations, when assessing claims for securities fraud. In Institutional Investors, shareholders brought a securities fraud class action against Avaya, a company that sold communications products and services, "alleging defendants made false or misleading statements about earnings growth potential and pricing pressure . . . ." Id. at 245. The district court granted the defendant's motion to dismiss. Id.

On appeal, the Third Circuit considered whether the plaintiffs had adequately pleaded scienter. The Third Circuit found that "the totality of the facts alleged by Shareholders here establishes a strong inference of scienter with respect to [defendant's] . . . denials of unusual pricing pressure." Id. at 269. The plaintiffs "proffer[ed] an array of circumstantial evidence giving rise to a strong inference that . . . [the] statements were at least reckless, which is enough to survive a motion to dismiss under the PSLRA." Id. Shareholders also "attempted to support their scienter pleadings with allegations of defendants' motive and opportunity to commit fraud." Id. at 276. The Third Circuit noted its pre-Tellabs holdings that "a showing of motive and opportunity" is "an independent means of establishing scienter." Id. However, the Institutional Investors court held that, in light of Tellabs, allegations of motive and opportunity alone are no longer sufficient to plead scienter. Id. Quoting Tellabs' admonition that such allegations "must be considered collectively," 551 U.S. at 325, the Third Circuit adduced that because "the significance of . . . motive allegations can be ascertained only by reference to the complete complaint, then a general rule that motive allegations are sufficient—or necessary—is unsound." Institutional Investors, 564 F.3d at 277. In that light, the Third Circuit explained, motive allegations "are not entitled to a special, independent status." Id. However, the Third Circuit also noted that the Second Circuit has continued to treat motive and opportunity allegations of scienter as a separate category despite Tellabs. Id. at 277 n.51.

The Sixth Circuit

In Ashland, Inc. v. Oppenheimer & Co., 648 F.3d 461 (6th Cir. 2011), the plaintiff claimed violations of Section 10(b), alleging that the defendant, a securities broker-dealer, engaged in fraud when it recommended that the plaintiff purchase Auction Rate Securities ("ARS"). Id. at 465, 468. The plaintiff alleged that the defendant continued to market ARS as "safe" and "liquid" knowing that the underwriters would not place proprietary bids on the investment instruments, which would harm the plaintiff's ability to sell their position. Id. at 465, 468-69. The district court dismissed the plaintiff's case with prejudice, finding that the plaintiff failed to allege scienter with the requisite particularity under the PSLRA. Id. at 467. The plaintiff appealed. Id.

The Sixth Circuit affirmed the district court's dismissal of the plaintiff's Section 10(b) claim because the plaintiff's factual allegations, when considered together, did not give rise to a strong inference that the defendant acted with scienter. Id. at 470, 472. The Sixth Circuit noted that under Tellabs' "entirely collective assessment" the plaintiff must put forth facts explaining why or how the defendant possessed advanced, non-public knowledge that the underwriters would jointly exit the market. Id. at 469 (citing Tellabs, 551 U.S. at 326 (2007)); accord Matrixx, 131 S. Ct. at 1324-25 (specifically endorsing, then engaging in, Tellabs' holistic scienter examination). In this case, the alleged facts merely suggested that the defendant knew what might happen if the underwriters left the market—a seemingly remote possibility. Ashland, 648 F.3d at 470. As such, the Sixth Circuit held the plaintiff failed to state sufficient facts on which this belief was formed. Id.

In Frank v. Dana Corp., 646 F.3d 954 (6th Cir. 2011), the plaintiffs claimed violations of Sections 10(b) and 20(a) and Rule 10b-5, alleging that two chief corporate officers of Dana Corporation ("Dana") intentionally or recklessly engaged in misstatements and material omissions which were calculated to artificially boost Dana's stock price. Id. at 956-67. Although the defendants continued to project positive growth for Dana's automotive supplier business amid rising raw material costs, Dana eventually announced restated financial earnings and uncovered material weaknesses in internal controls. Id. at 957.

The defendants moved to dismiss, arguing that the plaintiffs failed to meet the heightened pleading standard of the PLSRA. Id. The district court granted the motion, noting that under the Sixth Circuit's ruling in Helwig v. Vencor, Inc., 251 F.3d 540, 553 (6th Cir. 2001), it must accept a plaintiff's inferences of scienter only if those inferences are the most plausible among competing inferences. Frank, 646 F.3d at 957. The plaintiffs appealed the district court's decision. Id. The Sixth Circuit disagreed with the pleading standard that the district court applied, stating that under Tellabs, the plaintiffs' inferences of scienter need not be the most plausible, but only *at least as* plausible as any other non-culpable inference. Id. On remand, the district court granted the defendants' motion to dismiss a second time, finding that the plaintiffs failed Tellabs' "at least as compelling" standard. Id. at 962. The plaintiffs appealed. Id. at 957.

The Sixth Circuit again disagreed with the district court, noting that under Matrixx, a court must review the plaintiffs' allegations "holistically." Id. at 961. In doing so, the Sixth Circuit observed that it was "difficult to grasp the thought that [the defendants] really had no idea that Dana was on the road to bankruptcy" considering rising commodity prices, decreased product earnings, and a threat to the general industry. Id. at 962. Accordingly, the Sixth Circuit concluded that "the inference that [the defendants] recklessly disregarded the falsity of their extremely optimistic statements is at least as compelling to us as their excuse of failed accounting systems." Id. Consequently, the Sixth Circuit reversed the district court's order granting dismissal. Id. at 964.

The Ninth Circuit

In Sharenow v. Impac Mortgage Holdings, Inc., 385 F. App'x 714 (9th Cir. 2010), the plaintiff alleged that Impac's executives "committed fraud by representing that Impac's underwriting guidelines were strict and that its loans were high-quality, when in fact the executives were overriding the underwriting guidelines to originate and purchase poor-quality loans." Id. at 716. Plaintiffs attempted to plead scienter by using the statements of five former employees who claimed that Impac's officers received reports detailing the poor-quality loans and that they overrode the underwriting guidelines by approving them. Id.

The Ninth Circuit affirmed the district court's dismissal, noting the following deficiencies in the complaint: (1) the allegations of the former employees were of a general nature, identifying no specific underwriting guidelines and providing no details of when or how those guidelines were ignored; and (2) the alleged violations were not tied to the class period. Id. at 716. Further, the Ninth Circuit held that, even under the holistic approach of Tellabs, the inference that the defendants intended to deceive investors was not as strong as the competing inference of non-fraudulent intent. Id. at 716-17. As a result, the Ninth Circuit affirmed the district court's dismissal of the case with prejudice. Id. at 717.

In In re MRV Commc'ns, Inc. Deriv. Litig., 2010 WL 5313442, at *1 (C.D. Cal. Dec. 27, 2010), plaintiffs brought a derivative action against MRV in connection with the alleged secret backdating of stock options for its top directors and officers. Defendants contended that the complaint failed to allege scienter, citing numerous cases holding that facts such as a high executive position, committee membership, publication of a restatement, access to inaccurate accounting figures, and the signing of public filings, do not on their own establish scienter. Id. at *7.

The district court disagreed with the defendants' position, holding that the plaintiffs' complaint—which pleaded all of the above-referenced facts *together*—met the burden required to adequately plead scienter. Id. at *9 (emphasis added). The district court clarified that the cases relied upon by the defendants held merely that presence of one factor *alone* was insufficient to adequately plead scienter, and did not perform the holistic evaluation mandated in Tellabs. Id. at *7-8 (citations omitted). As a result, the district court held that scienter had been adequately alleged and denied the defendant's motion to dismiss the Section 10(b) claims. Id. at 10.

The Eleventh Circuit

In Waterford Twp. Gen. Emps. Ret. Sys. v. BankUnited Fin. Corp., 2010 WL 1332574, at *1 (S.D. Fla. Mar. 30, 2010), the district court granted the defendants' motion to dismiss the plaintiffs' putative class action for violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The lead plaintiffs, purchasers of common stock of BankUnited Financial Corporation ("BankUnited"), alleged that the defendants, three senior executive officers of BankUnited, and its primary subsidiary BankUnited FSB, made numerous false and misleading representations to conceal BankUnited's unsound lending practices. Id. at *2-4. Specifically, the plaintiffs alleged that BankUnited relied on limited or no documentation loans, made an aggressive push to increase the volume of risky option adjustable rate mortgage loans, failed to adequately reserve for probable loan losses, and asserted pressure to approve overstated appraisals. Id. at *3. The bank was eventually closed by the Office of Thrift Supervision ("OTS") and the Federal Deposit Insurance Corporation was appointed as receiver. Id. at *5.

The plaintiffs alleged that the defendants fraudulently understated probable loan losses. Id. at *16. The district court held that scienter could not be inferred from the defendants' representations that BankUnited maintained adequate loan loss reserves because BankUnited continually increased loan loss provisions in the face of mounting defaults and delinquencies. Id. Rather than concealing the risky nature of the mortgages it carried, the "more cogent and compelling" inference was that the defendants were disclosing the perceived riskiness of the loans to the market. Id. Likewise, the district court held that the defendants' allegedly false assertions that BankUnited was "well capitalized" did not create an inference of scienter because the plaintiffs failed to allege any facts that the defendants knew or should have known that BankUnited was undercapitalized prior to the OTS's demand that it raise more capital. Id.

Methods of Pleading Scienter: Motive and Opportunity, Conscious Misbehavior, and Recklessness

As shown above, Tellabs settled the question of how to determine whether a complaint establishes a "strong inference" of scienter under the PSLRA. Unfortunately, the Supreme Court declined to resolve whether recklessness is sufficient to meet that standard. Tellabs, 551 U.S. at 319 n.3 ("The question whether and when recklessness satisfies the scienter requirement is not presented in this case."). As a result of this lingering ambiguity, district and circuit courts have continued to develop their own standards on pleading scienter. In general, the Second Circuit continues to accept allegations of motive and opportunity as sufficient to establish scienter in their own right, while the Ninth, Eleventh, and recently Third Circuits hold that motive and opportunity allegations without more are incapable of establishing a "strong inference" of scienter. The remaining circuits to address this issue have been hesitant to draw such bright-lines.

The Second Circuit

Passage of the PSLRA had little effect on scienter pleading in the Second Circuit. See Novak v. Kasaks, 216 F.3d 300, 310 (2d Cir. 2000) (holding that the PSLRA "did not change the basic pleading standard for scienter in this circuit"). In the Second Circuit, a plaintiff can still establish scienter by alleging either:

1. facts showing that defendants had both motive and opportunity to commit fraud; *or*
2. facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness.

Id. at 307; see also, e.g., Ganino v. Citizens Utils. Co., 228 F.3d 154, 168-69 (2d Cir. 2000); Acito v. IMCERA Grp., Inc., 47 F.3d 47, 52 (2d Cir. 1995).

In Novak v. Kasaks, 216 F.3d 300 (2d Cir. 2000), the Second Circuit held that allegations of "motives possessed by virtually all corporate insiders" do not suffice to establish scienter; instead, plaintiffs must "allege that defendants benefited in some concrete and personal way from the purported fraud." Id. at 307-08. The Second Circuit also noted other motives it had previously held inadequate to establish motive, including the desire to maintain a high corporate credit rating and the desire to keep stock prices high to increase officer compensation. Id.; accord Shields v. Citytrust Bancorp, Inc., 25 F.3d 1124, 1130 (2d Cir. 1994) ("To allege a motive sufficient to support the inference [of fraudulent intent], a plaintiff must do more than merely charge that executives aim to prolong the benefits of the positions they hold.").

Where motive is not apparent, a plaintiff may still plead scienter by alleging facts showing conscious misbehavior or recklessness, "'though the strength of the circumstantial allegations must be correspondingly greater.'" ECA, Local 134 IBEW Joint Pension Trust of Chi. v. JP Morgan Chase Co., 553 F.3d 187, 198-99 (2d Cir. 2009) (quoting Kalnit v. Eichler, 264 F.3d 131, 142 (2d Cir. 2001)). To survive dismissal under this theory, a plaintiff must show that the defendants acted recklessly—a standard requiring, "at the least, conduct which is highly unreasonable and which represents an extreme departure from the standards of ordinary care to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it." In re Carter-Wallace, Inc. Sec. Litig., 220 F.3d 36, 39 (2d Cir. 2000) (internal quotation marks and citation omitted).

In Plumbers & Steamfitters Local 773 Pension Fund v. Canadian Imperial Bank of Commerce, 694 F. Supp. 2d 287 (S.D.N.Y. 2010), the lead plaintiff in a putative class action alleged that the Canadian Imperial Bank of Commerce ("CIBC") and four of its officers violated Sections 10(b) and 20(a) of the Exchange Act by misleading investors about CIBC's exposure to subprime residential mortgage-backed securities ("RMBS") and collateralized debt obligations ("CDOs"). Id. at 290-91. The plaintiff further alleged that CIBC failed to disclose that ACA Financial, a "financially unstable" institution, hedged a substantial portion of CIBC's fixed income portfolio backed by subprime mortgages. Id. at 293, 303. In support of its claim, the plaintiff relied on approximately fourteen public statements made by the defendants between May and December 2007, in which the defendants generally discussed CIBC's unhedged exposure to RMBS and CDO losses. Id. at 292-95. The district court granted the defendants' motion to dismiss the complaint, finding that the plaintiff had not adequately pleaded scienter. Id. at 290-91.

The district court held that the plaintiff failed to adequately plead scienter under the four-prong standard articulated by the Second Circuit in Novak. The district court explained that there are four kinds of deceitful behavior that, if well-pleaded, support a strong inference that defendants acted with scienter: (1) benefiting in a concrete and personal way from the purported fraud; (2) engaging in deliberately illegal behavior; (3) knowing facts or having access to information suggesting that their public statements were not accurate; or (4) failing to check information they had a duty to monitor. Id. at 298 (citing Novak, 216 F.3d at 311). The district court first determined that the plaintiff failed to plead any facts suggesting deliberately illegal behavior or that any defendant "benefited in a concrete and personal way" from misleading investors, noting the complaint's incorporation of news releases indicating that CIBC purchased approximately $300 million of its own stock and three of the four individuals increased their holdings during the class period. Id. at 298-99. It would be "nonsensical," the district court reasoned, "to impute dishonest motives to the Individual Defendants when each of them suffered significant losses in their stock holdings and executive compensation." Id. at 299.

The plaintiff likewise failed to plead an inference of scienter under the third and fourth prongs of Novak. To plead that the defendants recklessly disregarded the truth when making their public statements about CIBC's exposure to fixed income securities backed by subprime mortgages, the complaint had to "'*specifically identify* the reports or statements' that [we]re contradictory to the statements made." Id. (citing Novak, 216 F.3d at 309). Yet, the complaint "[made] no reference to internal CIBC documents or confidential sources discrediting Defendants' [public] assertions," and the plaintiffs identified no "specific instances" (using either dates or time frames) in which the defendants received information contrary to their public statements. Id. at 299-300. The district court dismissed the plaintiff's contentions that CIBC's CEO received contradictory information because he was "in charge of all CIBC's activities related to subprime exposure," and that the defendants would have been "on notice of the subprime credit crisis as early as May 2007," as too general to support an inference of scienter. Id. at 300. "[K]nowledge of a general economic trend does not equate to harboring a mental state to deceive, manipulate, or defraud." Id. (citing In re PXRE Grp., Ltd., Sec. Litig., 600 F. Supp. 2d 510, 540 (S.D.N.Y. 2009)). The district court concluded that the pleadings illustrated a classic case of inactionable fraud by hindsight: "CIBC, like so many other institutions, could not have been expected to anticipate the [credit] crisis with the accuracy Plaintiff enjoys in hindsight." Id. at 301.

In Gissin v. Endres, 739 F. Supp. 2d 488 (S.D.N.Y. 2010), putative class action plaintiffs brought claims against senior executives and directors of VeraSun Energy Corp. ("VeraSun"), a bankrupt ethanol producer, alleging that the defendants made false and misleading statements about VeraSun's pricing and hedging practices from March 12, 2008 to September 16, 2008 in violation of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The plaintiffs specifically contended that during the class period the defendants were aware VeraSun was suffering massive liquidity problems but nonetheless publicly stated that VeraSun had sufficient cash to meet its financial obligations. Id. at 499. The district court granted the defendants' motion to dismiss, finding that the plaintiffs failed to adequately plead scienter.

The district court held that the plaintiffs had not adequately pleaded scienter under either the "motive and opportunity" or the "conscious misbehavior or recklessness" standard. First, while the plaintiffs argued that the defendants were motivated in the aggregate to misrepresent VeraSun's liquidity in order to maintain a high stock price, they could not meet the Second Circuit's standard of individualized pleading for motive and opportunity requiring allegations of a specific benefit to each individual defendant stemming from the alleged fraud. Id. at 513. Second, the district court found that the plaintiffs failed to allege facts supporting a strong inference of conscious misbehavior or recklessness under Tellabs. Although the plaintiffs' asserted that the defendants were aware of VeraSun's liquidity problems when they made public statements to the contrary, the district court found the pleadings offered a more compelling plausible, non-culpable explanation for the defendants' conduct—that "VeraSun attempted to realize its expansion plans in a declining and volatile market, and then exacerbated its imprudence by locking itself into accumulator contracts on a faulty presumption that corn prices would remain high." Gissin, 739 F. Supp. 2d at 514. Such claims that were "'essentially grounded on corporate mismanagement do not adequately plead recklessness.'" Id. (quoting Inst'l Investors Grp. v. Avaya, Inc., 564 F.3d 242, 267 n.42 (3d Cir. 2009)). The district court therefore dismissed the plaintiffs' claims.

The Ninth Circuit

In contrast to the Second Circuit, the Ninth Circuit has held that "Congress intended to elevate the pleading requirement above the Second Circuit standard requiring plaintiffs merely to provide facts showing simple recklessness or a motive to commit fraud and opportunity to do so." In re Silicon Graphics, Inc. Sec. Litig., 183 F.3d 970, 974 (9th Cir. 1999)). Put simply, in a securities class action, "the plaintiffs must show that defendants engaged in '*knowing*' or '*intentional*' conduct . . . . [R]eckless conduct can also meet this standard 'to the extent that it reflects some degree of intentional or conscious misconduct,' or what we have called 'deliberate recklessness.'" S. Ferry LP, No. 2 v. Killinger, 542 F.3d 776, 782-83 (9th Cir. 2008) (citing Silicon Graphics, 183 F.3d at 983 (9th Cir. 1999)); see also Glazer Capital Mgmt., LP v. Magistri, 549 F.3d 736, 743 (9th Cir. 2008) (quoting In re Silicon Graphics, 183 F.3d at 974); In re Read-Rite Corp., Sec. Litig., 335 F.3d 843, 846 (9th Cir. 2003); Gompper v. VISX, Inc., 298 F.3d 893, 895 (9th Cir. 2002), abrogated on other grounds by Tellabs, 551 U.S. at 323; DSAM Global Value Fund v. Altris Software, Inc., 288 F.3d 385, 388-89 (9th Cir. 2002).

The Eleventh Circuit

In the Eleventh Circuit, scienter consists of either the "intent to defraud" or "severe recklessness." Edward J. Goodman Life Income Trust v. Jabil Circuit, Inc., 594 F.3d 783, 790 (11th Cir. 2010)). Severe recklessness is "limited to those highly unreasonable omissions or misrepresentations that involve . . . an extreme departure from the standards of ordinary care, and that present a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that the defendant must have been aware of it." Mizzaro v. Home Depot, Inc., 544 F.3d 1230, 1238 (11th Cir. 2008)).

The Eleventh Circuit follows the Ninth in rejecting the notion that "allegations of motive and opportunity to commit fraud, standing alone, are sufficient to establish scienter in this Circuit." Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1285 (11th Cir. 1999). This sentiment was recently reaffirmed in FindWhat Investor Grp. v. FindWhat.com, 658 F.3d 1282 (11th Cir. 2011). There, the plaintiffs brought a class action for violation of Section 10(b) of the Exchange Act and Rule 10b-5 against an internet commerce company that offered "pay-per-click" online advertising services. Advertisers paid for such services only when a user clicked on an online advertisement, and the revenue was split between the company and the websites on which the advertisement was displayed, or the "distribution partners." Id. at 1291. The plaintiffs alleged that they were damaged when the company's stock price dropped after the defendants revealed that the company's revenue was based in part on the "click fraud" of its distributors, i.e., clicking on an online advertisement for the sole purpose of forcing the advertiser to pay for the click. Id. at 1291.

The Eleventh Circuit affirmed the district court's dismissal because the plaintiffs failed to adequately plead scienter. Id. at 1299. The court agreed that the defendants' representations were materially misleading, id. at 1298, but concluded that the plaintiffs' scienter allegations—i.e., that the defendants "must have known" about the alleged click fraud of its distribution partners, or that the fraud was "commonly known"—were too speculative and conclusory to establish scienter. Id. at 1302-03. The Eleventh Circuit also noted that key omissions and ambiguities in the plaintiffs' allegations (including the dates many alleged events transpired) that further undermined an inference of scienter. Id. at 1304.

Significantly, the Eleventh Circuit found the defendants' alleged motives to meet revenue expectations insufficient to raise an inference of scienter, reiterating that it had previously "rejected the notion that 'allegations of motive and opportunity to commit fraud, standing alone, are sufficient to establish scienter in this Circuit.'" Id. at 1303 (quoting Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1285 (11th Cir. 1999)).

In Local 703, I.B. of T. Grocery & Food Emps. Welfare Fund v. Regions Fin. Corp., 2011 U.S. Dist. LEXIS 60761 (N.D. Ala. June 7, 2011), the district court denied the defendants' motion to dismiss the plaintiffs' Section 10(b) claim under the Exchange Act. The defendant corporation, a provider of consumer and commercial financial products and services, and three of its directors and officers allegedly made false and misleading statements about the internal risk-ratings on loans for real estate and on calculations of goodwill. Id. at *2. When the defendants reported a net loss "largely driven by a large charge for impairment of goodwill" that contradicted the defendants' prior statements, the stock price declined. Id. at *15.

Although the statements were made in the context of an unfolding global financial crisis, the district court held that the plaintiffs had adequately pleaded scienter. Id. at *25. When viewing the allegations in the aggregate, the district court found the inference that the defendants knowingly or recklessly ignored the falsity of their statements in public filings, calls with analysts, and financial statements was at least as plausible as the inference that the global financial crisis was the actual cause of the inaccuracies in the defendants' statements. Id.

Specifically, the district court found that defendants had a possible motive to inflate the company's income because their compensation was tied to company performance. Id. at *27. The district court also noted that defendants had access to reports showing the true state of affairs regarding the company's loans and deteriorating markets. Id. at *27-29. The district court also pointed to the company's sudden and significant increase in loan loss reserves and goodwill write-down. Id. at *29-30. Finally, the district court emphasized that defendants signed allegedly false SOX certifications, and that the company was subject to a Federal Reserve investigation regarding goodwill. Id. at *30-31. The district court found these allegations sufficient to create an inference of scienter. Id. at *25.

The Third Circuit

Third Circuit scienter jurisprudence largely mirrored that of the Second Circuit through the passage of the PSLRA. See, e.g., In re Advanta Corp. Sec. Litig., 180 F.3d

525, 534 (3d Cir. 1999) (noting that the language of the PSLRA closely paralleled the Second Circuit scienter standard and concluding that "Congress's use of the Second Circuit's language compels the conclusion that the Reform Act establishes a pleading standard approximately equal in stringency to that of the Second Circuit."). However, in the wake of Tellabs, the Third Circuit appears to have joined the Ninth and Eleventh Circuits in concluding that motive and opportunity is no longer sufficient to establish scienter on its own:

> Our conclusion that "motive and opportunity" may no longer serve as an independent route to scienter follows also from Tellabs's [sic] general instruction to weigh culpable and nonculpable inferences. Individuals not infrequently have both strong motive and ample opportunity to commit bad acts—and yet they often forbear, whether from fear of sanction, the dictates of conscience, or some other influence.

Inst'l Investors Grp. v. Avaya, Inc., 564 F.3d 242, 276-78 (3d Cir. 2009). District courts in the Third Circuit have followed this holding. E.g., In re Merck & Co. Sec., Deriv. & "ERISA" Litig., 2011 WL 3444199, at *20 (D.N.J. Aug. 8, 2011).

Remaining Circuits

Generally, the First, Fourth, Fifth, Sixth, Seventh, Eighth, and Tenth Circuits have taken a more middle-of-the-road approach with regard to scienter, reasoning that "Congress chose neither to adopt nor reject particular methods of pleading scienter . . . but instead only required plaintiffs to plead facts that together establish a strong inference of scienter." Ottmann v. Hanger Orthopedic Grp., Inc., 353 F.3d 338, 345 (4th Cir. 2003); accord Fla. State Bd. of Admin. v. Green Tree Fin. Corp., 270 F.3d 645, 659-60 (8th Cir. 2001); Nathenson v. Zonagen, Inc., 267 F.3d 400, 411-12 (5th Cir. 2001); City of Phila. v. Fleming Cos., 264 F.3d 1245, 1261-63 (10th Cir. 2001); Helwig v. Vencor, Inc., 251 F.3d 540, 550-52 (6th Cir. 2001) (en banc); Greebel v. FTP Software, Inc., 194 F.3d 185, 195-97 (1st Cir. 1999). However, each of these Circuits do vary somewhat in their approach to examining a securities fraud complaint. Recent representative cases from these jurisdictions are below.

The First Circuit

In City of Dearborn Heights Act 345 Police & Fire Ret. Sys. v. Waters Corp., 632 F.3d 751 (1st Cir. 2011), investors brought a securities fraud class action under Section 10(b) of the Exchange Act and Rule 10b-5 against Waters Corp. ("Waters") and two of its senior executives. Id. at 753. The complaint alleged that "defendants intentionally or recklessly failed to disclose a . . . change in Japanese regulations that predictably reduced demand for Waters' products and services in Japan, a significant market for the company." Id. The plaintiffs claimed there was a strong inference of scienter based on the company's omissions and the fact that the defendants sold considerable shares of stock during the class period. Id. The district court dismissed the action, and the plaintiffs appealed.

The First Circuit noted that the scienter element of a 10b-5 action may be satisfied "by showing that the defendant engaged in 'intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities.'" Id. at 757 (quoting Ernst & Ernst v. Hochfelder, 425 U.S. 185, 199 (1976)). However, the First Circuit also recognized that the PSLRA mandates a special pleading standard for scienter and requires that a complaint give rise to a "strong inference" of scienter for each alleged act or omission. Id. at 757. The court found that the key question was not whether defendants had knowledge of undisclosed facts, but whether defendants knew or should have known that failure to disclose would likely mislead investors. Id. at 758.

The First Circuit applied an objective test and found that "the inference of a nonculpable explanation for the lack of disclosure is much stronger than the inference of scienter, even viewing scienter as involving either intentionality or extreme recklessness." Id. The court found that defendants reasonably did not expect the change in Japanese regulations to significantly impact their worldwide sales, as this was a regulation change in only one of the company's many worldwide markets. Id. at 759. The First Circuit also noted that securities fraud cannot be based on a company's failure to disclose all non-public information. Id. at 760.

The Sixth Circuit

In Local 295/Local 851 IBT Emp'r Grp. Pension Trust & Welfare Fund v. Fifth Third Bancorp., 731 F. Supp. 2d 689 (S.D. Ohio 2010), the plaintiffs claimed violations of Sections 10(b) and Section 20(a) of the Exchange Act as well as Rule 10b-5, alleging that Fifth Third Bancorp. ("Bancorp.") issued material misrepresentations and omissions by stating that it followed conservative lending policies and had adequate capital reserves when in reality the defendants aggressively began originating risky sub-prime loans. Id. at 694. The defendants were engaged in originating sub-prime loans, for which the plaintiffs alleged that Bancorp. did not set aside adequate loan loss reserves. Id. After the defendants announced that Bancorp. would have to raise capital through new securities offerings, cutting its dividends, and selling off non-core business assets, the price of the company's stock declined. Id. at 710.

The defendants moved to dismiss for failure to raise a sufficient inference of scienter under the PSLRA. Id. at 716. The district court granted the motion for several reasons. First, the district court found the plaintiffs' failure to establish any of the factors listed in Helwig v. Vencor, Inc., 251 F.3d 540, 552 (6th Cir. 2001), while not dispositive, a serious omission. Id. at 727. Second, the district court held that plaintiffs failed to demonstrate motive or opportunity to commit securities fraud, noting that the plaintiffs' confidential witnesses failed to connect the defendants with the alleged misconduct. Id. Third, the district court noted that the allegedly concealed information was actually reported, which cut strongly against a finding of scienter. Id. Hence, the district court found that the allegations raised a more compelling inference that the decrease in the value of the company's shares was caused by a decline in the larger credit market and not fraud. Id.

The Seventh Circuit

In Plumbers & Pipefitters Local Union No. 630 Pension-Annuity Trust Fund v. Allscripts-Misys Healthcare Solutions, Inc., 778 F. Supp. 2d 858 (N.D. Ill. 2011), investors brought a class action alleging violations of Sections 10(b) and 20(a) against the defendant Allscripts and its executive officers for alleged misstatements in connection with delayed release of a software product. Id. at 863. The district court held that to survive a motion to dismiss, plaintiffs did not need to plead facts related to defendant's motive for making alleged misstatements. Id. at 885. The defendants argued that the plaintiffs could not meet the PSLRA's pleading requirements without some allegation as to motive, but the district court responded that Seventh Circuit decisions "have not assigned a special significance to the absence of motive allegations" and that this absence was not fatal. Id.

Pleading Scienter Through Motive and Opportunity

Executive Compensation

The Second Circuit

In Coyne v. Gen. Elec. Co., 2010 WL 2836730 (D. Conn. July 15, 2010), aff'd sub nom. Inter-Local Pension Fund GCC/IBT v. Gen. Elec. Co., 445 F. App'x 368 (2d Cir. 2011), the lead plaintiffs in a purported class action sued General Electric Company ("GE"), as well as GE's CEO and CFO for violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The plaintiffs alleged that the defendants made false and misleading statements between December 2007 and March 2008 when projecting, among other things, a 10% increase in earnings for 2008. Id. at *3. Following these positive earnings projections, GE announced in April 2008 that it had "failed to meet expectations" in the first quarter of 2008. Id. at *2. GE's stock price dropped immediately following the announcement. Id. at *3.

The district court dismissed the plaintiffs' complaint for failure to identify any actionable statement or omission by the defendants and for failure to allege that the defendants acted with scienter. Id. at *5, *10. Reviewing the district court's dismissal de novo, the Second circuit affirmed, agreeing that the plaintiffs adequately pleaded a strong inference of scienter. Inter-Local Pension Fund GCC/IBT, 445 F. App'x at 370.

In support of their scienter allegations, the plaintiffs alleged that the defendant officers received performance-based compensation tied to GE's stock price and that Immelt, who had underperformed his predecessor, "may have felt pressure to generate greater returns for shareholders." Id. The Second Circuit found these allegations insufficient to establish scienter via motive and opportunity because such motives are common to most corporate officers. Id. Moreover, the absence of motive to commit fraud was "underscored by the fact that [the defendants'] misstatements concerning [GE's] quarterly earnings prospects were made no more than a few weeks before GE would inevitably be required to report its quarterly earnings to the market." Id. Thus, the plaintiffs' pleadings failed to suggest how the defendants could "'benefit[] in a concrete and personal way'" from withholding earnings information that would be revealed shortly. Id. (quoting Novak v. Kasaks, 216 F.3d 300, 311 (2d Cir. 2000)).

In Newman v. Family Mgmt. Corp., 748 F. Supp. 2d 299 (S.D.N.Y. 2010), the plaintiffs, limited partner investors in the FM Low Volatility Fund ("FM Fund"), a fund investing in "Feeder Funds" which in turn invested with Bernard L. Madoff Securities LLC ("Madoff"), brought claims against Family Management Corporation ("FMC"), an investment adviser for FM Fund, and various other defendants associated with the FM Fund and the Feeder Funds. Id. at 302-03, 305. The plaintiffs brought claims against the defendants under Sections 10(b) and 20(a) of the Exchange Act, and under New York State law. The district court granted the defendants' motion to dismiss, holding, inter alia, that the plaintiffs had not adequately pleaded scienter. Id. at 311. The plaintiffs alleged that the FMC defendants were "willfully blind to the numerous red flags" indicating that Madoff was a fraud and "motivated by their own self-interest in obtaining exorbitant and unique fees and commissions." Id. at 309 (internal quotation marks omitted). The district court rejected this argument as "misguided" because the plaintiffs failed to allege that the defendants "benefited in some concrete and personal way from the purported fraud." Id. (quoting ECA, Local 134 IBEW Joint Pension Trust of Chi. v. JP Morgan Chase Co., 553 F.3d 187, 198 (2d. Cir. 2009)). The district court held that the plaintiffs could not raise a strong inference of scienter by alleging that the defendants benefited from "fees of 1.4%" because plaintiffs had not demonstrated that those fees were exorbitant or in excess of industry standards and "[t]he desire to maintain high compensation in such circumstances does not constitute motive for the purposes of [the scienter] inquiry." Id. at 309 (citing ECA, 553 F.3d at 197).

In In re SLM Corp. Sec. Litig., 740 F. Supp. 2d 542 (S.D.N.Y. 2010), the lead plaintiff in the putative class action lawsuit sued the student loan provider SLM Corporation ("Sallie Mae") and two of its senior officers, Albert Lord and Charles Andrews, under Sections 10(b) and 20(a) of the Exchange Act, alleging that between January 18, 2007 and January 23, 2008, the defendants made misleading statements in SEC filings, press releases and conference calls about Sallie Mae's financial performance to inflate the company's share price. Specifically, the plaintiff averred that Sallie Mae "lowered its borrowing criteria to increase its portfolio of private [education] loans, hid defaults by changing its forbearance policy, and inflated profits through inadequate loan loss reserves." Id. at 549.

The district court held that the plaintiff had adequately pleaded scienter as to Sallie Mae and Lord by pleading motive and opportunity under the Second Circuit's two-prong standard. First, because Lord and Andrews were in the highest positions of authority at Sallie Mae, the district court found they had the opportunity to commit fraud. Id. at 557 (citing San Leandro Emergency Med. Grp. Profit Sharing Plan v. Philip Morris Cos., 75 F.3d 801, 813 (2d Cir. 1996)). But on the pleadings, only Lord possessed a corresponding motive. The plaintiff alleged that Lord was motivated by a "concrete and personal benefit" to inflate Sallie Mae's share price because under a merger with J.C. Flower & Co., Lord would receive an approximately $225 million cash payment and Lord made "unusual" stock sales, liquidating 97% of his Sallie Mae holdings during the class period. Id. 557-58. The district court found these allegations, coupled with the allegation that the defendants sought to inflate Sallie Mae's share price to avoid financial risk under its equity forward contracts, "sufficiently concrete to give rise to an inference that Lord possessed the intent to defraud shareholders." Id. at 557. The district court further held that this motive and opportunity applied to Sallie Mae because the scienter of management-level employees can be attributed to corporate defendants. Id. (citing In re Marsh & McLennan Cos. Sec. Litig., 501 F. Supp. 2d 452, 481 (S.D.N.Y. 2006)).

The Seventh Circuit

In Greer v. Advanced Equities, Inc., 683 F. Supp. 2d 761 (N.D. Ill. 2010), the plaintiffs alleged that two officers of defendant Advanced Equities, Inc. ("AEI") advised them to invest through a private placement with Pixelon, Inc. ("Pixelon"), a company run by a convicted embezzler and fugitive. Id. at 764-65. The plaintiffs relied on statements by an AEI officer that AEI had worked with Pixelon for several months, that AEI would have members on the Pixelon board, and that AEI had access to Pixelon's books and records. Id. at 764.

The district court dismissed the plaintiffs' first amended complaint for failure to allege scienter with particularity, and the defendants moved to dismiss plaintiffs' second amended complaint ("SAC"). Id. at 764. The district court found that the changes in the SAC were "simply cosmetic and fail[ed] to properly address the substantive requirement that the complaint must create a strong inference of scienter *with respect to each individual defendant.*" Id. at 774 (emphasis added). For example, the plaintiffs changed references to "the defendants" in the first complaint to state the individuals named in the SAC. Id. The plaintiffs' allegations that the defendants personally benefited from inducing investments through commissions and through increases in the value in their stock shares were similarly insufficient to state a claim. Id. at 774. The district court made clear that "simple allegations of financial motive do not necessarily establish scienter." Id. at 775. If the court were to find such allegations sufficient, "disgruntled investor suits would multiply exponentially and Congress' intent in passing the stringent pleading requirements of the PSLRA would be significantly undermined." Id. The plaintiff's allegations of motive were therefore insufficient, and the defendants' motion to dismiss was granted. Id. at 777.

The Ninth Circuit

In In re XenoPort, Inc. Sec. Litig., 2011 WL 6153134 (N.D. Cal. Dec. 12, 2011), investors brought suit under Sections 10(b) and 20(a) alleging misstatements on calls with analysts in connection with development of a drug. Id. at *1. The plaintiffs alleged that the defendants were motivated to inflate the company's stock price to ensure that a secondary offering of stock would be successful and to increase their compensation under the company's corporate bonus plan. Id. at *5. The district court stated that "corporate bonuses, even those explicitly tied to financial performance or stock price, have only limited probative value as to scienter." Id. To create a strong inference of scienter, the court continued, plaintiffs must show a "strong correlation" between the company's financials and compensation, which requires plaintiffs to plead facts demonstrating how closely the company's financials effected compensation. Id. The facts pleaded, on the other hand, showed that the defendants received their bonuses months before the secondary offering occurred, that their bonuses were mostly based on internal performance measures, and that the defendants received their bonuses in the form of stock. Id. Finding that "plaintiff ha[d] not articulated a reason defendants would knowingly hold on to allegedly inflated shares," the district court held that the alleged facts, taken together, failed to adequately plead scienter. Id.

The Eleventh Circuit

In Phila. Fin. Mgmt. of San Francisco, LLC v. DJSP Enter., Inc., 2011 WL 4591541 (S.D. Fla. Sept. 30, 2011), the district court granted the defendants' motion to dismiss the plaintiffs' putative class action for violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The defendants included DJSP Enterprises, Inc. ("DJSP"), a publicly-traded company that provided processing services for residential mortgage foreclosures and related matters, David J. Stern, its President, CEO, and Chairman, and Kumar Gursahaney, its Executive Vice President and CFO. Id. at *1. The plaintiffs, investors in DJSP, alleged that the defendants made numerous material misrepresentations regarding their business operations and financial prospects, which harmed them when DJSP's stock value dramatically declined. Id. at *8.

The plaintiffs alleged that Stern intentionally concealed the downturn in DJSP's foreclosure processing business because he had a particular financial motive to portray DJSP's business prospects in a positive light. Id. at *17. Pursuant to conditions on warrants held by DJSP, the company needed a sustained increase in the value of DJSP's shares in order to exercise these options, which would provide Stern with substantial financial gains. Id. Although Stern had a financial incentive to conceal DJSP's downturn, the district court rejected the plaintiffs' allegations that this incentive established motive and opportunity to commit fraud. Id. The district court pointed to additional factual allegations undermining the plaintiffs' motive argument, including the allegations that Stern had limited knowledge of the cause for the slowdown in DJSP's core business and did not attempt to sell his equity interest in DJSP's processing business. Id. Accordingly, these facts did not create an inference that Stern had a motive to fraudulently conceal the downturn in foreclosures. Id.

Appearance of Stability/Profitability

The Second Circuit

In In re Sanofi-Aventis Sec. Litig., 774 F. Supp. 2d 549 (S.D.N.Y. 2011), the district court addressed the defendants' motion to dismiss the plaintiffs' claims for violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The investor plaintiffs alleged that the defendants, pharmaceutical company Sanofi-Aventis SA ("Sanofi") and seven of its executives, made materially misleading statements regarding the commercial viability of rimonabant, an obesity drug. Id. at 556. The United States Food and Drug Administration ("FDA") directed the defendants to assess the link between rimonabant and suicidality, and the information obtained eventually led to the FDA Advisory Committee's recommendation that the FDA deny Sanofi's New Drug Application, which Sanofi withdrew before it was denied. Id. at 558-59.

The district court held that the defendants' alleged motivation to conceal the link between rimonabant and suicidality—to increase sales and obtain approval for the drug outside of the United States before the truth about the drug emerged—did not create an inference of scienter because the desire to have a drug application approved can be ascribed to any pharmaceutical company and the desire to maximize revenue can be ascribed to any for-profit company. Id. 570. To the district court, neither motive was "'sufficiently concrete'" to allege scienter. Id. (quoting Chill v. Gen. Elec. Co., 101 F.3d 263, 268 (2d Cir. 1996)).

Insider Stock Sales

The First Circuit

In City of Dearborn Heights Act 345 Police & Fire Ret. Sys. v. Waters Corp., 632 F.3d 751 (1st Cir. 2011), investors brought a securities fraud class action under Section 10(b) of the Exchange Act and Rule 10b-5 against Waters Corp. ("Waters") and two of its senior executives. Id. at 753. The complaint alleged that the "defendants intentionally or recklessly failed to disclose a . . . change in Japanese regulations that predictably reduced demand for Waters' products and services in Japan, a significant market for the company." Id. The plaintiffs claimed there was a strong inference of scienter based on the company's omissions and the fact that the defendants sold considerable shares of stock during the class period. Id. The district court dismissed the action, and the plaintiffs appealed.

The First Circuit was not swayed by plaintiffs' insider trading allegations. While noting that "allegations of insider trading may offer some support for inferences of scienter," the First Circuit still held that the complaint did not properly allege scienter. Id. at 760. The First Circuit found that the trading by one defendant was much less than he was allowed during the class period (only 4.82% of the shares he could have sold), and found with respect to another defendant that plaintiffs failed to allege "unusual" trading activity during the period where the defendant sold 7% and 22% of his available shares in the third and fourth quarters, respectively. Since the plaintiffs failed to allege that these sales were not normal trading patterns for this defendant, the First Circuit held that the action was properly dismissed. Id. at 761.

The Second Circuit

In Plumbers & Pipefitters Local Union No. 630 Pension-Annuity Trust Fund v. Arbitron Inc., 741 F. Supp. 2d 474 (S.D.N.Y. 2010), investors asserted securities fraud allegations against Arbitron, Inc. ("Arbitron"), a firm engaged in audience measurement services for radio stations, as well as Arbitron's CEO Stephen Morris and CFO Sean Creamer. The complaint alleged that between July 19, 2007 and November 26, 2007, the defendants made false and materially misleading statements or omissions about Arbitron's planned rollout of its Portable People Meter ("PPM") (an electronic device that identifies the radio broadcasts one is listening to) in violation of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Id. at 477. The defendants moved to dismiss the complaint for failure to state a securities fraud claim. The district court granted dismissal of the claims against Creamer with prejudice, holding that the plaintiffs had not established scienter under either the "motive and opportunity" or the "recklessness" standard. The district court denied dismissal of claims against Morris and Arbitron, however, holding that the plaintiffs had adequately pleaded recklessness as to Morris and corporate scienter as to Arbitron. Id. at 490-91.

The plaintiffs attempted to plead scienter via motive and opportunity, alleging that seven high-level Arbitron insiders, including Creamer and Morris, engaged in insider trading during the class period. Id. at 482, 488. The plaintiffs claimed that these trades amounted to over $8.9 million worth of Arbitron common stock during the class period, that some insiders sold as much as 40% of their Arbitron holdings, and that the majority of insider sales occurred within a month of Arbitron's announcement that it would delay commercialization of PPM. Id. at 482. The district court observed that "a complaint that seeks to base scienter on a corporate insider's sale of his or her own stock must show . . . 'unusual' insider sales," which could be measured by the following factors: (1) the amount of profit from the sales; (2) the portion of stockholdings sold; (3) the change in volume of insider sales; and (4) the number of insiders selling. Id. at 488 (citing In re Scholastic Corp. Sec. Litig., 252 F.3d 63, 74-75 (2d Cir. 2001)).

The district court concluded that the plaintiffs' "minimal" allegations that Creamer made one sale a month before the allegedly suspicious trading began, "selling a slight 0.7% of his shares for $16,904 . . . lack[ed] any indicia of unusual insider trading . . . ." Id. The district court also found the plaintiffs' unusual insider trading allegations against Morris "insubstantial" because, although Morris had sold over $1.3 million in Arbitron common stock, those shares represented just 6.6% of Morris' holdings and "were made in such a regular pattern—6,724 or 6,725 shares once a month at the beginning of each month—that they [could not] be called 'unusual.'" Id. at 490-91. Thus, the district court held that the plaintiff failed to plead scienter via insider trading during the class period. See id. at 488, 490-91.

The Third Circuit

In In re Radian Sec. Litig., 2010 WL 1767195 (E.D. Pa. Apr. 30, 2010), plaintiff shareholders brought suit under Section 10(b) of the Exchange Act and Rule 10b-5, alleging that the defendants (Radian Group, Inc. and its officers) made materially false and misleading statements regarding Radian's investment in Credit Based Asset Servicing and Securitization L.L.C. ("C-BASS"), a mortgage investment and servicing company specializing in subprime residential mortgage assets and securities, and that "this deception caused Radian's shares to decline in value . . . ." Id. at *1. The defendants moved to dismiss the complaint, and the district court granted the motion.

The district court held that the plaintiff's allegations of insider trading were insufficient to establish scienter on the part of the defendants. Id. at *12. The court found that the plaintiff's allegations in this respect failed to: (1) refute the court's findings of a more compelling, nonculpable explanation; (2) include information about the defendants' trading history; and (3) refute that trading was consistent with the defendants' prior trading history. Id. at *11. The district court also found that the plaintiffs failed to adequately plead scienter with respect to the defendants' *aggregate* stock sales, noting that the defendants collectively retained over 88% of their Radian securities during the class period and that the complaint failed "to allege with particularity how and when the defendants knew that their investment . . . was impaired." Id. at *12.

The Fourth Circuit

In In re Coventry Healthcare, Inc. Sec. Litig., 2011 WL 1230998 (D. Md. Mar. 30, 2011), the defendants moved to dismiss the plaintiffs' 10b-5 class action for failure to adequately plead scienter. Id. at *8. The district court recognized that Fourth Circuit case law allowed evidence of insider trading to plead scienter if the trading is "unusual or suspicious." Id. at *9 (quoting Teachers' Ret. Sys. of La. v. Hunter, 477 F.3d 162, 184 (4th Cir. 2007)). In this vein, the plaintiffs alleged that the individual defendants sold "more than 314,000 shares of Coventry stock for proceeds of nearly $18 million [during a five-week period] . . . the most active trading period in the Individual Defendants' history." Id. However, the district court found that such allegations of heavy trading or profit alone would not satisfy the element of scienter. Id. The court also thought it "important to highlight" that "insider trading supports a strong inference of scienter, but does not necessarily equate to a finding that scienter has adequately been pled." Id. The district court thus granted the defendant's motion to dismiss in relevant part. Id. at *10.

The Seventh Circuit

In Garden City Emps.' Ret. Sys. v. Anixter Int'l, Inc., 2011 WL 1303387 (N.D. Ill. Mar. 31, 2011), investors brought a class action against Anixter International, Inc. ("Anixter") and its executives alleging misstatements and omissions that artificially inflated Anixter's stock price in violation of Sections 10(b) and 20(a) of the Exchange Act. Id. at *1. The defendants moved to dismiss on several grounds, including failure to plead scienter. Id. Considering the motion to dismiss, the district court rejected the notion that the defendants' trades from outside the class period were irrelevant to scienter, finding instead that "the opposite is true." Id. at *13. Under Pugh v. Tribune Co., 521 F.3d 686, 695 (7th Cir. 2008), a plaintiff may establish scienter by alleging facts that show unusual or suspicious trading within the class period. Id. at *13. Therefore, forms showing trades made outside the class period are relevant to determining whether the trades are unusual in context. Id. at *14. The plaintiffs only provided information from within the class period, alleging that the trades were suspicious in timing and in amount, but the district court stated that it could not evaluate those claims without comparative information from outside the class period. Id. at *30. The defendants, on the other hand, provided public filings from outside the class period showing that the defendants sold no more shares during the period than in each of the two prior years. Id. at *31. In light of this, the district court dismissed plaintiffs' claims. Id.

The Ninth Circuit

In In re MannKind Sec. Actions, 2011 WL 6327089 (C.D. Cal. Dec. 16, 2011), investors brought a class action alleging violations of Sections 10(b) and 20(a) stemming from alleged misstatements indicating that the FDA had pre-approved MannKind Corporation's drug testing protocol for a new product. Id. at *1. Later, the FDA sent a Complete Response Letter ("CRL") to the company refusing to approve the product, which the company failed to disclose to investors. Id. at *2. The company continued testing the products and making positive statements to the public, but eventually received a second CRL that it later disclosed to the public, after which the stock dropped in price. Id. at *4-6. The defendant moved to dismiss contending, inter alia, that the plaintiffs' allegations of motive failed to sufficiently plead scienter. Id. at *1, *13. The plaintiffs alleged that one of the individual defendants sold 10.5% of his stock holdings after receiving the second CRL, but before that information was released to the public. Id. at *14.

The district court noted the three factors that the Ninth Circuit had identified as relevant to the suspiciousness of a stock sale: "(1) the amount and percentage of shares sold by insiders; (2) the timing of the sales; and (3) whether the sales were consistent with the insider's prior trading history." Id. (citing Ronconi v. Larkin, 253 F.3d 423, 435 (9th Cir. 2001)). Considering these factors, the district court found that the plaintiffs' allegations failed to create a strong inference of scienter, emphasizing that the sales were made pursuant to a pre-determined 10b5-1 trading plan—a fact the plaintiffs failed to rebut. Id. at *14. Nonetheless, the scienter element was ultimately established on other grounds and the defendants' motion to dismiss was denied. Id. at *18.

The Tenth Circuit

In In re Thornburg Mortg., Inc. Sec. Litig., 695 F. Supp. 2d 1165 (D.N.M. 2010), investor plaintiffs brought a putative class action for violations of Rule 10b-5 against Thornburg Mortgage, Inc. ("TMI"), a mortgage company, and its officers. Id. at 1173. The plaintiffs alleged, inter alia, that Larry Goldstone, TMI's COO (and after December 18, 2007, its CEO), had made false and materially misleading statements regarding the types of loans TMI had originated and that the other officers were liable as control persons under Section 20(a). Id. at 1176-78. The defendants moved to dismiss, arguing that their purchase of more than $25 million dollars' worth of TMI stock (most of which at its peak price), showed a lack of motive to fraudulently inflate the stock price of the company. Id. at 1194-95. They further argued that because the plaintiffs did not allege that the defendants gained anything from the alleged fraud, the strong inference of scienter necessary to support a 10b-5 action was negated. Id.

The district court recognized that motive is an element to consider in the scienter analysis, but stated that "lack of insider trading [does not] always negate[] or weaken[] an inference of scienter" and that a lack of motive "is not fatal to an allegation of scienter under the PSLRA." Id. at 1194. The court continued that, regardless of the fact that a lack of motive is not dispositive in a scienter analysis, in this case there was a motive: survival of the company. Id. The district court stated that because many of the defendants already held a substantial amount of interest in TMI, it was plausible to infer that they bought the stock when they did to inject capital into the company and increase public confidence. Id.

The Eleventh Circuit

In City of Pontiac Gen. Emp. Ret. Sys. v. Schweitzer-Mauduit Int'l, Inc., 806 F. Supp. 2d 1267 (N.D. Ga. 2011), the district court granted the defendants' motion to dismiss the plaintiffs' putative class action, which alleged violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The plaintiffs were shareholders in

Schweitzer-Maduit International, Inc. ("Schweitzer"), which supplied tobacco products to tobacco companies internationally. Id. at 1270. The plaintiffs alleged that the company and two of its directors and officers engaged in a fraudulent scheme to artificially inflate the company's stock price by misleading the market about: (1) Schweitzer's relationship with one of its largest customers; (2) the strength of Schweitzer's intellectual property protections; and (3) pressures Schweitzer faced from European competitors. Id.

The plaintiffs alleged that scienter could be inferred from the substantial stock sales by one of the individual defendants during the class period. Id. at 1295. The district court explained that in order to create an inference of scienter, the plaintiffs must provide a meaningful trading history for the purposes of comparison to the stock sales alleged. Id. at 1296. Since the plaintiffs failed to provide information on the defendant's trading history, the district court could not determine whether the sales during the class period were unusual or suspicious. Id. In addition, the district court found the plaintiffs' allegation that only one of the two individual defendants engaged in suspicious stock sales (although both were allegedly knowledgeable about the company's impending business problems) to further undercut an inference of scienter. Id.

In Waterford Twp. Gen. Emps. Ret. Sys. v. BankUnited Fin. Corp., 2010 WL 1332574 (S.D. Fla. Mar. 30, 2010), the district court granted the defendants' motion to dismiss the plaintiffs' putative class action for violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The lead plaintiffs, purchasers of common stock of BankUnited Financial Corporation ("BankUnited"), alleged that the defendants, three senior executive officers of BankUnited, and its primary subsidiary, BankUnited FSB, made numerous false and misleading representations to conceal BankUnited's unsound lending practices. Id. at *1. Specifically, the plaintiffs alleged that BankUnited relied on limited or no documentation loans, made an aggressive push to increase the volume of risky option adjustable rate mortgage loans, failed to adequately reserve for probable loan losses, and asserted pressure to approve overstated appraisals. Id. The bank was eventually closed by the Office of Thrift Supervision ("OTS") and the Federal Deposit Insurance Corporation was appointed as receiver. Id. at *5.

The plaintiffs alleged that scienter could be inferred from the individual defendant's insider stock sales during the class period. Id. at *14. The plaintiffs contended that the gross proceeds from the defendant's pre-class period stock sales were about 60% less than each of the sales during the class period. Id. The district court held that the plaintiffs failed to allege how the sales were suspiciously timed because the sales occurred prior to the OTS investigation, which allegedly first alerted the defendants to unreported risks in their lending practices. Id. Further, the plaintiffs failed to specify the proportion of the defendant's stock sold, compared to the proportion that was held during the relevant time period. Id. Accordingly, the district court held that these allegations lacked the necessary particularity to create an inference of scienter. Id.

Desire to Complete Acquisitions

The Second Circuit

In Engstrom v. Elan Corp., 2011 WL 4946434 (S.D.N.Y. Oct. 18, 2011), the plaintiff brought claims under Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 against the defendants, alleging that they intentionally failed to inform the public about a "secret" provision in a relevant contract. Id. at *4. The plaintiff represented purchasers of American Depository Shares ("ADSs") of defendant Elan Corporation ("Elan"). Id. at *1. The defendant, a biotechnology company, entered into an agreement with Biogen to develop and finance a drug. Id.

After the defendant was faced with liquidity issues the defendant entered into a separate agreement with Johnson & Johnson ("J&J"). Id. at *2. The J&J Agreement contained an option permitting J&J to finance the defendant's purchase of Biogen's rights to the drug. Id. at *2. Following a press release announcing J&J's option, the price of the defendant's ADSs increased. Id.

However, Biogen sent a letter to the defendant complaining that the defendant delegated an obligation to J&J that violated the Biogen Agreement. Id. at *3. The defendant sought a declaratory judgment that the J&J Agreement did not breach the Biogen Agreement, which the district court denied. Id. at *3. Consequently, the defendant renegotiated its contract with J&J. Id. at *4. However, because of the elimination of the option, J&J agreed to invest only $885 million, rather than $1 billion. Id. at *4. As such, the price of the defendant's ADSs declined. Id.

The plaintiff alleged that the defendant did not disclose the "secret" option to "'coerce Biogen into acceding to the J&J Agreement.'" Id. at *2. The plaintiff further asserted that the defendant knew that Biogen also needed a purchaser, and this agreement "scare[d] away any potential purchasers of Biogen." Id. at *8.

The defendant moved to dismiss for failure to sufficiently plead a strong inference of scienter. Id. at *1. The district court granted the motion. Id. at *1, *7. The court noted that while the artificial inflation of stock prices in order to acquire another company may in some circumstances be sufficient for scienter, the plaintiff in Engstrom claimed only an intentional breach of contract, rather than an inflation of stock price. Id. at *9. The district court found an inference that the defendant sought to secure immediate financing more compelling, particularly because the defendant "stood to lose nearly all of its revenue from a breach." Id.

In In re Bank of Am. Corp. Sec., Deriv., & ERISA Litig., 2011 WL 3211472 (S.D.N.Y. July 29, 2011), the district court granted in part a motion to dismiss claims brought pursuant to Section 10(b) of the Exchange Act and Rule 10b-5. The plaintiff investors alleged that the defendants, Bank of America Corporation ("BofA"), its former CEO Kenneth D. Lewis, and its former CFO Joe L. Price, made material misstatements and omissions related to BofA's acquisition of Merrill Lynch & Co. ("Merrill"). Id. at *1.

The plaintiffs contended that the defendants failed to adequately disclose Merrill's deteriorating financial condition in the fourth quarter of 2008 prior to obtaining shareholder approval of the acquisition. Id. at *1-2. The district court held that the plaintiffs failed to adequately allege scienter based on Lewis's alleged desire to acquire

Merrill and to retain his position as CEO, since they failed to allege that Lewis or Price could have personally profited from either the delay or closure of the Merrill transaction. Id. at *4. Further, despite the plaintiffs' allegation that the United States Secretary of the Treasury, Henry Paulson, threatened to terminate BofA's management if Merrill was not acquired, the district court found allegations of motive to "'prolong the benefits of holding corporate office'" insufficient to support an inference of scienter. Id. (quoting Novak v. Kasaks, 216 F.3d 300, 307 (2d Cir. 2000)).

Desire to Maintain Financial Performance

The Second Circuit

In Local No. 38 Int'l Bhd. of Elec. Workers Pension Fund v. Am. Express Co., 724 F. Supp. 2d 447 (S.D.N.Y. 2010), aff'd, 430 F. App'x 63 (2d Cir. 2011), the lead plaintiff, a pension fund, brought a putative class action against American Express Company ("Amex") and two of its officers alleging that the defendants misled investors about Amex's underwriting guidelines and exposure to delinquent credit card holder payments in violation of Sections 10(b) and 20(a) of the Exchange Act. Specifically, the lead plaintiff alleged that in 2007, when the economy was deteriorating and Amex was facing losses, the two officer defendants made a series of oral misrepresentations about Amex's underwriting guidelines, the credit quality of the company's portfolio, and its level of loss reserves. Id. at 453-55. The district court held that the plaintiff failed to plead facts establishing scienter and dismissed the claims. Id. at 464. The Second Circuit affirmed.

In evaluating whether the lead plaintiff pleaded facts giving rise to a "strong inference of scienter" under Tellabs, the district court first considered whether the defendants had "benefited in a concrete and personal way from the purported fraud," and determined that because the only motive identified by the plaintiff was the defendants' desire to maintain a strong credit rating, lead plaintiff had not satisfied the "strong inference" standard. Local No. 38, 724 F. Supp. 2d at 459 (citing Novak v. Kasaks, 216 F.3d 300, 311 (2d Cir. 2000)). The district court reasoned that "[t]he desire to maintain a strong credit rating, possessed by nearly every corporate executive, is not within the class of 'benefits' that give rise to a strong inference of scienter." Id.

The Third Circuit

In Dow Corning Corp. v. BB & T Corp., 2010 WL 4860354 (D.N.J. Nov. 23, 2010), the district court granted in part a motion to dismiss claims brought pursuant to Section 10(b) of the Exchange Act and Rule 10b-5. The plaintiffs alleged that the defendants, BB & T Corp., a financial services firm, and its wholly owned subsidiary, Scott & Stringfellow, LLC ("S&S"), a registered broker-dealer, induced the plaintiffs to invest in auction rate securities by their material misrepresentations and omissions concerning the liquidity of the market. Id. at *1. The defendants allegedly misrepresented the dramatically increased risk of auction failures between the fall of 2007 and February 13, 2008, the date on which the auction rate securities market is alleged to have "collapsed." Id. at *3. The defendants allegedly concealed this risk by creating a false impression of supply, demand, and liquidity in the auction rate securities market by making undisclosed support bids, and continuing to advise the plaintiffs to buy while the market deteriorated. Id. After the collapse, the market remained illiquid, which rendered it impossible for the plaintiffs to sell their auction rate securities except at a steep discount. Id. at *6.

The plaintiffs alleged a strong inference of scienter against S&S because: (1) S&S artificially propped up the auction rate securities market with its support bids in order to earn commissions and fees and to maintain favorable business relationships; and (2) S&S concealed its knowledge of the increasing illiquidity in the auction rate securities market and its growing use of undisclosed support bids to "keep that market alive" to unload its own auction rate securities. Id. at *10. The district court held that the first allegation, without more, was insufficient to create an inference of scienter because such motives are common to all for-profit enterprises. Id. at *9.

However, the district court held that the second alleged motive supported a strong inference of scienter. Id. at *11. Given that S&S had knowledge of the market's increasing illiquidity and held large inventories of auction rate securities, the district court found it reasonable to infer that S&S had a motive to conceal the auction rate securities' illiquidity risk from potential buyers of securities from its own portfolio. Id. at *10. The district court held that this culpable inference was more compelling than non-culpable inferences, especially considering that S&S allegedly increased its auction rate securities inventory in order to artificially sustain the market and to "buy enough time to exit." Id. at *11.

The Ninth Circuit

In In re MannKind Sec. Actions, 2011 WL 6327089 (C.D. Cal. Dec. 16, 2011), investors brought a class action alleging violations of Sections 10(b) and 20(a) stemming from alleged misstatements indicating that the FDA had pre-approved MannKind Corp.'s drug testing protocol for a new product. Id. at *1. Later, the FDA sent a Complete Response Letter ("CRL") to the company refusing to approve the product, which the company failed to disclose to investors. Id. at *2. The company continued testing the products and making positive statements to the public, and eventually received a second CRL that was later disclosed to the public, after which the stock dropped in price. Id. at *4-6. The defendants moved to dismiss arguing, inter alia, that the plaintiffs' allegations of motive were sufficient to prove scienter. Id. at *1, *13. The plaintiffs alleged that MannKind had entered into a financing agreement for another company to purchase over eighteen million shares as long the shares were trading above a certain price. Id. at *13.

The district court recognized that other district courts in the Ninth Circuit were split over whether motive allegations about a company's need for capital are sufficient to plead the element of scienter. Id. Some district courts had held that motive allegations relating to increasing company capital were not sufficient to meet the heightened pleading standards. Id. (citing In re PetSmart, Inc. Sec. Litig., 61 F. Supp. 2d 982 (D. Ariz. 1999)). However, other courts had found that allegations of a need to inflate the stock price for a short period of time to obtain much needed operating capital are sufficient to state a claim. Id. at *14 (citing In re Portal Software, Inc. Sec. Litig., 2005 WL 1910923 (N.D. Cal. Aug 10, 2005)). The district court ultimately found that the plaintiffs' allegations supported a finding of scienter because the defendants' motive went beyond a general desire to raise capital. Id.

In Cho v. UCBH Holdings, Inc., 2011 WL 3809903 (N.D. Cal. May 17, 2011), the district court granted the defendants' motion to dismiss because, inter alia, the plaintiffs had not adequately pleaded a strong inference of scienter. Id. at *17-18.

The plaintiffs, shareholders in UCBH Holdings, Inc. ("UCBH"), filed a class action complaint against several of UCBH's directors and officers. Id. at *1. The plaintiffs alleged that the defendants issued materially false and misleading statements concerning the effectiveness of UCBH's financial reporting controls as well as UCBH's allowance and provision for loan losses. Id. According to the complaint:

> UCBH's auditor, KPMG, met with examiners from the Federal Deposit Insurance Corporation ("FDIC") . . . about the deterioration in asset quality and overall financial condition of UCBH's subsidiary, United Commercial Bank . . . . [The following week], KPMG alerted UCBH's audit committee that illegal acts may have occurred related to overvaluation of impaired and real estate owned loans, prompting the audit committee to initiate an internal investigation.

Id. As a result of the internal investigation, UCBH was forced to restate its financial statements and enter into a consent agreement with the FDIC concerning a cease and desist order regarding the underlying improprieties, which the plaintiffs argued caused the value of UCBH's stock to decline. Id. In their complaint, the plaintiffs relied on the following to establish an inference of scienter: (1) KPMG's report that illegal activity may have occurred; (2) UCBH's internal investigation; and (3) a report by the FDIC stating that "senior executives" at United Commercial Bank "engaged in deliberate misconduct to conceal the [b]ank's 'deteriorating financial conditions . . .'" Id. at *12-13.

The district court found the plaintiffs' allegations were insufficient because they did not establish which senior executives learned of, or engaged in, the alleged misconduct and because they did not allege when the executives became aware of it. Id. Accordingly, the district court granted the defendants' motion to dismiss. Id. at *18.

Pleading Scienter Through Allegations of Conscious Misbehavior or Recklessness

The Second Circuit

In Valentini v. Citigroup, Inc., 837 F. Supp. 2d 304 (S.D.N.Y. 2011), the plaintiffs, purchasers of structured notes from defendants, Citigroup Financial Services and Citi Private Bank, brought claims under Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Id. at 312. These structured notes included equity linked securities that were linked to the value of the American Depository Receipts or common stock of U.S. or Brazilian companies traded on the NYSE. Id. at 311. If the value of the assets to which the note was linked fell below a certain percentage of their initial value, the note would then convert to a certain number of shares of the lowest valued asset linked to the note. Id.

The plaintiffs argued that the defendants intentionally misrepresented the risks associated with these structured securities. Id. at 313. The defendants moved to dismiss, contending that the plaintiffs failed to sufficiently plead scienter. Id. at 315. The plaintiffs alleged that the defendants exhibited conduct that was highly unreasonable because the defendants failed "to provide [p]laintiffs with prospectuses or other detailed written information about the complex debt instruments they were purchasing." Id. at 316. The district court concurred, finding that the defendants' conduct was an "'extreme departure from the standards of ordinary care' provided [to] investors." Id. (quoting Brown v. E.F. Hutton Grp., Inc., 991 F.2d 1020, 1033 (2d Cir. 1993)).

The plaintiffs also claimed that the defendants consciously misbehaved by intentionally lying when they filled out their Regulation U form, which dictates how much credit a bank can extend to investors to purchase stock on margin. Id. at 316. The district court found that these allegations provided "strong evidence" of the defendants' conscious misbehavior. Id. In fact, the district court noted that the defendants' "active efforts to circumvent federal regulations designed to protect investors against the very high risks associated with trading on . . . margin suggests, at the very least, that they knew, or should have known, of the dangers associated with [p]laintiffs' extremely leveraged investment strategy, and nonetheless failed to inform them of these dangers. We find this sufficient to establish a 'strong inference' of fraudulent intent . . . ." Id.

In Solow v. Citigroup, Inc., 2011 WL 5869599 (S.D.N.Y. Nov. 22, 2011), the plaintiffs brought a claim under Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 against the defendants, Citigroup and its CEO Vikram Pandit, alleging that the defendants issued intentionally false and misleading statements about the strength of Citigroup's liquidity. Id. at *1. Following the Lehman Brothers bankruptcy, the defendants made several statements that Citigroup was well-capitalized and very strong. Id. at *1-2. The plaintiffs claimed that during this time the defendants also "secretly" borrowed hundreds of billions of dollars from the Primary Dealer Credit Facility ("PDCF"), a facility that the Federal Reserve created to help banks in distress. Id. at *3. According to the plaintiffs, the PDCF was "the 'lender of last resort' that served as a 'back-up source of liquidity for institutions that are unable to access short-term funding in the market.'" Id. at *3. The defendants moved to dismiss for failure to adequately plead scienter under the PSLRA. Id. at *4, *7. The district court found that the plaintiffs adequately pleaded scienter, noting that Citigroup's borrowing from the PDCF and receiving $326 billion in additional TARP infusions and guarantees was "relevant to the question of [d]efendants' knowledge of the risks to Citigroup's liquidity and capital position . . . ." Id. at *8-9. Thus, the plaintiffs alleged sufficient facts to give rise to an inference of the defendants' intent to defraud. Id. at *9.

In City of Monroe Emps.' Ret. Sys. v. Hartford Fin. Servs. Grp., Inc., 2011 WL 4357368 (S.D.N.Y. Sept. 19, 2011), the plaintiffs brought claims under Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 against the defendants. The plaintiffs were investors in The Hartford Financial Services Group, Inc. ("Hartford"). Id. at *1. The plaintiffs alleged that the defendants, Hartford and three of its directors and officers, knowingly and intentionally misstated their capital position by inflating the fair value of certain of Hartford's assets. Id. at *1, 12.

The defendants issued an investment vehicle called MVA FA, which created a contract to provide future income in return for an initial investment. Id. at *3. The defendants heavily invested funds received from the MVA FA assets in asset-backed securities ("ABS"), and more specifically residential mortgage-backed securities ("RMBS") and commercial mortgage-backed securities ("CMBS"). Id. at *3. The defendants then accounted for the "fair value" of the MVA FA assets as required under Standard Statutory Accounting Principles ("SAP"). Id. at *4. After the collapse of the subprime mortgage market the defendants suffered significant losses because of their heavy exposure to the ABS market. Id. at *4.

The plaintiffs alleged that the defendants artificially inflated the value of the MVA FA assets and the defendants' capital by intentionally (1) selling their ABS at prices lower than their internal valuation and (2) continuing to overvalue the ABS that they held. Id. at *4. The district court determined that the plaintiffs failed to demonstrate "strong circumstantial evidence of conscious misbehavior or recklessness" as required to plead scienter. Id. at *12, *18. Indeed, the district court remarked that "it is simply bizarre to suggest that defendants concocted a fraudulent scheme in which they would sell an asset for $697,500 yet internally value that asset at $1,500,000, only to reveal this massive overvaluation to the world a few months later. If defendants were willingly engaged in a substantial fraud . . . it would be extremely illogical for them to disclose the fraudulent numbers at the end of the year." Id. at *17. Accordingly, the district court stated that the "plaintiffs' inference of systemic and intentional overvaluation of retained ABS is not at least as strong as any opposing inference." Id. (internal quotation marks and citation omitted).

In In re Bank of Am. Corp. Sec., Deriv., & ERISA Litig., 2011 WL 3211472 (S.D.N.Y. July 29, 2011), the district court denied the defendants' motion to dismiss claims brought pursuant to Section 10(b) of the Exchange Act and Rule 10b-5. The plaintiffs, investors, alleged that the defendants, Bank of America Corporation ("BofA"), its former CEO Kenneth D. Lewis, and its former CFO Joe L. Price, made material misstatements and omissions related to BofA's acquisition of Merrill Lynch & Co. ("Merrill"). Id. at *1.

BofA allegedly failed to reveal Merrill's fourth quarter 2008 losses to shareholders prior to the acquisition, which amounted to $14 billion, not including an additional $2 billion writedown to Merrill's goodwill value. Id. at *2, *6. The district court held that the plaintiffs sufficiently alleged that Price engaged in "'conscious recklessness'" amounting to "'an extreme departure from the standards of ordinary care'" by failing to update BofA's attorneys with accurate information about Merrill's losses prior to the acquisition. Id. at *9 (quoting S. Cherry St., LLC v. Hennessee Grp. LLC, 573 F.3d 98, 109 (2d Cir. 2009)); ECA, Local 134 IBEW Joint Pension Trust of Chi. v. JP Morgan Chase Co., 553 F.3d 187, 202-03 (2d Cir. 2009)). The district court held that Price knew BofA's general counsel believed disclosure was likely warranted based upon his knowledge of the initial loss report, which projected losses of $8.9 billion. Id. at *6, *8-9. The district court found that, as Price learned more information about Merrill's higher actual losses, he withheld information about these increasing losses from legal counsel. Id. at *8-9. Even though Price claimed he was not expressly told he had to disclose the higher amount of losses, the court held that it was implausible that Price did not appreciate the correlation between the size of Merrill's losses and BofA's disclosure obligations. Id. at *8. Further, the district court held that the fact that Price consulted with counsel did not undermine a finding of scienter: since Price impeded counsel from making a fully informed analysis, he could not also claim that he relied on counsel's advice in good faith. Id.

In addition, the district court held that Lewis's inaction and failure to ensure compliance with BofA's disclosure obligations raised a strong inference of recklessness. Id. at *10. Lewis, like Price, was informed as to Merrill's losses. Id. at *9. Lewis' "'egregious refusal to see the obvious, or to investigate the doubtful'" thus gave rise to an inference of recklessness. Id. (quoting Novak v. Kasaks, 216 F.3d 300, 308 (2d Cir. 2000)).

In In re Wachovia Equity Sec. Litig., 753 F. Supp. 2d 326 (S.D.N.Y. 2011), the district court dismissed the plaintiffs' claims brought pursuant to Sections 10(b) and 20(a) under the Exchange Act and Rule 10b-5. The case involved four complaints and seven motions to dismiss arising from the "financial disintegration" experienced by the defendant Wachovia Corporation ("Wachovia") between its 2006 purchase of Golden West Financial Corporation ("Golden West") and its 2008 merger with Wells Fargo & Company. Id. at 341. The plaintiffs alleged that Wachovia began focusing on selling Golden West's main product, the "Pick-A-Payment" mortgage, which allowed borrowers to choose from multiple payment options each month, including a minimum payment that ultimately increased the principal of the loan, a phenomenon known as negative amortization. Id. at 342. The plaintiffs alleged that Wachovia made numerous misrepresentations to conceal its risky practices and the true risk of the Pick-A-Payment loans which, when revealed in early 2008, led to a drastic decrease in the value of Wachovia's shares. Id. at 343.

The district court held that the plaintiffs failed to plead that the defendants had access to contrary facts or breached a duty to monitor that would support an inference of recklessness. Id. at 366. The plaintiffs also failed to specify that contradictory information was available to the defendants at the time of their alleged misstatements (including alleged violations of Generally Accepted Accounting Principles ("GAAP")). Id. at 351, 365. The plaintiffs further failed to allege which reports revealed the supposedly widespread lending problems, what information those reports contained, and whether the reports contradicted the public declarations of the defendants. Id. at 352. Similarly, the district court also held that the magnitude of Wachovia's increased loan loss reserves, following earlier statements regarding its adequacy, did not create an inference of scienter. Id. at 361. "In the absence of particularized allegations that Wachovia was experiencing or internally predicting losses exceeding their set reserves, the subsequent disclosures provide no basis to conclude that [d]efendants recklessly misstated previous reserve levels." Id. at 362.

In In re Bear Stearns Cos. Sec. Deriv. & ERISA Litig., 763 F. Supp. 2d 423 (S.D.N.Y. 2011), plaintiff purchasers of The Bear Stearns Companies Inc. ("Bear") common stock brought an action against Bear, individual directors and officers of Bear, and Deloitte & Touche LLP ("Deloitte"), Bear's independent auditor, alleging violations of Section 10(b) of the Exchange Act and Rule 10b-5. With respect to Bear's valuation and risk procedures, the complaint alleged that the SEC Office of Compliance Inspections and Examinations found Bear's evaluation of its modeling processes inadequate and that the company continued to rely on flawed valuation models throughout the 2007-2008 housing market decline. Id. at 451-53. Significantly, the complaint alleged that Bear's December 2006 press release discussing year-end results reported diluted earnings using valuation techniques that ignored severely declining housing prices and rising default rates. Id. at 454. Furthermore, despite the fact that various indexes focusing on asset backed securities showed steep declines in the value of various collateralized debt obligations ("CDOs"), the plaintiffs alleged that Bear continued to aggressively expand its subprime business. Id. at 455-56. Finally, with respect to accounting standards violations, the plaintiffs alleged that Bear systematically violated Generally Accepted Accounting Principles ("GAAP") as a result of weaknesses in its internal controls. Id. at 467. The district court denied the defendants' motion to dismiss.

The district court held that the plaintiffs failed to demonstrate scienter through a showing of motive and opportunity. Id. at 499-501. However, the court went on to determine that the plaintiffs had established a proper inference of scienter via conscious misbehavior or recklessness, highlighting the complaint's assertion that the defendants "willfully or recklessly disregarded warnings from the SEC regarding Bear Stearns' risk and valuation models which allegedly were designed to give falsely optimistic accounts of the Company's risk and finances during the Class Period." Id. at 501. In response to the defendants' contention that the plaintiffs' allegations of scienter constituted classic fraud by hindsight, the district court replied that "the incantation" of fraud-by-hindsight "will not defeat an allegation of misrepresentations and omissions that were misleading and false *at the time they were made*." Id. at 504 (emphasis added). Thus, with respect to the defendants' contention that a competing inference existed as a result of the unpredictable market-wide collapse, the district court held that the alleged misconduct was integral to the decline of Bear as well as the broader financial markets. Id. at 505 (citing In re Ambac Fin. Grp., Inc. Sec. Litig., 693 F. Supp. 2d 241 (S.D.N.Y. 2010)). Therefore, because the plaintiffs' allegations concerning asset valuation, false and misleading statements, and liquidity constituted adequate allegations of scienter when coupled with allegations of knowledge of recklessness, the district court denied the defendants' motion to dismiss. Id. at 584.

In In re Citigroup Sec. Litig., 753 F. Supp. 2d 206 (S.D.N.Y. 2010), putative class action plaintiffs brought claims against Citigroup, Inc. ("Citigroup") and fourteen of its directors and officers, alleging violations of Sections 10(b) and 20(a) of the Exchange Act. The plaintiffs claimed that, at various times from 2006 to 2008, the defendants materially misled investors about the company's financial health by knowingly understating the risks it faced in various financial instruments related to the subprime mortgage industry, and overstating the value of its assets. These misstatements and omissions allegedly caused harm to investors when the truth about Citigroup's assets was revealed. Id. at 212.

A number of the plaintiffs' allegations concerned Citigroup's exposure to collateralized debt obligations ("CDOs"). In particular, the plaintiffs alleged that "the defendants failed to give a full and truthful account of the extent of Citigroup's CDO exposure," by revealing only the size of Citigroup's underwriting activities and not the size of Citigroup's CDO holdings. Id. at 217-18. The plaintiffs further claimed that Citigroup's SEC filings "failed to convey the subprime-related risks inherent in its CDO portfolio," because the filings did not distinguish which Citigroup CDOs were backed by subprime mortgages and which were not. Id. at 217, 220. The plaintiffs also contended that Citigroup violated accounting rules when valuing Citigroup's CDO holdings in its SEC filings because it failed to "take[] writedowns . . . in reaction to precipitous drops in the 'TABX,' a widely used index that tracked the price of mezzanine CDOs." Id. at 217, 223. The defendants moved to dismiss, arguing that the plaintiffs failed to meet the heightened pleading standards for securities fraud. The district court granted the motion in part but allowed the plaintiffs to proceed against Citigroup and seven of the individual defendants on the claim that between February 2007 and August 2008, the defendants misrepresented the extent of Citigroup's CDO exposure. Id.

The district court determined that the plaintiffs adequately alleged scienter under the recklessness standard as to three classes of misstatements or omissions attributable to seven defendants (by virtue of their "corporate insider" status) between February 2007 and October 2007. First, the district court found "a set of statements that gave the impression that Citigroup had minimal, if any exposure to CDOs when, in fact, it had more than $50 billion in exposure," actionable because there was a duty to disclose Citigroup's CDO holdings in order to prevent the "boilerplate statement that the company *may* have such exposure," from being misleading. Id. at 235. Second, the court found statements and omissions that "allegedly gave the impression that Citigroup's CDO holdings were insulated from the subprime mortgage market," were actionable because the complaint alleged in detail that "the deterioration of the subprime market put Citigroup's CDO holdings directly at risk." Id. Third, the plaintiffs adequately pleaded that between February 2007 and October 2007, Citigroup overstated the value of its CDO holdings by consistently valuing its CDOs at par when the ABX and TABX indicated a clear decline in the value of Citigroup's CDOs over the same period. Id. at 235-36.

The district court found these statements inconsistent with the actions Citigroup took between February 2007 and October 2007. The plaintiffs claimed, for instance, that during this period "Citigroup 'to a greater extent than ever before,' hedged away the risks associated with the super senior CDO tranches," "set up a special purpose entity . . . to assume the credit risks" associated with certain tranches, and altered its CDO prospectuses to reflect increased risk from the deteriorating mortgage market. Id. at 237. The plaintiffs also pleaded in detail that "Citigroup, as the underwriter of the CDOs it held . . . was in the best position to recognize the threats [it] faced as the subprime mortgage market deteriorated." Id. Finally, by pointing to a March 2007 report and investor conference, the plaintiffs adequately alleged that "people within Citigroup were foreseeing an upcoming CDO meltdown" at the time. Id. The district court found that "[t]his incongruity between word and deed establishe[d] a strong inference of scienter." Id. at 238. Viewing the factual allegations in the complaint as a whole, the district court reasoned that the plaintiffs had pleaded particularized facts giving rise to "a strong inference that someone whose intent is attributable to Citigroup was, at the least, reckless in failing to recognize the risks associated with Citigroup's CDO exposure." Id. at 237.

In In re Fannie Mae 2008 Sec. Litig., 742 F. Supp. 2d 382 (S.D.N.Y. 2010), the plaintiffs brought securities fraud claims against Fannie Mae ("Fannie"), four of Fannie's senior officers, and Fannie's external auditor Deloitte & Touche LLP ("Deloitte"), alleging violation of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The plaintiffs also asserted claims arising under the Securities Act, which the district court previously dismissed. Id. at 393. The plaintiffs asserted three principal allegations under the Exchange Act: (1) that the defendants materially misrepresented Fannie's exposure to the subprime and Alt-A mortgage markets and its related risks; (2) that the defendants materially misrepresented the quality of Fannie's internal risk management and controls; and (3) that the defendants filed materially inaccurate financial statements and, in connection with those filings, Deloitte violated Generally Accepted Accounting Principles ("GAAP") and Generally Accepted Auditing Standards ("GAAS"). Id. at 397. The defendants moved to dismiss the plaintiffs' Exchange Act claims. The district court granted the motion as to the first and third principal allegations, but denied dismissal on the second principal allegation regarding misrepresentation of Fannie's internal risk management and controls. Id. at 417.

The district court found the plaintiffs' allegations that the defendants had made material misstatements about the adequacy of Fannie's internal risk management and controls sufficient to survive a motion to dismiss, largely because the plaintiffs had identified internal emails written by Fannie's chief risk officer ("CRO") that "highlight[ed] the alleged misstatements and show[ed] that Fannie may have been saying one thing while believing another." Id. at 405. The district court identified public statements made by Fannie between November 2006 and September 2007 wherein Fannie indicated that it had the capability to manage its subprime market-related risks. Id. at 405. Yet, in July 2007, Fannie's CRO, a named defendant, complained via email to Fannie's chief operating officer ("COO") that Fannie had "one of the weakest control processes" he had ever witnessed and that Fannie was "not even close to hav[ing] proper control processes for credit, market and operational risk." Id. at 405-06.

The district court found, based on the content of the CRO's emails, that the plaintiffs' had adequately pleaded recklessness. The emails, the district court found, "suggest that Fannie was conscious of its internal inability to manage the risks associated with subprime loans." Id. at 406. "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," the court held, "is certainly enough of 'an extreme departure from the standards of ordinary care' to show an inference of scienter." Id. (citing Chill v. Gen. Elec. Co., 101 F.3d 263, 269 (2d Cir. 1996)). This inference of recklessness was more compelling than the defendants' suggestion that the emails evidenced reactions to budget cuts and theoretical fears. Id. Hence, the district court denied the motion to dismiss on this issue.

In In re Ambac Fin. Grp., Inc. Sec. Litig., 693 F. Supp. 2d 241 (S.D.N.Y. 2010), investor plaintiffs filed an action against defendant Ambac Financial Group, Inc.

("Ambac"), an insurer of financial products, along with associated individuals, the underwriters of Ambac's securities offerings, and Ambac's auditor. With respect to its increasing involvement in the insurance of CDOs backed by residential mortgage-backed securities ("RMBS"), Ambac executives frequently issued statements concerning the high degree of due diligence conducted before deciding to insure a financial product. Id. at 254-55. When Ambac announced a multi-billion dollar loss to its CDO portfolio, the plaintiffs filed an action alleging violations of Section 10(b) of the Exchange Act and Rule 10b-5, contending that Ambac misled investors by continuing to represent its underwriting procedures as conservative. The district court denied the defendants' motion to dismiss. Id. at 261-62.

Despite its determination that the motive and opportunity prong of a scienter analysis had not been adequately demonstrated, the district court highlighted that Section 10(b) claims tend to satisfy the recklessness requirement when they allege knowledge of or access to information that contradicts their public statements. Id. at 267 (citing Novak v. Kasaks, 216 F.3d 300, 308 (2d Cir. 2000)). The district court found that the Ambac plaintiffs had made detailed allegations that the company lowered its underwriting standards and that these changes were known to company insiders. Id. at 267-68. Thus, the district court held that the plaintiffs' allegations of scienter complied with Tellabs, and since materiality and loss causation were sufficiently established, defendants' motion to dismiss with respect to all Section 10(b) claims was denied.

The Third Circuit

In Steamfitters Local 449 Pension Fund v. Alter, 2011 WL 4528385 (E.D. Pa. Sept. 30, 2011), the lead plaintiff brought a class action for violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 on behalf of all persons and entities that purchased publicly-traded securities of Advanta Corp. ("Advanta"), an issuer of credit cards to small businesses. The plaintiff alleged that it purchased shares after the defendants artificially inflated Advanta's stock price by making material misstatements about the credit quality of Advanta's customers, its delinquency and charge-off rates, and a re-pricing strategy allegedly designed to raise interest rates and minimum payments. Id. at *1-3. The defendants included Advanta's officers (the "Management Defendants") and directors (the "Outside Director Defendants"), John F. Moore, the president of an Advanta subsidiary, and Christopher J. Carroll, who initiated the internal audits of Advanta's delinquency practices and reported the company to the Federal Deposit Insurance Corporation. Id. at *1. The district court granted the motions to dismiss claims against the Outside Director Defendants and defendants Moore and Carroll, but denied in relevant part the Management Defendants' motion to dismiss. Id.

The district court held that the Management Defendants made misstatements about customer credit quality and delinquency rates, and omitted statements about their re-pricing strategy, "with knowledge that the information was materially misleading and of the likely effect the information would have on the market." Id. at *9. The district court held that the plaintiff adequately pleaded scienter because allegations that the Management Defendants directly approved the fraudulent practices, and that they allowed the practices to continue so as to meet "short-term Wall Street expectations, knowing the long-term risks," demonstrated "an extreme and reckless or conscious departure from the standards of ordinary care." Id. at *8-9.

In In re Radian Sec. Litig., 2010 WL 1767195 (E.D. Pa. Apr. 30, 2010), plaintiff shareholders brought suit under Section 10(b) of the Exchange Act and Rule 10b-5, alleging that the defendants, Radian Group, Inc. ("Radian") and its officers, made materially false and misleading statements regarding Radian's investment in Credit Based Asset Servicing and Securitization L.L.C. ("C-BASS"). C-BASS was a mortgage investment and servicing company that specialized in securitizing subprime residential mortgages. The defendants moved to dismiss the complaint, and the district court granted the motion.

The district court found that the plaintiff's allegations detailing the subprime market and C-BASS's general business model did not support a finding of scienter. Id. at *8. The district court further held that this only "serve[d] to establish that the market at large knew of the subprime industry's downward trend." Id. (citing First Nationwide Bank v. Gelt Funding Corp., 27 F.3d 763, 772 (2d Cir. 1994)). The district court also noted that Radian acknowledged this market trend as early as January 2007 in conference calls, press releases, and public filings. Id. at *9.

The Seventh Circuit

In Puskala v. Koss Corp., 799 F. Supp. 2d 941 (E.D. Wis. 2011), Koss Corp.'s vice president of finance and principal accounting officer Sujata Sachdeva pleaded guilty to embezzling $30 million dollars from the corporation for personal luxury items. Id. at 944. The scheme was hidden through false accounting entries, which allegedly made all public disclosures and SEC filings materially false. Id. at 944-45. Investors brought a class action for violations of Section 10(b) and Rule 10b-5 against Sachdeva, Koss Corp., CEO Michael K. Koss, and the accounting firm Grant Thornton. Id. at 945. All defendants except for Sachdeva moved to dismiss. Id.

The plaintiffs alleged that Koss acted recklessly in signing the SEC disclosure forms. Id. at 948. The Seventh Circuit has held that recklessness "satisfies the scienter element in action under Rule 10b-5" when the defendant "is actually aware of a danger of misleading but consciously disregards it" or "if it can be shown that the danger was so obvious that a reasonable person would have known about it." Id. at 949. The plaintiffs failed to sufficiently plead recklessness because their assertions of deficient internal controls at the company relied on the fact that Sachdeva was able to embezzle tens of millions of dollars. Id. at 950-52. The district court likened this to "a distorted form of res ipsa loquitor," rejecting the argument that a fraud itself can be the main allegation of recklessness. Id. at 950. Finding that the innocent explanations were "more compelling" than the plaintiffs' allegations, the district court dismissed the claims against Koss. Id. at 951.

The Tenth Circuit

In Dronsejko v. Thornton, 632 F.3d 658, 661-64 (10th Cir. 2011), the plaintiffs appealed the district court's dismissal of their complaint for failure to properly plead scienter, arguing that the district court erroneously held them to an intentional fraud standard.

The plaintiffs were shareholders in iMergent, an e-services company that sold software licenses to small businesses. Id. at 662. Although iMergent recognized 100% of the revenue from its license sales, it typically was only able to collect 53% of the total purchase price. Id. Under GAAP rules, this type of revenue recognition was allowed if, in addition to the satisfaction of other factors, a company could demonstrate that collectability of the revenue is "probable." Id. Following the SEC's determination that 53% was not sufficiently likely to be classified as "probable," iMergent was forced to alter its method of recording revenue in previous financial statements, leading to a decline in reported earnings and the company's stock price. Id. at 662-63.

The plaintiffs alleged that the company's auditor, Grant Thornton, violated Rule 10b-5 by recklessly certifying that iMergent's financial statements complied with GAAP. Id. at 663-64. Recklessness is defined in the Tenth Circuit as "'conduct that is an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.'" Id. at 665 (quoting City of Phila. v. Fleming Cos., 264 F.3d 1245, 1257-58 (10th Cir. 2001)). Examining the available accounting literature, the Tenth Circuit noted that discussions on the definition of "probable" under GAAP were ambiguous and generalized. Id. The Tenth Circuit recognized that scienter may be shown through either intentional or reckless acts, but held that the plaintiffs' allegations did not demonstrate the requisite recklessness because there was a more "plausible nonculpable inference" that Grant Thornton had simply acted negligently in misinterpreting "probable," which the Tenth Circuit found insufficient to establish liability under 10b-5. Id. at 668-70.

The Eleventh Circuit

In In re BankAtlantic Bancorp, Inc. Sec. Litig., 2010 WL 6397500 (S.D. Fla. Aug. 18, 2010), the district court granted in part and denied in part the defendants' motion for summary judgment, and granted the plaintiffs' motion for partial summary judgment. The plaintiffs, a class of investors in BankAtlantic Bancorp, Inc. ("BankAtlantic"), the publicly traded parent company of a federally-chartered bank, alleged that BankAtlantic and its insiders and directors violated Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Id. at *1. The defendants allegedly misrepresented and concealed the true value of the company's "land loans" made for the acquisition and residential development of land. Id. at *1-3. The plaintiffs alleged that the truth about BankAtlantic's lending practices—i.e., that it made misleading statements about the credit quality of certain land loans and failed to follow conservative lending practices, that it failed to timely disclose that the credit quality of the land loan portfolio had deteriorated, and that it misrepresented that its reserves for loan losses were adequate—was revealed in April and October of 2007 and caused the stock price to decline. Id. at *1-2.

The district court denied the defendants summary judgment motion on the issue of scienter. Id. at *24. The district court held that a genuine issue of material fact existed regarding whether the defendants misrepresented the nature of their underwriting practices and the consequent level of risk to the land loan portfolio. Id. at *23-24. The court also pointed to evidence that the defendants' statements regarding their allegedly conservative lending practices concealed violations of BankAtlantic's internal underwriting policies, and that these statements were severely reckless because the defendants knew or should have known their statements "presented a danger of misleading investors" about the true credit quality of the land loan portfolio. Id. at *24.

The district court also found a genuine issue of material fact existed regarding whether the defendants misrepresented and failed to disclose the accelerating deterioration of credit quality throughout the land loan portfolio as it became apparent. Id. The defendants made statements about the worsening credit and repayment problems regarding only a portion of the loans in the land loan portfolio. Id. The court found a genuine factual issue remained as to whether defendants knew or should have known that loans in all segments of the land loan portfolio were requesting extended maturity dates and had been downgraded, such that their statements omitting information about the problems in the remainder of the portfolio "presented an obvious danger of misleading investors." Id. at *77.

Pleading Recklessness Through Sarbanes-Oxley Certifications

Section 302 of the Sarbanes-Oxley Act ("SOX") states that a company's periodic financial reports filed with the SEC must include signed certifications by the company's CEO and CFO affirming that:

(1) the signing officers have reviewed the report;

(2) to their knowledge, the report does not contain any materially untrue statement or omit a material fact necessary to make a statement not misleading under the circumstances made;

(3) to their knowledge, the financial information included in the report fairly represents the company's financial condition and results of operations;

(4) the signing officers—

  (A) are responsible for establishing and maintaining internal controls;

  (B) have designed those internal controls to ensure material information regarding the company and its consolidated subsidiaries is promptly reported to them;

  (C) have evaluated the company's internal controls within 90 days of issuing the report;

  (D) have presented the conclusions of their evaluation in the report;

(5) the signing officers have disclosed all significant deficiencies and material weaknesses in the company's internal controls to the company's audit committee and outside auditors; and

(6) the report identifies any changes subsequent to the signing officers' evaluation that could have a significant impact on the company's internal controls.

See 15 U.S.C. § 7241; see also 17 C.F.R. § 240.13a-14.

Plaintiffs have argued that a corporate officer's certification of a financial report that is later revealed to be materially misleading establishes a strong inference of scienter as to that officer (i.e., that the officer knew or was reckless in not knowing the misleading nature of the report when it was issued). However, as discussed below, the few courts addressing this argument suggest that SOX certifications are not themselves sufficient to establish scienter, and have required additional specific factual allegations showing actual knowledge or recklessness.

The Eleventh Circuit

In City of Pontiac Gen. Emps. Ret. Sys. v. Schweitzer-Mauduit Int'l, Inc., 806 F. Supp. 2d 1267 (N.D. Ga. 2011), the district court dismissed a putative class action alleging violations of Sections 10(b) and 20(a) of the Exchange Act. The plaintiffs were shareholders in Schweitzer-Maduit International, Inc. ("Schweitzer"), a supplier of tobacco products. Id. at 1270. The plaintiffs alleged that the company and two of its directors and officers engaged in a fraudulent scheme to artificially inflate the company's stock price by misleading the market about: (1) Schweitzer's relationship with one of its largest customers; (2) the strength of Schweitzer's intellectual property protections; and (3) pressures Schweitzer faced from European competitors. Id.

The plaintiffs alleged that the individual defendants' SOX certifications supported a strong inference of scienter. Id. at 1295. The district court disagreed, explaining that "'a Sarbanes-Oxley certification is only probative of scienter if the person signing the certification was severely reckless in certifying the accuracy of the financial statements.'" Id. (quoting Mizzaro v. Home Depot, Inc., 544 F.3d 1230, 1252 (11th Cir. 2008)). The court noted that severe recklessness exists only where the certifier "'had reason to know, or should have suspected, due to the presence of glaring accounting irregularities or other red flags, that the financial statements contained material misstatements or omissions.'" Id. (quoting Mizzaro, 544 F.3d at 1252). Significantly, the district court identified financial restatements as the kind of specific factual allegations that could adequately support the claim that original statements were false when made. Id. at 1296. Because Schweitzer did not issue any financial restatements, and because the plaintiffs failed to plead any other specific facts showing severe recklessness, the district court found that the certifications were not probative on the question of scienter. Id.

Recklessness by Virtue of High-Ranking Position and/or Knowledge of Market Conditions

The Second Circuit

In In re Sec. Capital Assurance, Ltd. Sec. Litig., 729 F. Supp. 2d 569 (S.D.N.Y. 2010), a class of investors brought an action against insurers of collateralized debt obligations ("CDOs") backed by residential mortgage-backed securities ("RMBS") under Section 10(b) of the Exchange Act alleging that defendants understated their exposures, took inadequate reserves, misrepresented their independent ability to assess subprime risks, and provided false information regarding the discipline of their underwriting processes. The district court granted defendants' motion to dismiss.

Since plaintiffs failed to establish motive and opportunity or deliberate behavior under Novak, the district court analyzed whether an inference of scienter could be established via a showing of recklessness. Id. at 593-94 (citing Novak v. Kasaks, 216 F.3d 300, 311 (2d Cir. 2000)). With respect to plaintiffs' allegations against individual defendants that, because of their positions as insiders, they had access to and recklessly disregarded non-public information about finances, products, markets, and business prospects, the district court determined that "broad allegations that [d]efendants received and were aware of information contradicting their public statements because they held management roles is not enough to allege scienter." Id. at 595. With respect to plaintiffs' allegations of recklessness as a result of defendants' general knowledge of the housing market crisis, the district court highlighted that "[k]nowledge of a general economic trend does not equate to harboring a mental state to deceive, manipulate or defraud." Id. at 596 (quoting Plumbers & Steamfitters Local 773 Pension Fund v. Canadian Imperial, 694 F. Supp. 2d 287, 300 (S.D.N.Y. 2010)). In any event, since defendants only became aware of the true risk of their investments' exposure to the market on July 24, 2007, the district court held that allegations of misrepresentation made on or before this date must fail for lack of scienter.

In Sgalambo v. McKenzie, 739 F. Supp. 2d 453 (S.D.N.Y. 2010), the lead plaintiff in a putative class action brought securities fraud claims against five former officers of Canadian Superior Energy, Inc. ("Canadian Superior"), a company engaged in the acquisition and production of petroleum and natural gas. In February 2009, Canadian Superior's common stock, which traded on the AMEX, fell after the company announced that its interest in a joint venture drilling project was appointed to an interim receiver and that repayment had been demanded on its forty-five million dollar credit facility. On March 6, 2009, Canadian Superior filed for bankruptcy protection under Canada's bankruptcy laws. Id. at 467. The plaintiff alleged that between January 14, 2008 and February 17, 2009 the defendants issued over twenty materially false and misleading statements, reporting positive test results of drilling projects when in fact the natural gas wells discovered were "sub-economic," and failing to disclose that Canadian Superior was in violation of its joint venture agreement and would be unable to meet its joint venture obligations. Id. at 467-69.

The district court dismissed the Section 10(b) and Rule 10b-5 claims against two defendant-officers to whom the plaintiff did not attribute any false or misleading statements but whom the plaintiff contended were liable for the misstatements of others based on their status as senior executive officers and/or directors. Id. at 475-76. Relying on the Second Circuit's analysis in Pac. Inv. Mgmt. Co. v. Mayer Brown LLP, 603 F.3d 144 (2d Cir. 2010), cert. denied, 131 S. Ct. 3021 (2011), the court concluded that the plaintiff failed to plausibly allege liability of two officer defendants for statements made by Canadian Superior and the other defendants because the plaintiff "provide[d] no facts to show that [the two defendant-officers] had a discernible role in issuing Canadian Superior's public statements, let alone facts to show that he or any other investor relied on [the two defendant-officers'] role in issuing those public statements." Sgalambo, 739 F. Supp. 2d at 475.

In Defer LP v. Raymond James Fin., Inc., 2010 WL 3452387 (S.D.N.Y. Sept. 2, 2010), the plaintiffs, investors in auction rate securities ("ARS"), sued a financial services firm and its two wholly owned subsidiaries, alleging violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The plaintiffs alleged that the defendants "engaged in a scheme to defraud ARS purchasers by knowingly misrepresenting the securities as highly liquid investments." Id. at *1.

More specifically, one named plaintiff ("Rubin") alleged that, some time prior to April 2003, she had been encouraged to invest in ARS as "'safe, short-term investments'" by her financial advisor at Raymond James Financial Services, Inc. ("RJFS"). The other named plaintiff ("Gold") similarly alleged that a financial advisor from Raymond James & Associates ("RJA") recommended ARS to him in January 2008 as "a safe and liquid investment." Id. at *3. The plaintiffs contended that the financial advisors made these representations "when, in fact, the ARSs' liquidity was a façade and wholly dependent on auction dealer intervention in the market." Id. at *2. The defendants moved to dismiss the complaint for failure to state a claim. The district court dismissed certain claims but allowed the claims against RJA for misrepresentations made between November 2007 and February 2008 to proceed. See id. at *13.

The plaintiffs alleged that, prior to November 2007, RJA knew or was reckless in not knowing that the ARS market appeared to be liquid only because of auction broker intervention. Id. at *6. The plaintiffs contended that RJA's knowledge of this market condition could be inferred from a variety of facts, including that the SEC issued a cease and desist order to other auction dealers in May 2006 to end "'undisclosed manipulative practices'" regarding ARS and that RJA was an underwriter and broker-dealer and therefore obligated to know about ARS market functionality. See id. The district court, however, rejected both propositions as too vague and general to support the plaintiffs' claim. With regard to the plaintiffs' argument that scienter could be inferred from the May 2006 SEC order, the district court faulted the plaintiffs for failing to allege "(1) the nature of the allegedly manipulative practices that were the subjects of the SEC complaint, (2) the extent to which those prevailed in the ARS market, and (3) whether those practices affected any of the ARS[s] underwritten or sold by RJA." Id. Additionally, the plaintiffs had failed to allege whether RJA even became aware of the SEC order. Thus, the district court reasoned, "[t]he SAC fails to allege any specific facts that RJA would have discovered had it made a more searching inquiry or any information to which it had access that would have indicated any sort of systematic, market-wide wrongdoing, let alone that the market would have become illiquid in its absence." Id. at *7. The district court therefore dismissed the plaintiffs' claims against RJA related to the period preceding November 2007.

The Third Circuit

In In re Merck & Co. Sec., Deriv. & "ERISA" Litig., 2011 WL 3444199 (D.N.J. Aug. 8, 2011), the district court granted in part the defendants' motions to dismiss the plaintiffs' putative securities fraud class action. The plaintiff investors alleged that the defendants, Merck & Co. ("Merck") and several of its officers, made materially misleading statements and omissions regarding the commercial viability of a prescription arthritis medication, Vioxx, both leading up to and following its withdrawal from the market. Id. at *1. The defendants allegedly downplayed the possible link between Vioxx and an increased risk of heart attack or other cardiovascular ("CV") events, which inflated Merck's stock price and harmed the plaintiffs when the truth about the risks of Vioxx emerged. Id.

The district court held that the plaintiffs failed to sufficiently allege scienter for seven of the individual officer defendants because the plaintiffs failed to plead specific facts against the defendants under the PSLRA. Id. at *27-29. The plaintiffs relied on the defendants' positions and access to information, asserting that they "must have known" or "should have known" about the data indicating that Vioxx caused heart attacks, which allegations the court found lacked the specificity to plead scienter. Id. at *26-27. Allegations regarding motive and opportunity to commit fraud that are generally possessed by most corporate directors and officers, such as the link between Merck's sales and the defendants' compensation, were likewise held insufficient to plead scienter. Id. at *26. In addition, the district court held that allegations that the defendants made misleading statements because they signed various annual and quarterly SEC filings, despite their access to information that contradicted Merck's public statements, failed to satisfy the heightened pleading requirement for scienter under the PSLRA. Id. at *28.

The Eleventh Circuit

In Durgin v. Mon, 415 F. App'x 161 (11th Cir. 2011), the Eleventh Circuit affirmed the district court's dismissal of the plaintiffs' putative class action claims under Section 10(b) and Rule 10b-5 for failure to adequately plead scienter under the PSLRA. The lead plaintiff, a pension fund, purchased common stock in a company that built and marketed homes. Id. at 162. The defendants, executive officers of the company, allegedly misrepresented the terms of a loan taken by the company in SEC filings, press releases, and analysts' conference calls by, among other things, characterizing the loan as "non-recourse." Id. at 163.

Following Tellabs, the Eleventh Circuit held that to adequately plead scienter under the PSLRA, the plaintiffs' allegations must give rise to a strong inference that the defendants acted with either: (1) an intent to deceive, manipulate, or defraud; or (2) severe recklessness. Id. at 165. The Eleventh Circuit held that even if the defendants improperly characterized the loan as non-recourse, the plaintiffs failed to allege that the defendants knew the loan was non-recourse. Id. at 165-66. Instead, the plaintiffs made only conclusory allegations that the defendants, based upon their management level roles in the company and the significance of the loan, "'*must have known about*'" the misleading nature of their statements. Id. at 165. Further, because of the terms and conditions of the loan, it was not "'highly unreasonable'" or an "'extreme departure from the standards of ordinary care'" to describe the loan as non-recourse. Id. at 166 (quoting Mizzaro v. Home Depot, Inc., 544 F.3d 1230, 1238 (11th Cir. 2008)). Accordingly, the inference that the defendants acted with severe recklessness by failing to recognize that their statements about the loan could be perceived as false or misleading was "*not* as compelling as an inference that, at worst, defendants acted with inexcusable negligence." Id. at 167.

In Waterford Twp. Gen. Emps. Ret. Sys. v. BankUnited Fin. Corp., 2010 WL 1332574 (S.D. Fla. Mar. 30, 2010), the district court granted the defendants' motion to dismiss the plaintiffs' putative class action for violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The lead plaintiffs, purchasers of common stock of BankUnited Financial Corporation ("BankUnited"), alleged that the defendants, three senior executive officers of BankUnited, and its primary subsidiary, BankUnited FSB, made numerous false and misleading representations to conceal BankUnited's unsound lending practices. Id. at *1-2. Specifically, the plaintiffs alleged that BankUnited relied on limited or no documentation loans, made an aggressive push to increase the volume of risky option adjustable rate mortgage loans, failed to adequately reserve for probable loan losses, and asserted pressure to approve overstated appraisals. Id. at *1. The bank was eventually closed by the Office of Thrift Supervision and the Federal Deposit Insurance Corporation was appointed as receiver. Id. at *5.

The plaintiffs alleged that the defendants' extensive experience in the banking industry and attendance at weekly executive management meetings created an inference that they knew or should have known about the alleged fraud relating to BankUnited's loan underwriting practices, real estate appraisals, and loan loss reserves. Id. at *13-14. The district court held that the plaintiffs failed to allege any specific facts regarding the defendants' knowledge base and attendance at meetings, which improperly required the court to "fill in the factual gaps with conjecture and speculation." Id. at *14. Thus, such generalized allegations did "not support an inference of scienter, let alone a strong one" as required by the PSLRA. Id.

Corporate Scienter

In a typical 10b-5 private action, the plaintiff must prove scienter for each defendant. If the defendant is a corporation, however, courts face the challenge of imputing scienter to a legal entity. Circuit courts have embraced a variety of approaches in imputing scienter to a corporate defendant. On one end of the spectrum is the collective scienter approach, which imputes to the corporation the aggregate knowledge of all of its directors and officers. See Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital Inc., 531 F.3d 190, 195 (2d Cir. 2008). On the other end, the traditional agency approach rejects collective scienter and imputes to the corporation only the knowledge of named individual defendants who both make a misstatement and do so with the requisite scienter. See Southland Sec. Corp. v. INSpire Ins. Solutions, Inc., 365 F.3d 353, 366 (5th Cir. 2004). As is often the case, many circuits have neither expressly adopted nor rejected the theory of collective scienter, suggesting that they would consider it in certain circumstances in the future. See, e.g., Glazer Capital Mgmt., LP v. Magistri, 549 F.3d 736 (9th Cir. 2008); Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital Inc., 531 F.3d 190 (2d Cir. 2008).

Recent district court decisions in the Second Circuit generally continue to embrace a traditional agency approach. E.g., In re Wachovia Equity Sec. Litig., 753 F. Supp. 2d

326 (S.D.N.Y. 2011); Vining v. Oppenheimer Holdings Inc., 2010 WL 3825722 (S.D.N.Y. Sept. 29, 2010). However, one noteworthy decision appears to move more in the direction of collective scienter. See In re Vivendi Universal, S.A. Sec. Litig., 765 F. Supp. 2d 512 (S.D.N.Y. 2011). Courts in the Third Circuit have similarly declined to follow the collective scienter approach, at least on the facts before them. See City of Roseville Emps.' Ret. Sys. v. Horizon Lines, Inc., 442 F. App'x 672 (3d Cir. 2011); See also Zavolta v. Lord, Abbett & Co., 2010 WL 686546 (D.N.J. Feb. 24, 2010).

The Second Circuit

In In re Wachovia Equity Sec. Litig., 753 F. Supp. 2d 326 (S.D.N.Y. 2011), the district court dismissed claims brought pursuant to Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The case involved four complaints and seven motions to dismiss that arose from the "financial disintegration" experienced by the defendant Wachovia Corporation ("Wachovia") between its 2006 purchase of Golden West Financial Corporation ("Golden West") and its 2008 merger with Wells Fargo & Company. Id. at 341. The plaintiffs alleged that Wachovia began focusing on selling Golden West's main product, the "Pick-A-Payment" mortgage, which allowed borrowers to choose from multiple payment options each month, including a minimum payment that ultimately increased the principal of the loan. Id. at 342. The plaintiffs alleged that Wachovia made numerous misrepresentations to conceal its risky practices and the true risk of the Pick-A-Payment loans which, when revealed in early 2008, led to a drastic decrease in the value of Wachovia's shares. Id. at 343.

The district court considered whether the doctrine of corporate scienter created an inference of scienter based upon the alleged concealment of Wachovia's exposure to subprime collateralized debt obligations ("CDOs") and the alleged overstated value of the CDO holdings. Id. at 364. The plaintiffs needed to allege facts showing that the misstatements were so "'dramatic'" that it could be inferred that they would have been approved by "'corporate officials sufficiently knowledgeable about the company to know that the [statements were] false.'" Id. at 365 (quoting Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital Inc., 531 F.3d 190, 195 (2d Cir. 2008)). The district court held that the plaintiffs did not allege sufficient facts regarding the actual value of the CDOs held by Wachovia at the time of the alleged misrepresentations to show that the misstatements were sufficiently dramatic. Id. at 365. Thus, the plaintiffs failed to raise an inference of corporate scienter. Id.

In In re Vivendi Universal, S.A. Sec. Litig., 765 F. Supp. 2d 512 (S.D.N.Y. 2011), foreign and domestic shareholders filed a class action asserting derivative claims based partially on Section 10(b) of the Exchange Act and Rule 10b-5 against a foreign global media corporation and various affiliated individuals. The action was initially brought in 2002, alleging that ordinary shares traded primarily on the Paris Bourse exchange and American Depository Receipts (ADRs) listed and traded on the NYSE were purchased at artificially inflated prices as a result of material misrepresentations and omissions. Id. at 521. In January 2010, a jury determined that no liability existed with respect to Vivendi's CEO and CFO, but that Vivendi itself had committed securities fraud under Section 10(b).

Id. at 524. As such, Vivendi moved for judgment as a matter of law or, in the alternative, a new trial, while plaintiffs moved for the entry of judgment and for approval of their proposed class notice and claims administration procedures. Id. at 525.

The Vivendi court observed that when a defendant is a corporate entity, the law traditionally imputes the state of mind of agents or employees who made the statements in question to the corporation. Id. at 543. Indeed, according to the prevailing Second Circuit standard, "'[t]o prove liability against a corporation . . . a plaintiff must prove that an agent of the corporation committed a culpable act with the requisite scienter, and that the act (and accompanying mental state) are attributable to the corporation.'" Id. (quoting Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital Inc., 531 F.3d 190, 195 (2d Cir. 2008)). The Vivendi jury found that the company itself violated Section 10(b), but that the individual defendants to whom most of the allegedly false statements were attributed did not violate the securities laws. Id. at 524. Vivendi's argument, which was based on this inconsistency, was rejected in part because "an inconsistency challenge to a verdict will succeed only if the Court is unable to determine any reasonable way to reconcile the jury's findings." Id. at 552 (citing Turley v. Police Dep't of the City of N.Y., 167 F.3d 757, 760 (2d Cir. 1999)). Since the district court was able to identify a reasonable basis for reconciliation, it was determined that the jury's verdict was not inconsistent. Id. at 554. As such, the district court held that a jury may hold a corporation liable for Section 10(b) violations based on the scienter of its former officers even when such liability was not imposed against those former officers. Id.

In Vining v. Oppenheimer Holdings Inc., 2010 WL 3825722 (S.D.N.Y. Sept. 29, 2010), two purchasers of auction rate securities ("ARS") brought a purported class action against Oppenheimer Holdings Inc. and its subsidiary Oppenheimer & Co. (collectively, "Oppenheimer"), alleging violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Id. at *1. The plaintiffs alleged, inter alia, that between March 19, 2003 and February 13, 2008, "Oppenheimer directed its financial advisors to represent ARS[s] as cash-equivalent, highly liquid, short-term investment vehicles when, in fact, ARS[s] have long-term maturity dates and there is no guarantee that investors will be able to liquidate their holdings if auction dealers decide not to place support bids to prevent auction failures." Id. at *3. The plaintiffs further claimed that Oppenheimer failed to disclose that the ARS market was under "increasing stress" in 2007 "and that withdrawal of support for the auctions by any single auction dealer would cause the ARS market to collapse." Id. at *4. The district court granted the defendants' motion to dismiss the complaint, holding that the plaintiffs failed to allege a strong inference of scienter. Id. at *15.

The plaintiffs attempted to plead "corporate scienter" by arguing that the intent or recklessness of Greg White, a Managing Director of Oppenheimer's Auction Rate Department who purportedly gave presentations on ARS to Oppenheimer financial advisors, could be imputed to the corporate entity. The plaintiffs also asserted generally that corporate scienter could be found in Oppenheimer's company-wide scheme to tout ARS to investors as cash-equivalent, safe, liquid investments. Id. at *12-13. The district court articulated the standard for corporate scienter: "Generally, a plaintiff can raise an inference of corporate scienter by establishing scienter on behalf of an employee who acted within the scope of his employment." Id. at *12 (citations omitted). In the first instance, the district court found that the plaintiffs had not satisfied this standard because the plaintiffs failed to raise specific allegations—e.g., that "White directed financial advisors to market ARS as cash-equivalent, safe, or highly liquid investments"—that would support an inference that White exhibited conscious misbehavior or recklessness when giving presentations to Oppenheimer's financial advisors. Id. Nor had the plaintiffs successfully pleaded that White had a motive to defraud, since allegations regarding White's ARS sales during the class period were insufficiently specific. Id. Additionally, the plaintiffs' company-wide scheme theory failed to specify who issued management directives and sales materials to Oppenheimer financial advisors regarding ARS, when they were issued, or where they were issued from. Id. at *13.

The district court noted that "it is possible . . . to draw a strong inference of corporate scienter without being able to name the individuals who concocted and disseminated the fraud." Id. at *6, *13 (citing Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital Inc., 531 F.3d 190, 195 (2d Cir. 2008) (internal quotation marks and citations omitted)). Such an inference, however, was not appropriate in this case because there was no corporate statement at issue that was "so important and dramatic that it 'would have been approved by corporate officials sufficiently knowledgeable about the company to know that the announcement was false.'" Id. at *13 (quoting Dynex, 531 F.3d at 196).

The Third Circuit

In City of Roseville Emps.' Ret. Sys. v. Horizon Lines, Inc., 442 F. App'x 672 (3d Cir. 2011), the plaintiffs alleged securities fraud arising out of a price fixing scheme in Horizon's shipping business from the United States to Puerto Rico. Id. at 673. Under the Exchange Act and Rule 10b-5, the plaintiffs claimed that the defendants made false statements about the company's apparent success in Puerto Rico, which was allegedly due to price fixing and not the reasons the defendants stated. Id. The defendants in this action included both senior executives and Horizon itself.

As to the senior executives, the Third Circuit, applying the Tellabs standard, held that "plaintiff did not plead sufficient facts, when viewed in their totality, to raise a strong inference of scienter as to the senior executives." Id. at 676. The Third Circuit also noted that "allegations akin to corporate mismanagement are not sufficient." Id. at 675 (quoting Inst'l Investors Grp. v. Avaya, Inc., 564 F.3d 242, 267 (3d Cir. 2009)). Accordingly, the Third Circuit further held that Horizon's scienter could not be based on that of any individual.

The Third Circuit then questioned whether a plaintiff may plead scienter with respect to a company "without successfully pleading a claim against any individual," and whether that had occurred in this case. Id. at 676. The Third Circuit reviewed City of Monroe Emps. Ret. Sys. v. Bridgestone Corp., in which the Sixth Circuit dismissed claims against individual defendants but nevertheless found that the facts supported scienter for corporate defendants where corporations engaged in a large-scale "secret settlement" to hide problems from safety regulators. 399 F.3d 651, 656-59 (6th Cir. 2005). The Third Circuit determined that the facts of Bridgestone were inapplicable to the case before it, and that, even if "it were possible to plead scienter against a corporation without pleading scienter against an individual, the facts alleged here would not survive a motion to dismiss." Id. at 676-77.

In Zavolta v. Lord, Abbett & Co., 2010 WL 686546 (D.N.J. Feb. 24, 2010), the plaintiff's employer established a retirement plan that invested in and was managed by the defendants. The plaintiff brought a 10b-5 action for fraud against the defendants alleging that they "knew or recklessly disregarded the fact that the contents of . . . prospectuses, registration statements, semiannual reports, and annual reports omitted material information." Id. at *1. The district court found that the complaint failed to state a claim for relief and dismissed the action with leave to amend. Id. at *3.

The district court found that the plaintiffs failed to adequately plead scienter. Noting that there were no individual defendants in this case (only a corporate defendant), the district court stated that in order to plead scienter "the complaint must allege with particularity facts giving rise to a strong inference that '*someone* whose intent could be imputed to the corporation acted with the requisite scienter.'" Id. at *7 (internal citations omitted). "Persons whose intent could be fairly imputed to the corporation include corporate directors, officers, and perhaps, certain employees or other agents, such as those charged by the corporation with disseminating the allegedly untrue statements of material fact." Id. Since there were no individuals named in the Zavolta complaint who could be judged with respect to scienter, the district court then considered the "collective scienter" approach approved by other Circuits, id. (citing Makor Issues & Rights, Ltd. v. Tellabs, 513 F.3d 702, 710 (7th Cir. 2008)). The district court recognized that "[c]ollective scienter permits finding that a corporation had the requisite scienter if some unnamed corporate officer acted with the requisite scienter." Id. However, in dicta, the district court suggested that collective scienter "does not survive the Third Circuit's bar against group pleading in securities cases." Id. "[I]f one cannot impute corporate statements to corporate officers with control, i.e., group pleading," the court surmised, "then it seems odd to allow corporate statements to be imputed to unnamed corporate officers . . . ." Id. The district court reserved judgment on this issue, but nevertheless held that the plaintiff's allegations failed to create a strong inference of scienter for any corporate officer whose intent could be imputed to the corporation. Id. at *8. As such, the case was dismissed.

The Seventh Circuit

In Pugh v. Tribune Co., 521 F.3d 686 (7th Cir. 2008), purchasers of common stock brought a 10b-5 action against Tribune Company ("Tribune"), its executive officers, and employees of two of its newspapers, alleging that the subsidiary newspapers "falsely boosted" circulation numbers, leading to inflated revenues for Tribune. Id. at 690. The district court dismissed the complaint with prejudice, and the plaintiffs appealed. Id. at 692. The plaintiffs attempted to establish primary liability for Tribune itself. Id. at 697. The Seventh Circuit held that the focus of a corporate scienter inquiry must be on "'the state of mind of the individual corporate official or officials who make or issue the statement (or order or approve it or its making or issuance, or who furnish information or language for inclusion therein, or the like) rather than generally to the collective knowledge of all the corporation's officers and employees acquired in the course of their employment.'" Id. (quoting Makor, 513 F.3d at 708). Since the Seventh Circuit already determined that the plaintiffs' complaint failed to allege facts sufficient to support a strong inference of scienter on the part of any of the individual defendants, the company's scienter could not be based on their states of mind. Id. The plaintiffs attempted to make additional liability arguments based on *respondeat superior*, but these allegations also failed because the defendant employee was not an executive officer of the parent company, but of a subsidiary. Id. at 698. Thus, the Seventh Circuit held the plaintiffs' claims for primary liability against the corporation was properly dismissed by the district court. Id.

In Makor Issues & Rights, Ltd. v. Tellabs Inc., 513 F.3d 702 (7th Cir. 2008), on remand from the Supreme Court, the Seventh Circuit considered whether a reasonable person would deem the plaintiffs' scienter allegations as to defendants Tellabs Inc. ("Tellabs") and its CEO "'cogent and at least as compelling as any opposing inference one could draw from the facts alleged.'" Id. at 705 (quoting Tellabs, 551 U.S. at 324). The Seventh Circuit reaffirmed its prior conclusion that the plaintiffs had succeeded in pleading scienter as required under the PSLRA, and adhered to its decision reversing the district court's dismissal. Id. at 712.

In December 2000, Tellabs, a manufacturer of equipment used in fiber optic cable networks, announced that it had begun selling a successor to its principal product, TITAN 5500, and that Sprint had signed a multi-year contract to purchase the successor, TITAN 6500. The company also announced that sales of the 5500 would continue to grow. Id. at 706. Over the next several months, Tellabs continued to tout the success of both the 5500 and the 6500. However, the plaintiffs alleged that "Tellabs had been flooding its customers with tens of millions of dollars' worth of 5500s that the customers had not requested, in order to create an illusion of demand." Id. at 706. In June 2001, Tellabs later announced a drop in revenue, at which time the company's stock price fell. Id. at 707.

The Seventh Circuit held that establishing corporate liability for a violation of Rule 10b-5 requires "'look[ing] to the state of mind of the individual corporate official or officials who make or issue the statement . . . rather than generally to the collective knowledge of all the corporation's officers and employees acquired in the course of their employment.'" Id. at 708 (quoting Southland Sec. Corp. v. INSpire Ins. Solutions, Inc., 365 F.3d 353, 366 (5th Cir. 2004)). To this point, the Seventh Circuit noted that a corporation "is liable for statements by employees who have apparent authority to make them." Id. The Seventh Circuit found that the key question in this regard was whether the allegedly false statements "were the result of merely careless mistakes at the management level based on false information fed it from below, rather than of an intent to deceive or a reckless indifference to whether the statements were misleading." Id. at 709. The Seventh Circuit found the non-culpable inference highly unlikely, noting that the 5500 and the 6500 were Tellabs's most important products:

> That no member of the company's senior management who was involved in authorizing or making public statements about the demand for the 5500 and 6500 knew that they were false is very hard to credit, and no plausible story has yet been told by the defendants that might dispel our incredulity.

Id. Notably, despite rejecting the "collective knowledge" approach to evaluating allegations of corporate scienter, the Seventh Circuit stated that

> it is possible to draw a strong inference of corporate scienter without being able to name the individuals who concocted and disseminated the fraud. Suppose General Motors announced that it had sold one million SUVs in 2006, and the actual number was zero. There would be a strong inference of corporate scienter, since so dramatic an announcement would have been approved by corporate officials sufficiently knowledgeable about the company to know that the announcement was false.

Id. at 710.

The D.C. Circuit

In Plumbers Local No. 200 Pension Fund v. Washington Post Co., 2011 WL 6445252, at *11-12 (D.D.C. Dec. 23, 2011), the district court granted the defendants' motion to dismiss because the plaintiff failed to establish a strong inference of scienter. Plumbers Local No. 200 Pension Fund was the lead plaintiff in a putative class action alleging violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Id. at *1. The defendants were the Washington Post ("WPO"), the parent company of Kaplan, Inc. ("Kaplan"), which in turn was the parent of Kaplan Higher Education Corp. ("KHE"), a private, for-profit college, and two high-level executives of WPO. Id. The plaintiff alleged that the defendants "fail[ed] to disclose that WPO's business was driven by illegal predatory enrollment practices and provided false statements behind WPO's financial performance and future business prospects," which led to an artificially high value in WPO stock. Id. (internal quotation marks and citation omitted).

The plaintiff contended that it had established a strong inference of scienter by alleging that: (1) confidential witness statements regarding company-wide policies demonstrative of predatory enrollment practices; (2) one of the defendant-executives attended compensation committee meetings in relation to Kaplan and KHE; and (3) the defendants had a closely-monitored data system that demonstrated Kaplan's predatory business practices. Id. at *3. However, citing the plaintiff's failure to allege specific facts or conduct demonstrating the individually-named defendants' personal knowledge, the district court found that the plaintiff failed to establish scienter under the heightened pleading standard of the PSLRA. Id. at *4. Significantly, the court repeatedly rejected plaintiff's arguments that knowledge could be imputed to a high-level executive based on what the executives and employees of a subsidiary and a second-level subsidiary were alleged to have known. See, e.g., id. at *5 ("[T]o the extent that [p]laintiff seeks to establish scienter through an assumption that [d]efendants knew what their employees knew, this is inadequate.") (internal quotation marks and citation omitted); id. at *7 ("[C]orporate management's general awareness of the day-to-day workings of the company's business does not establish scienter."). Even assuming that executives of the subsidiaries did know of misconduct, the district court continued, the allegations could only give rise to an inference of negligence on the part of the parent executives, which is insufficient to show scienter. Id. at *7.

Group Pleading

The group pleading doctrine allows plaintiffs to rely, for pleading purposes only, on a presumption that group-published documents are the collective work of those individuals with direct involvement in the company's everyday business. Examples of such documents include press releases, registration statements and prospectuses, annual reports, and periodic filings with the SEC. See, e.g., In re Constellation Energy Grp., Inc. Sec. Litig., 738 F. Supp. 2d 614 (D. Md. 2010). The effect of this doctrine is to allow plaintiffs the ability, to a limited extent, to circumvent the general pleading requirement that fraudulent statements must be linked directly to the accused party. However, its application is limited in that it requires a plaintiff to allege facts indicating that the defendant served as a corporate insider. See, e.g., Footbridge Ltd. v. Countrywide Home Loans, Inc., 2010 WL 3790810 (S.D.N.Y. Sept. 28, 2010). Following the passage of the PSLRA, certain circuits—most notably the Third, Fifth, and Seventh—have concluded that the group pleading doctrine is no longer viable. See, e.g., Winer Family Trust v. Queen, 503 F.3d 319, 337 (3d Cir. 2007). On the other hand, the First and Second Circuits have continued to allow the application of the group pleading doctrine despite the PSLRA's heightened pleading standards. See, e.g., Miss. Pub. Empls. Ret. Sys. v. Bos. Sci. Corp, 523 F.3d 75 (1st Cir. 2008); Camofi Master LDC v. Riptide Worldwide, Inc., 2011 WL 1197659 (S.D.N.Y. Mar. 25, 2011). Note, however, that the applicability of the doctrine in the secondary liability context remains in flux after the Supreme Court's decision in Janus. See Rolin v. Spartan Mullen ET Cie, S.A., 2011 WL 5920931, at *5-6 (S.D.N.Y. Nov. 23, 2011) (citing Janus, 131 S. Ct. 2296 (2011)).

The Second Circuit

In Camofi Master LDC v. Riptide Worldwide, Inc., 2011 WL 1197659 (S.D.N.Y. Mar. 25, 2011), investor plaintiffs filed an action against defendant corporation ("Riptide") and various individual directors and officers under Section 10(b) of the Exchange Act and Rule 10b-5. According to the terms of a securities purchase agreement ("SPA"), plaintiffs loaned funds to Riptide, receiving in exchange secured notes and warrants to purchase common stock. Id. at *1. In their complaint, plaintiffs alleged that defendants made material misrepresentations with respect to the due diligence conducted, the transaction documents, and the various SEC filings. Id. The district court denied the individual defendants' motion to dismiss.

Although the group pleading doctrine is narrow in scope and is limited to group-published documents, the district court found that plaintiffs could use it to rely on a presumption that SEC filings and the SPA were the collective work of various high-level executives that "played a daily role in the activities of Riptide." Id. at *6-8 (citing In re Oxford Health Plans, 187 F.R.D. 133, 142 (S.D.N.Y. 1999); 380544 Canada, Inc. v. Aspen Tech., Inc., 544 F. Supp. 2d 199, 218 (S.D.N.Y. 2008)). The court noted, however, that the group pleading doctrine is inapplicable to oral statements, making it impossible for the plaintiffs to rely on it for statements made during negotiations regarding the SPA or during due diligence. Id. at *9. However, "by virtue of their executive positions within the company," the district court held that the individual defendants were "linked to the allegedly fraudulent statements . . . in the Transaction Documents and the SEC filings." Id. As a result, the individual defendants' motion to dismiss with respect to alleged misstatements made in the SPA and the SEC filings was denied. Id. at *10.

In Rolin v. Spartan Mullen ET Cie, S.A., 2011 WL 5920931 (S.D.N.Y. Nov. 23, 2011), the plaintiffs filed a Second Amended Complaint ("SAC") alleging violations of Section 10(b) of the Exchange Act against the moving defendants, executives at Chimay Capital Management ("CCM"). Id. at *1. According to the SAC, Guy Albert de Chimay ("Chimay"), owner, partner, and investment manager of CCM, presented the plaintiffs with the opportunity to invest in a Bridge Loan Facility ("BLF"), making warranties about the BLF and representing it as a safe investment that was "guaranteed by CCM." Id. at *2. Once plaintiffs had made an initial investment, a meeting occurred between Chimay, moving defendants, and plaintiffs during which the moving defendants provided the plaintiffs with materials about the firm and told them that "CCM was a respectable and honest company." Id. As a result of this meeting, the plaintiffs invested additional funds into the BLF. Id. at *3. According to the SAC, the plaintiffs' invested capital was diverted into various other investment vehicles for the benefit of Chimay and the moving defendants. Id.

The district court sought to determine whether the moving defendants could be held accountable for statements made by Chimay to investors regarding the safety of investments made in the BLF. Id. at *5. The plaintiffs invoked the group pleading doctrine. Id. at *5-6. However, considering the logic of Janus, where the Supreme Court determined that a mutual fund advisor could not be held liable in a private 10b-5 action for false statements included in a client's mutual fund prospectus since the advisor did not actually "make" the statements in question, id., the district court determined that it remained unclear whether Janus abrogated the "group pleading" doctrine in this context. However, because the plaintiffs' allegations with respect to these theories were conclusory and without merit, defendants' motion to dismiss with respect to plaintiffs' 10b-5 claims was granted. Id.

In In re Citigroup Sec. Litig., 753 F. Supp. 2d 206 (S.D.N.Y. 2010), the putative class action plaintiffs brought claims against Citigroup, Inc. ("Citigroup") and fourteen of its directors and officers, alleging violations of Sections 10(b) and 20(a) of the Exchange Act. The plaintiffs claimed that, at various times from 2006 to 2008, the defendants materially misled investors about the company's financial health by knowingly understating the risks it faced in various financial instruments related to the subprime mortgage industry and overstating the value of its assets, causing investors to suffer damages when the truth about Citigroup's assets was revealed. Id. at 212.

A number of the plaintiffs' allegations concerned Citigroup's exposure to collateralized debt obligations ("CDOs"). In particular, the plaintiffs alleged that "the defendants failed to give a full and truthful account of the extent of Citigroup's CDO exposure" by revealing only the size of Citigroup's underwriting activities and not the size of Citigroup's CDO holdings. Id. at 217-18. The plaintiffs further claimed that Citigroup's SEC filings "failed to convey the subprime-related risks inherent in its CDO portfolio" because they did not distinguish which Citigroup CDOs were backed by subprime mortgages and which were backed by other assets. Id. at 217, 220. The plaintiffs also contended that Citigroup's SEC filings violated accounting rules with respect to valuing its CDO holdings because Citigroup failed to "take[] writedowns on its CDO holdings in reaction to precipitous drops in the 'TABX,' a widely used index that tracked the price of mezzanine CDOs." Id. at 217, 223. The defendants moved to dismiss the plaintiffs' claims, arguing that the plaintiffs failed to meet the heightened pleading standards for securities fraud. The district court granted the defendants' motion in part but allowed the plaintiffs to proceed against Citigroup and seven of the individual defendants on claims that, between February 2007 and August 2008, the defendants misrepresented the extent of Citigroup's CDO exposure. Id.

The district court permitted the plaintiffs to employ the group pleading doctrine to show that the seven "corporate insider" defendants were responsible for Citigroup's misleading statements and omissions. To invoke the doctrine, the court explained, "the complaint must allege facts indicating that the defendant was a corporate insider, with direct involvement in day-to-day affairs, at the entity issuing the statement." Id. at 239 (quoting Anwar v. Fairfield Greenwich Ltd., 728 F. Supp. 2d 372, 405-06 (S.D.N.Y. 2010)) (internal quotation marks and citations omitted). Because the complaint alleged that seven of the defendants were corporate insiders either (1) involved in the collectively-authored SEC filings containing the alleged misrepresentations or (2) "otherwise deeply involved in Citigroup's day-to-day activities," the district court allowed plaintiffs' claims against those seven defendants to continue under the group pleading doctrine. Id.

In SEC v. Espuelas, 699 F. Supp. 2d 655 (S.D.N.Y. 2010), the SEC brought an enforcement action against former executives of the Internet media company StarMedia Network, Inc. ("StarMedia") for accounting fraud, alleging violations of the Securities Act and the Exchange Act. The district court allowed certain claims against the defendant Betsy Scolnik to survive the defendants' motion to dismiss. Thereafter, Scolnik moved for summary judgment on those claims. Id. at 656.

The district court found that Scolnik was entitled to summary judgment on the SEC's Section 17(a), Section 10(b) and Rule 10b-5 claims because the SEC had not alleged that Scolnik actually made a false or misleading statement. While the SEC could survive a motion to dismiss by invoking the group pleading doctrine and pleading facts sufficient to allege that Scolnik was a corporate insider, the SEC could not rely on the group pleading doctrine at the summary judgment stage. See id. at 660. "There is good reason . . . to think that group pleading is and has always been just a pleading device, designed to aid plaintiffs at the pleading stage and prior to discovery but not to free them of their ultimate burden to link the defendant to the making of a misstatement." Id. The district court stated that it "[was] aware of no authority in [the Second] Circuit for converting the pleading doctrine into a substantive ground for fraud liability." Id. at 662. Because Scolnik had presented evidence to "rebut[] any presumption that . . . she must have had a hand in creating the StarMedia disclosures that contained misstatements," and because the SEC conceded that it could not establish Scolnik's personal responsibility for any misstatements, the district court found Scolnik entitled to summary judgment as to those claims which required a misstatement to be attributed to her. Id. at 662-63.

The Sixth Circuit

In Local 295/Local 851 IBT Emp'r Grp. Pension Trust & Welfare Fund v. Fifth Third Bancorp., 731 F. Supp. 2d 689 (S.D. Ohio 2010), the plaintiffs claimed violations of Sections 10(b), Section 20(a), and Rule 10b-5, alleging that the defendants made material misrepresentations and omissions by stating that the company followed conservative lending policies and had adequate capital reserves when in reality the defendants aggressively began originating risky sub-prime loans and did not set aside adequate loan loss reserves. Id. After the defendants announced that it would have to raise capital through new securities offerings, cut its dividends, and sell off non-core business assets, the price of the defendants' stock declined. Id. at 710.

The defendants moved to dismiss for failure to raise a sufficient inference of scienter under the PSLRA. Id. at 716. The defendants argued that the plaintiffs failed to demonstrate scienter because they failed to allege facts giving rise to a sufficient inference of scienter as to each individual defendant. Id. at 719. Rather, according to the defendants, the plaintiffs relied upon the group pleading doctrine, which was abolished by the PSLRA. Id. The district court acknowledged that "[t]he Sixth Circuit has not decided whether group pleading survives the enactment of the PSLRA." Id. at 719. However, the district court adopted the reasoning of the Sixth Circuit that the "group pleading [doctrine] is 'antithetical' to the PSLRA's requirement that the complaint state with particularity facts giving rise to a strong inference of scienter." Id. at 719. As such, the district court found that the plaintiffs could not rely on group pleading to establish the individual defendants' scienter. Id. at 720.

The Seventh Circuit

In Pugh v. Tribune Co., 521 F.3d 686 (7th Cir. 2008), purchasers of common stock brought a 10b-5 action against Tribune Company ("Tribune"), its executive officers, and employees of two of its newspapers alleging that the subsidiary newspapers "falsely boosted" circulation numbers, leading to inflated revenues for Tribune. Id. at 690. The district court dismissed the complaint with prejudice, and the plaintiffs appealed. Id. at 692. The Seventh Circuit held that, following Tellabs, courts must "weigh the strength of the plaintiffs' inferences in comparison to plausible nonculpable explanations." Id. at 693. Further, the Seventh Circuit rejected the group pleading doctrine—"a judicial presumption that statements in group-published documents are attributable to officers who have daily involvement in company operations." Id. Therefore, "the plaintiffs must create a strong inference of scienter with respect to each individual defendant." Id. With regard to scienter, the plaintiffs alleged that the defendants were recklessly indifferent to the quality of their SEC filings, that they intentionally or recklessly had weak internal controls, and that the defendants' stock sales showed motive. Id. at 694-95. The Seventh Circuit found these allegations failed to create a strong inference of scienter with regard to the individual defendants and affirmed the district court's dismissal of the complaint. Id. at 695, 701.

The Tenth Circuit

In In re SemGroup Energy Partners, L.P. Sec. Litig., 729 F. Supp. 2d 1276, 1282-83 (N.D. Okla. 2010), the defendants moved to dismiss for failure to state a claim under the Exchange Act.

Investors in SemGroup Energy Partners, L.P. ("SGLP") brought a putative class action against SGLP, its parent company SemGroup L.P. ("Parent"), SGLP's general partner in the limited partnership, SemGroup Energy Partners G.P. ("General Partner"), and individual officers of all three entities. Id. at 1283-85. The directors and officers of the General Partner "control[ed] SGLP and manage[d] its operations and activities." Id. at 1283. Following the collapse of the Parent, allegedly caused by speculative and unauthorized trading in commodities, the lead plaintiff brought suit, alleging material misrepresentations in SGLP's initial public offering and secondary offering documents as well as SGLP's financial reports. Id. at 1285.

The district court rejected the defendants' claim that the group pleading doctrine had been abolished by the PSLRA. Id. at 1294 (citing Schwartz v. Celestial Seasonings, Inc., 124 F.3d 1246, 1254 (10th Cir. 1997)). Three of the General Partner directors further argued that statements in group-published documents could only be attributed to the SEC filings they had signed. Id. at 1294-95. The district court disagreed and found that group-published documents they had not signed could be attributed to them because all three had actual control or the power to exercise control over the day-to-day operations of SGLP. Id. at 1294-95. The district court declined to distinguish between inside and outside directors, citing case law stating that outside directors are also susceptible to the group pleading doctrine when "by virtue of their status or a special relationship with the corporation, they have access to information more akin to a corporate insider." Id. at 1295 (citing Schnall v. Annuity & Life Re (Holdings) Ltd., 2004 WL 231439, at *4 (D. Conn. Feb. 4, 2004)).

The district court, however, did grant the motion to dismiss with respect to the treasurer of the Parent because, although the plaintiffs alleged the treasurer had knowledge of the activities leading up to the Parent's collapse, they did not allege that he had actively participated in the dissemination of false information associated with SGLP. Id. at 1295-96. Specifically, the claim against the treasurer failed because the complaint did not allege that he "signed the allegedly fraudulent filings, had any control over the content of the filings or was involved in the day-to-day management of either SGLP or the General Partner." Id. at 1296.

In In re Thornburg Mortg., Inc. Sec. Litig., 695 F. Supp. 2d 1165 (D.N.M. 2010), the plaintiffs were investors that brought a putative class action suit for violations of Section 10(b) of the Exchange Act and Rule 10b-5 against Thornburg Mortgage, Inc. ("TMI") and its officers. Id. at 1173. The plaintiffs alleged, inter alia, that Larry Goldstone, TMI's COO (and after December 18, 2007, its CEO), had made false and materially misleading statements regarding the types of loans TMI had originated and that the other officers of the company were implicated through the group pleading doctrine. Id. at 1176-78. The defendants moved to dismiss, arguing that the plaintiffs did not satisfy the requirements of the PSLRA because they failed to plead facts supporting an inference of scienter for each defendant. Id. at 1196.

The district court noted that while the Tenth Circuit had not addressed the group pleading doctrine since the passage of the PSLRA, a number of other circuits found that the PSLRA eliminated it. Id. at 1197 (citing Winer Family Trust v. Queen, 503 F.3d 319, 336-37 (3d Cir. 2007); Fin. Acquisition Partners LP v. Blackwell, 440 F.3d 278, 287 (5th Cir. 2006); Makor Issues & Rights, Ltd. v. Tellabs Inc., 437 F.3d 588, 602-03 (7th Cir. 2006), rev'd on other grounds, 551 U.S. 308 (2007); Phillips v. Scientific-Atlanta, Inc., 374 F.3d 1015, 1018 (11th Cir. 2004)); but see Glazer Capital Mgmt., LP v. Magistri, 549 F.3d 736 (9th Cir. 2008) (stating that the group pleading doctrine is applicable in certain circumstances). The district court, unwilling to find that the PSLRA prohibits all instances of group pleading, drew a distinction between use of the doctrine to describe conduct and use to allege the mental state of a defendant. Id. at 1199-1200. The district court explained that the circuit courts that found that the PSLRA abolished group pleading relied on the statute's language requiring plaintiffs to "state *with particularity* facts giving rise to a strong inference that *the defendant* acted with the required state of mind." Id. at 1199. The district court continued by explaining that it did not deem it "necessary or prudent to find that the PSLRA eliminates group-pleading when a plaintiff is trying to describe conduct . . . [but that it will] only consider scienter allegations that are specific as to an actor or allegations as to which the [c]ourt can readily discern the actor." Id. at 1200. Accordingly, the district court dismissed the 10b-5 claims against all of TMI's officers other than Goldstone. Id. at 1212-13. The district court found the plaintiffs had sufficiently pleaded scienter as to Goldstone because he alone made public statements that were materially misleading with respect to TMI's mortgage portfolio. Id. at 1210-11.

The Core Operations Doctrine

Under the core operations doctrine, a strong inference of scienter may be imputed to an officer or director of a company when alleged misstatements relate to the core operations of that company, such that high-ranking individuals should have known that the statements were false. See In re Wachovia Equity Sec. Litig., 753 F. Supp. 2d 326, 352-53 (S.D.N.Y. 2011). Although courts continue to disagree on whether the core operations doctrine survived the passage of the PSLRA, a growing consensus seems to be forming that the statute's requirement that facts supporting scienter be pleaded with particularity eliminates the doctrine's applicability. See id. at 353 ("the Court ventures to suggest that the future of the [core operations] doctrine may be tenuous."); Plumbers Local No. 200 Pension Fund v. Wash. Post Co., 2011 WL 6445252, at *11-12 (D.D.C. Dec. 23, 2011) (collecting cases for the proposition that "since the enactment of the PSLRA, several Courts of Appeals have held that the doctrine has been significantly narrowed.").

The Second Circuit

In In re Wachovia Equity Sec. Litig., 753 F. Supp. 2d 326 (S.D.N.Y. 2011), the district court dismissed the plaintiffs' claims brought pursuant to Sections 10(b) and 20(a) under the Exchange Act and Rule 10b-5. The case involved four complaints and seven motions to dismiss that arose from the "financial disintegration" experienced by the defendant Wachovia Corporation ("Wachovia") between its 2006 purchase of Golden West

Financial Corporation ("Golden West") and its 2008 merger with Wells Fargo & Company. Id. at 341. The plaintiffs alleged that Wachovia began focusing on selling Golden West's main product, the "Pick-A-Payment" mortgage, which allowed borrowers to choose from multiple payment options each month, including a minimum payment that ultimately increased the principal of the loan, a phenomenon known as negative amortization. Id. at 342. The plaintiffs alleged that Wachovia made numerous misrepresentations to conceal its risky practices and the true risk of the Pick-A-Payment loans, which when revealed in early 2008 led to a drastic decrease in the value of Wachovia's shares. Id. at 343.

In support of their claims, plaintiffs relied on the "'core operations' doctrine" identified in In re Atlas Air Worldwide Holdings, Inc. Sec. Litig., 324 F. Supp. 2d 474, 489 (S.D.N.Y. 2004), which imputes scienter to key corporate officers on the assumption that they should have known about matters relating to the core operations of the company. Id. at 352-53. The district court held that the seminal Second Circuit case on the issue, Cosmas v. Hassett, 886 F.2d 8 (2d Cir. 1989), occurred prior to the passage of the PSLRA in 1995, and the Second Circuit has yet to pass on the current viability and scope of the doctrine. Wachovia, 753 F. Supp. 2d at 353. The district court noted the disagreement among district courts in the Second Circuit as to whether the PSLRA (which requires facts supporting the scienter analysis to be "'state[d] with particularity,'") limits the force of general allegations about core company operations. Id. (quoting 15 U.S.C. § 78u-4(b)(1)). The district court stated that "[b]ased on the trajectory of 'core operations' law in this and other circuits, the Court ventures to suggest that the future of the doctrine may be tenuous," and determined to consider core operations allegations as supplementary but not independently sufficient to plead scienter. Id. at 353. The district court ultimately rejected the plaintiffs' core operations allegations as they related to lending policies and practices because the plaintiffs failed to allege the significance of those policies to core Wachovia businesses and failed to articulate a cognizable limit to the core operations definition. Id. at 358, 360-61.

The Fourth Circuit

In In re Constellation Grp., Inc. Sec. Litig., 738 F. Supp. 2d 614 (D. Md. 2010), investors brought a class action against the company and its directors and officers alleging violations of Sections 10(b) and 20(a) of the Exchange Act as well as Sections 11, 12(a), and 15 of the Securities Act. Id. at 619. Constellation Energy Group, Inc. ("Constellation") was involved in energy trading that required the company to post large amounts of collateral. Id. at 620. Due to an error in a computer program, Constellation incorrectly stated the amount of collateral it would need in the event of a credit downgrade, and that error was incorporated into the company's Form 10-Q. Id. at 621. When Lehman Brothers filed for bankruptcy one month later, Constellation revealed that Lehman was a counter-party to some of its transactions. Id. at 622. These two events provided the basis for most of the plaintiffs' claims.

For the element of scienter, the plaintiffs argued that the liquidity and capital obligations were so important to Constellation that the defendants were extremely reckless in not understanding the collateral downgrade requirements and other details of relevant agreements with Lehman. Id. at 635. The district court found that although "in some circumstances it may be reasonable to assume that officers of a company know of facts critical to the company's core operations," pleading the importance of liquidity to the overall business was not sufficient to meet the heightened PSLRA standard for scienter. Id. To survive a motion to dismiss, the district court advised, the plaintiffs would need to plead that the defendants knew about the error in the computer system. Id. at 636. Further, the district court determined the agreements with Lehman Brothers were not important enough to the overall business to create an inference of scienter. Id. at 637. The district court also found insufficient the plaintiffs' allegations that Constellation placed Lehman Brothers on its internal credit watch list before September 2008, explaining that general concerns did not translate into an intentional or reckless masking of Lehman Brothers' financial condition. Id. Thus, the district court granted defendant's motion to dismiss plaintiff's 10b-5 claims. Id.

The Eighth Circuit

In In re St. Jude Med., Inc. Sec. Litig., 2011 WL 6755008 (D. Minn. Dec. 23, 2011), the district court denied the defendants' motion to dismiss in relevant part, holding that plaintiffs had sufficiently pleaded scienter and loss causation.

The plaintiffs, a pension trust fund and a retirement system, brought claims under Section 10(b) of the Exchange Act and Rule 10b-5 against St. Jude Medical, Inc. ("St. Jude") and four of its officers. Id. at *1. The plaintiffs alleged that the defendants engaged in "channel stuffing" for its cardiac rhythm management devices ("CRMs"), i.e., pressuring customers to purchase large quantities of the company's products at the end of a quarter in order to artificially inflate earnings. Id. at *2. The defendants claimed such "quarter-end quantity purchases" ("QPs") are a common and normal occurrence in their field. Id. at *9.

The plaintiffs argued that scienter could be imputed to the executives under the core business theory because QPs of CRMs were extremely important to the company's revenue. Id. at *21. The defendants argued that CRMs were not as relevant as the plaintiffs contended, stating that the CRM division was only one of four divisions in the company. Id. The district court was unconvinced by the defendants' arguments and noted that they accounted for approximately 60% of St. Jude's sales and appeared to be the main focus of the company. Id. Moreover, the district court observed, the plaintiffs did not rely exclusively on the core business theory, but also alleged that other supervisory personnel at St. Jude's had actual knowledge that the data given to the public was inaccurate. Id. Acknowledging that the Eighth Circuit had not yet decided whether the core business theory was sufficient by itself to plead scienter, the district court stated that it was appropriate to employ the theory where plaintiffs allege that the critical facts were known within the company—even if no claim is made that the named defendants had such knowledge. Id.

The D.C. Circuit

In Plumbers Local No. 200 Pension Fund v. Washington Post Co., 2011 WL 6445252 (D.D.C. Dec. 23, 2011), the district court granted the defendants' motion to dismiss, holding that the plaintiff failed to establish a strong inference of scienter.

Plumbers Local No. 200 Pension Fund was the lead plaintiff in a putative class action alleging violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Id. at *1. The defendants were the Washington Post ("WPO"), the parent company of Kaplan, Inc. ("Kaplan"), which in turn was the parent of Kaplan Higher Education Corp. ("KHE"), a private, for-profit college, and two high-level executives of WPO. Id. The plaintiff alleged that the defendants "fail[ed] to disclose that WPO's business was driven by illegal predatory enrollment practices and provided false statements behind WPO's financial performance and future business prospects," which led to an artificially high value in WPO stock. Id. (internal quotation marks and citation omitted). The plaintiff contended that it had established a strong inference of scienter by alleging, inter alia, that Kaplan was the core business of WPO. Id. at *3.

The district court rejected plaintiff's "core business" argument that the named defendants' knowledge of the alleged fraud should be inferred because Kaplan and KHE accounted for a significant share (between 57.3% and 62.2%) of WPO's total revenues throughout the class period. Id. at *9. The district court limited the core business theory, noting that it is rarely used, not recognized by the D.C. Circuit, has been significantly narrowed following the passage of the PSLRA, and that even if it were applicable, requires that "the operation in question constitute nearly all of a company's business before finding scienter based on this doctrine." Id. at *10 (internal quotation marks and citations omitted).

Pleading Accounting Fraud

The First Circuit

In Hoff v. Popular, Inc., 727 F. Supp. 2d 77 (D.P.R. 2010), the plaintiffs brought a class action under Section 10(b) of the Exchange Act and Rule 10b-5 against a bank holding company, Popular, Inc. ("Popular"), and its executive directors. The defendant offered a variety of financial and banking services, and the plaintiffs alleged that the defendants made false or misleading statements in press releases and SEC filings. Id. at 85. The plaintiffs claimed that the defendants committed securities fraud by making false or misleading statements about Popular's finances in order to artificially inflate the company's earnings and liquidity. Id. at 86. The defendants moved to dismiss the Section 10(b) and Rule 10b-5 actions.

The district court first addressed whether the defendants had made materially false statements. Id. at 88. The district court noted that the First Circuit has held that "[w]hile a company need not reveal every piece of information that affects anything said before, it must disclose facts, 'if any, that are needed so that what was revealed [before] would not be so incomplete as to mislead.'" Id. at 89 (quoting Miss. Pub. Emps.' Ret. Sys. v. Bos. Scientific Corp., 523 F.3d 75, 87 (1st Cir. 2008)). Here, the district court noted that GAAP violations can properly give rise to Section 10(b) liability, and the plaintiffs' theory of "material falsity is premised on the allegation that, under GAAP, Popular should have recorded a full valuation allowance several months before it did." Id. The district court held that the plaintiffs had adequately alleged a violation of GAAP, and therefore met the material misstatement prong of Rule 10b-5, because the defendants should have taken a valuation allowance. The district court found that the defendants "did not have a strong enough earnings history, nor would it have been reasonable for Popular to interpret that the historical losses in its U.S. operations were . . . anything but a continuing condition." Id. at 90. Because of these continued losses, the district court concluded that GAAP required the defendants to record a valuation allowance, which they failed to do.

Furthermore, the district court held that the plaintiffs adequately pleaded scienter. Examining the plaintiffs' allegations that: (1) defendants repeatedly violated GAAP by not taking the required valuation allowance against the deferred tax assets; (2) defendants were motivated to achieve a well-capitalized status; (3) defendants concealed the accounting ramifications of their actions; (4) these concealments led to overstated balance sheets and SEC filings; and (5) defendants made a public offering while doing this; the district court held the allegations raised a strong inference of scienter. Id. at 92. Because the company continuously violated GAAP and was motivated to do so in order to achieve "a well-capitalized status," the district court found that the plaintiffs raised a strong inference of scienter with respect to the company. Id.

The district court also held that the plaintiffs had adequately pleaded scienter with respect to the individual officers. The court found that because the officers knew all the company's negative financial information, or were at least reckless in not knowing, and given the large valuation allowance that had to be taken when GAAP protocols were finally complied with ($100 million greater than the previous allowance), the plaintiffs had established the requisite scienter. Id. at 93.

The Second Circuit

In In re Lehman Bros. Sec. & ERISA Litig., 799 F. Supp. 2d 258 (S.D.N.Y. 2011), the district court granted in part and denied in part the defendants' motion to dismiss. The plaintiffs, investors, brought a putative class action for violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 against the defendants, the former officers and the external auditor of Lehman Brothers ("Lehman"). Id. at 264. The plaintiffs alleged that the defendants made false and misleading statements and omissions in Lehman's offering materials and during conference calls relating to the company's liquidity, credit risks, and the value of its commercial real estate holdings. Id. The plaintiffs alleged that the defendants engaged in quarterly balance sheet manipulations to falsely present the company as being in a stronger financial position than it was through "Repo 105" transactions, which temporarily decreased the company's net leverage ratio at the end of each quarter before being re-adjusted shortly after each quarter closed. Id. at 268-69.

The district court held that the defendants made materially misleading statements regarding the Repo 105 transactions because the artificially lowered net leverage violated the overriding requirement of Generally Accepted Accounting Principles ("GAAP") to present the financial condition of the company accurately, and because the defendants made false and misleading statements regarding their treatment of the transactions for accounting purposes. Id. at 279, 281-82. The district court held that the allegations raised "red flags" that created an inference of scienter:

> The allegations that these transaction were used at the end of each reporting period, in amounts that increased as the economic crisis intensified, to affect a financial metric that allegedly was material to investors, credit rating agencies, and analysts support a strong inference that the [i]nsider [d]efendants knew, or were reckless in not knowing, that the use of the Repo 105 transactions and the manner in which they were accounted for painted a misleading picture of the company's finances.

Id. at 296.

The district court held that the defendants made material misrepresentations about their compliance with internal risk management practices and failed to disclose that they routinely altered risk limit policies. Id. at 284. Furthermore, the defendants were involved in setting Lehman's risk policies and knew about or knowingly tolerated their routine alteration, and the defendants knew their statements concerning enforcing the risk management policies were false. See id. at 297. The defendants also violated the Statement of Financial Accounting Standards ("SFAS"), which requires an entity to disclose all significant concentrations of credit risk arising from all financial instruments. Id. at 298. The district court found the plaintiffs adequately alleged that the defendants were aware of and failed to disclose Lehman's significant concentration of credit risk, pointing to a presentation made to Lehman's Executive Committee warning of the risks inherent in the over-concentration of its global commercial real estate portfolio. Id. at 291-92. The district court held that scienter could be inferred for those defendants who were members of the committee at the time the presentation was given. Id. at 298.

The Seventh Circuit

In Fulton Cnty. Emps.' Ret. Sys. v. MGIC Inv. Co., 2010 WL 5095294 (E.D. Wis. Dec. 8, 2010), aff'd, 675 F.3d 1047 (7th Cir. 2012), plaintiffs brought suit under Sections 10(b) and 20(a) of the Exchange Act alleging that defendants made misleading statements regarding company financials. Id. at *5. The plaintiffs' case involved two affiliated companies that suffered losses as a result of the subprime financial crisis. Id. at *1. Defendant MGIC owned a 46% stake in C-BASS, a company that purchased subprime single-family residential mortgages and packaged them into mortgage-backed securities. Id. The plaintiffs alleged that the defendant made false statements about the value of C-BASS's portfolio of mortgage-backed securities and about C-BASS's liquidity. Id. at *3. Specifically, the plaintiffs alleged that the defendants knowingly failed to write down C-BASS's assets after the value of those assets declined, which the district court noted required the plaintiffs to plead facts "showing that the assets were not valued properly for financial accounting purposes." Id. at *5.

The district court added that, because accounting is not a science and there is usually a range of reasonable accounting treatments, in order to satisfactorily plead a securities fraud claim, plaintiffs must identify the accounting principles that govern and plead facts giving rise to a reasonable belief that the company did not properly apply those principles. Id. The plaintiffs must plead "enough background about these concepts to enable the reader to conclude" that the defendants misapplied them. Id. at *6. Then, the plaintiffs must run the facts pleaded in the complaint through the accounting system to show "that one could not reasonably come up with the values that the defendants reported." Id. The plaintiffs identified three "red flags" about the defendant's valuation techniques: (1) the performance of the ABX index, which tracked a basket of subprime mortgage-backed securities, declined significantly during the time period; (2) the defendants received hundreds of millions of dollars of margin calls; and (3) statements from confidential witnesses indicated that "things were not particularly good at C-BASS during the first half of 2007." Id. at *7. The district court found that none of these alleged facts or red flags gave rise to a reasonable belief that the defendants made false statements about the value of the assets. Id. at *9.

The Ninth Circuit

In In re Medicis Pharm. Corp. Sec. Litig., 2010 WL 3154863 (D. Ariz. Aug. 9, 2010), investors brought an action against defendant corporation ("Medicis") and associated individuals alleging violations of Section 10(b) under the Exchange Act and Rule 10b-5. Medicis, a pharmaceutical company selling products to wholesale distributors, allowed distributors to exchange expiring pharmaceuticals for fresher products. Though Medicis established a reserve, it did not do so according to the full sales price for estimated exchanges. Id. at *1. Once this error was identified, Medicis issued a restatement reflecting a GAAP violation, which resulted in a dramatic drop in the company's share price and prompted the plaintiffs' lawsuit. Id. at *2. The district court denied the defendants' motion to dismiss.

The district court noted that allegations of GAAP violations are normally insufficient to demonstrate scienter unless they are accompanied by other details showing that a defendant acted with the requisite state of mind. Id. at *4 (citing In re Ramp Networks, Inc. Sec. Litig., 201 F. Supp. 2d 1051, 1074 (N.D. Cal. 2002)). Plaintiffs first contended that the obviousness of the defendants' accounting mistake gave rise to an inference of scienter, prompting the district court to note that both the magnitude of the error and the complexity of the accounting standard must be weighed. Id. at *5 (citing Edward J. Goodman Life Income Trust v. Jabil Circuit, Inc., 594 F.3d 783, 792 (11th Cir. 2010)). Thus, although the alleged violation was not very severe, the district court determined that the relevant regulation was relatively straightforward, allowing this allegation to give rise to at least some inference of deliberate misconduct. Id. at *7. Plaintiffs also contended that the defendants' alleged failure to disclose its interpretation of accounting treatment gave rise to an inference of scienter. Id. The district court recognized that, generally, "when a Defendant knowingly adopts a questionable or tenuous accounting methodology and fails to disclose material facts regarding that methodology to investors, an inference of scienter may arise." Id. As such, the district court held that the omission of facts relating to the accounting methodology in question gave rise to an inference of purposeful conduct, holding that the plaintiffs' allegations pleaded a cogent inference of scienter sufficient to deny defendants' motion to dismiss. Id. at *11.

The Eleventh Circuit

In Edward J. Goodman Life Income Trust v. Jabil Circuit, Inc., 594 F.3d 783 (11th Cir. 2010), the Eleventh Circuit affirmed the district court's dismissal of the plaintiffs' putative securities fraud class action. The plaintiffs, shareholders of a publicly traded electronics and technology company, alleged that the defendant company and its directors and officers violated Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Id. at 787. The defendants allegedly issued back-dated stock options and failed to properly record them as compensation expenses, thereby violating GAAP and overstating earnings. Id. at 788.

The Eleventh Circuit held that the plaintiffs failed to raise a sufficient inference of scienter. Id. at 793. The plaintiffs conceded that no individual allegation satisfied the Tellabs standard, but they contended that their allegations, when aggregated, sufficed. Id. at 791 (citing Tellabs, 551 U.S. at 324). The Eleventh Circuit held that the plaintiffs did not plead sufficient facts, even when aggregated, to indicate that any individual defendant knew about either the company's accounting irregularity that resulted in the overstatement of earnings or the company's violation of a GAAP accounting standard. Id. at 791-92. The Eleventh Circuit rejected the plaintiffs' argument that the restated amounts, which the plaintiffs detailed as a percentage of net income, were so large (up to 50% in one year) that they implied fraudulent intent. Id. at 791. However, "[b]ecause net income can vary so widely period to period," the Eleventh Circuit found that "using it as a baseline for comparison provides . . . no real standard on which to judge the significance of the accounting error." Id. at 792. Instead, the Eleventh Circuit stated that the plaintiffs needed to place the restated amounts in the context of the total corporate business in order to determine whether any insider should have noticed the accounting error. Id. The Eleventh Circuit held that the plaintiffs' allegations did not create an inference of scienter that was at least as probable as the non-fraudulent explanation that none of the defendants knew of the accounting errors until the SEC began an investigation. Id. at 793.

In Meyer v. St. Joe Co., 2011 WL 3750324 (N.D. Fla. Aug. 24, 2011), the district court granted the defendants' motion to dismiss the plaintiffs' putative class action for violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The plaintiffs, investors, alleged that the defendants, a timber and paper company and five of its officers, intentionally deceived investors about the value of the company's residential real estate projects following the national real estate market downturn. Id. at *1. The plaintiffs alleged that, despite knowledge of a downturn in value of these properties, the defendants failed to take the appropriate "impairment charges" under GAAP and SEC regulations to properly reflect the decreased value of the properties and correspondingly reduced earnings. Id.

The plaintiffs contended that by reporting only minimal impairments, the defendants violated GAAP and misrepresented that the company's financial statements conformed to GAAP. Id. at *7. While recognizing that violations of GAAP may constitute false or misleading statements of material fact, the district court also stated that plaintiffs must "detail how the results of an impairment test were reported fraudulently in the company's financial disclosures, or how impairment testing should have been conducted and how that testing would have necessarily required a recognition of impairment." Id. at *8. The district court concluded that the defendants had not misrepresented any information that they relied upon in conducting their impairment analysis. Id. at *10. Rather than concealing or misrepresenting any adverse facts, the district court explained, the plaintiffs essentially contended that the defendants' "opinions based on those facts were wrong." Id. The district court held these allegations did not adequately plead that the defendants made false statements of fact. Id.

In Waterford Twp. Gen. Emps. Ret. Sys. v. BankUnited Fin. Corp., 2010 WL 1332574 (S.D. Fla. Mar. 30, 2010), the district court granted the defendants' motion to dismiss the plaintiffs' putative class action for violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The lead plaintiffs, purchasers of common stock of BankUnited Financial Corporation ("BankUnited"), alleged that the defendants, three senior executive officers of BankUnited, and its primary subsidiary, BankUnited FSB, made numerous false and misleading representations to conceal BankUnited's unsound lending practices. Id. at *1-2. Specifically, the plaintiffs alleged that BankUnited relied on limited or no documentation loans, made an aggressive push to increase the volume of risky option adjustable rate mortgage loans, failed to adequately reserve for probable loan losses, and asserted pressure to approve overstated appraisals. Id. at *1. The bank was eventually closed by the Office of Thrift Supervision and the Federal Deposit Insurance Corporation was appointed as receiver. Id. at *5.

The plaintiffs alleged that the defendants fraudulently concealed the risks inherent in BankUnited's loan portfolio and inadequately provided for probable loan losses in their accounting practices, which practices violated GAAP. Id. at *17. The district court held that the plaintiffs failed to adequately plead GAAP violations because they did not plead the existence of any glaring accounting irregularities, or "red flags," that suggested the risk and loan losses were evident to the defendants. Id. at *17-18. Further, the plaintiffs failed to allege how the defendants were reckless in their SOX certifications because the alleged misjudgment of risk with respect to the loan portfolio was not "obvious" enough for the asserted accounting irregularities to support an inference of scienter. Id. at *18.

Pleading Allegations Based on Confidential Sources of Information

The Second Circuit

In Glaser v. The9, Ltd., 772 F. Supp. 2d 573 (S.D.N.Y. 2011), shareholders of the defendant company ("The9"), an entity that operated online video games in China, filed a class action against The9 and certain associated individuals under Section 10(b) of the Exchange Act, alleging that the defendants misrepresented facts relating to the likelihood of renewal of the company's most profitable exclusive license. The complaint referred to gaming company Blizard's refusal to renew a 2004 contract with The9 that made The9 the exclusive operator of a popular game in China. Id. at 577. The district court granted the defendants' motion to dismiss.

After finding plaintiffs' allegations unable to support a strong inference of scienter based on motive, the district court assessed whether allegations concerning circumstantial evidence were sufficient. Id. at 591. In considering plaintiffs' contentions concerning confidential witnesses ("CWs"), the district court determined that these allegations did not give rise to a strong enough inference of scienter. Id. at 595. The district court found that statements attributed to three of the four CWs did not reach the requisite level of specificity, while allegations attributed to former "senior executive" CW4 failed because neither the scope of CW4's duties at The9 nor the extent to which CW4 had access to the individual defendant were adequately pleaded. Id. Thus, the district court granted the defendants' motion to dismiss largely because the allegations pleaded in the complaint with respect to the CWs did not comply with Tellabs. Id. at 595-99.

In Local No. 38 Int'l Bhd. Of Elec. Workers Pension Fund v. Am. Express Co., 724 F. Supp. 2d 447 (S.D.N.Y. 2010), aff'd, 430 F. App'x 63 (2d Cir. 2011), the lead plaintiff, a pension fund, brought a putative class action against American Express Company ("AMEX") and two of its officers alleging that the defendants misled investors about AMEX's underwriting guidelines and exposure to delinquent credit cardholder payments in violation of Sections 10(b) and 20(a) of the Exchange Act. Specifically, the plaintiff alleged that in 2007, when the economy was deteriorating and AMEX was facing losses, the two officer defendants made a series of oral misrepresentations about AMEX's underwriting guidelines, the credit quality of the company's portfolio, and the company's level of loss reserves. Id. at 453-55. The district court held that the plaintiff failed to plead facts establishing scienter and dismissed the plaintiff's claims. Id. at 464. The Second Circuit affirmed.

The plaintiff's fraud allegations stemmed from information supplied by twelve confidential witnesses, many of whom were low-level, rank-and-file employees or outside contractors who "had no access to aggregated data regarding [AMEX's] credit risk." Id. at 460. The district court noted that those confidential witnesses who were privy to AMEX's credit or lending data failed to aver "that such data had been presented to management around the time of Defendants' allegedly misleading statements." Id. at 461. Only one of the plaintiff's confidential witnesses "identif[ied] a report demonstrating that the [i]ndividual [d]efendants were aware of a less restrictive lending policy or specific adverse credit data contradicting their public statements." Id. at 460. That confidential witness prepared reports for AMEX's senior executives and "asserted that the head of AMEX's U.S. Card division reported data compiled by Risk Management to AMEX's Chief Financial Officer, and that higher delinquency rates due to small business loans 'would have been reported to the Company's CFO' in monthly meetings." Id. at 461. Although these allegations contained the "most specific information on scienter pled" in the complaint, the Second Circuit determined that "even these averments fail[ed] to raise a strong inference that the [i]ndividual [d]efendants had specific information contradicting their public statements." Id.

The Third Circuit

In Local 731 I.B. Of T. Excavators & Pavers Pension Trust Fund v. Swanson, 2011 WL 2444675 (D. Del. June 14, 2011), the district court denied the defendants' motion to dismiss the plaintiffs' putative class action brought pursuant to Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The plaintiff investors alleged that the defendants, a leading publisher of print yellow pages directories and provider of online local commercial search tools, and some of its officers, deliberately misrepresented the financial performance and continued viability of the company, which artificially inflated the stock price. Id. at *1. The lead plaintiff contended that they were harmed when the market learned the truth about the company, which later entered into bankruptcy protection. Id.

The district court held that the lead plaintiff alleged "'the who, what, when, where and how'" supporting the confidential witnesses' knowledge of the alleged securities fraud. Id. at *6-7 (quoting Inst'l Investors Grp. v. Avaya, Inc., 564 F.3d 242, 253 (3d Cir. 2009)). The lead plaintiff included information regarding the confidential witnesses' positions, duties, and time and place of employment. Id. at *7. Thus, the district court was able to decipher whether the allegations regarding the defendants' knowledge about the true condition of the company's yellow pages business were based upon "'firsthand knowledge'" or mere "'rumor.'" Id. at *8 (quoting Cal. Pub. Emps.' Ret. Sys. v. Chubb Corp., 394 F.3d 126, 148 (3d Cir. 2004)).

The Fourth Circuit

In In re Conventry Healthcare, Inc. Sec. Litig., 2011 WL 3880431 (D. Md. Aug. 30, 2011), the defendants moved for reconsideration of a previous holding that two of sixty alleged misstatements were adequately pled. Id. at *3. Using information from numerous confidential witnesses, the plaintiffs brought suit under Sections 10(b) and 20(a) of the Exchange Act. Id. at *2. The defendants argued that Fourth Circuit precedent in Teachers' Ret. Sys. of La. v. Hunter, 477 F.3d 162 (4th Cir. 2007), required individualized assessment of the reliability of confidential witnesses. Id. at *4. The district court disagreed "that Teachers' Retirement requires such an individualized assessment of the reliability of the confidential witnesses, as Teachers' Retirement allows the Court to assess the 'complaint as a whole.'" Id. at *4 (quoting Teachers' Ret. Sys. of La., 477 F.3d at 174). Evaluating the allegations in concert, the district court found the facts alleged by the confidential witnesses and their positions within the company sufficient to survive a motion to dismiss. Id. at *5.

The Seventh Circuit

In Makor Issues & Rights, Ltd. v. Tellabs Inc., 513 F.3d 702 (7th Cir. 2008), on remand from the Supreme Court, the Seventh Circuit considered whether the plaintiffs' allegations of fraud under Section 10(b) created a "strong inference" of scienter. The plaintiffs alleged that Tellabs and its former CEO had made false and misleading statements regarding its two principal products, the TITAN 5500 and its successor, the TITAN 6500. The plaintiffs supported their assertions with the statements of twenty-six "confidential sources." The defendant asserted that the plaintiffs' dependence on the confidential sources to support the plaintiffs allegations of falsity and scienter was improper. Id. at 711.

The Seventh Circuit rejected the contention that a strong inference of scienter had not been pleaded because key facts came from confidential sources. Significantly, the Seventh Circuit did not apply the "steep discounts" standard it had applied in Higginbotham v. Baxter Int'l, Inc., 495 F.3d 753 (7th Cir. 2007). In Baxter, the Seventh Circuit found that the failure to name sources cited in the complaint "conceals information that is essential to the sort of comparative evaluation required by Tellabs" because courts are unable to fully evaluate the reliability of those witnesses. Id. at 757. As a result, the Baxter court held that allegations from confidential witnesses must be "discounted" in determining whether a plaintiff has pleaded a strong inference of scienter and that discount will usually be "steep." Id. In this case, the Seventh Circuit concluded that the steep discount should not be applied because, in contrast to the anonymous allegations in Baxter, the statements by confidential witnesses in this case were "numerous" and made by "persons who from the descriptions of their jobs were in a position to know at first hand the facts to which they are prepared to testify." Tellabs, 513 F.3d at 712.

In City of Livonia Emps.' Ret. Sys. v. The Boeing Co., 2010 WL 2169491 (N.D. Ill. May 26, 2010), plaintiffs brought a class action for violations of Sections 10(b) and 20(a) of the Exchange Act on behalf of purchasers of Boeing Company ("Boeing") common stock. Id. at *1. The plaintiffs alleged misrepresentations and omissions regarding negative Federal Aviation Administration test results concerning Boeing's Dreamliner Airplane. Id. at *1-4. Boeing moved to dismiss. Id. at *1. Using information from confidential sources, the plaintiffs pleaded that the defendants knew the negative results would lead to delays in the Dreamliner's first flight and delivery to customers. Id. at *5. Following the Seventh Circuit's guidance in Higginbotham v. Baxter Int'l, Inc., 495 F.3d 753 (7th Cir. 2007), the district court found that allegations from confidential sources must be "discounted (usually steeply)," and that such allegations will only be given weight if plaintiffs plead "with particularity facts showing how the source was in a position to know the information and why the source should be credited." City of Livonia, 2010 WL 2169491 at *5. The district court rejected the plaintiffs' offer to provide information to the court in camera out of concern that it would inappropriately create an informers' privilege for confidential witnesses. Id. The district court stated that the defendants had a right to "learn the information in discovery," meaning that they had a right to the information used to state the claims against them. Id. Finding that the plaintiffs pleaded no such information for the confidential source, the district court granted the defendant's motion to dismiss. Id. at *6.

The Ninth Circuit

In In re NVIDIA Corp. Sec. Litig., 2011 WL 4831192 (N.D. Cal. Oct. 12, 2011), investors brought a class action for violations of Sections 10(b) and 20(a) of the Exchange Act alleging misstatements about product defects in the company's semiconductor microchip packaging. Id. at *1. The district court previously dismissed the plaintiffs' complaint with leave to amend, and upon the plaintiffs' filing of a second amended complaint, the defendants moved to dismiss. Id. The amended complaint included allegations from seventeen different confidential witnesses. Id. at *6. The district court observed that the Ninth Circuit had set out a two part test to determine whether allegations from confidential witnesses ("CWs") meet the pleading requirements of the PSLRA: "First, a CW must be described with sufficient particularity to establish his or her reliability and personal knowledge. Second, the statements supplied by CWs 'with sufficient reliability and personal knowledge must themselves be indicative of scienter.'" Id. (quoting Zucco Partners, LLC v. Digimarc Corp., 552 F.3d 981, 992 (9th Cir. 2009)). The district court found all but one of the CWs to be deficient because those witnesses had not worked on the allegedly defective chip and the plaintiffs failed to allege any contact between those witnesses and senior management. Id. One CW was allegedly involved in the testing of the relevant product components, but the district court deemed even those allegations insufficient as they "merely reiterate[d] that NVIDIA knew of a problem by early 2007" and did not "provide details about specific communications or statements made by NVIDIA." Id. at *7. Without specific statements, the witness could not have known what conclusions the company made about the reported problems. Id. Finding that the plaintiffs failed to adequately plead scienter through statements by CWs or in any other way, the district court granted the defendants' motion to dismiss without leave to amend. Id. at *11.

In Szymborski v. Ormat Techs., Inc., 776 F. Supp. 2d 1191 (D. Nev. 2011), plaintiffs brought a claim for violations of Rule 10b-5 based on two incidents when the defendants allegedly misled stockholders: first in connection with a February 24, 2010 disclosure regarding a restatement of 2008 financial statements and second regarding a delay in completion and capacity of a power plant. In connection with its claims regarding the power plant, the plaintiffs relied on the testimony of a confidential witness to plead scienter. Id. at 1196.

The district court first cited the heightened standard that confidential witness testimony must meet to satisfy the requirements of the PSLRA: (1) the confidential witness "'must be described with sufficient particularity to establish [his] reliability and personal knowledge'"; (2) the statements must be indicative of scienter. Id. at 1200 (quoting Zucco Partners, 552 F.3d at 995). The district court noted the following facts in eventually dismissing the power plant claims for failure to sufficiently allege scienter: (1) the confidential witness was employed not by the company, but by a contractor; (2) the confidential witness left the company while the power plant project was still being completed; (3) the confidential witness was not personally familiar with drilling or testing wells central to the plaintiff's power plant claim, but rather only knew about them as a contractor performing unrelated electrical work; and (4) the confidential witness did not have any direct contact with Defendant's management or any individual defendant. Id. at 1200-01. As no evidence was provided to show that the defendants intentionally lied about the construction of the power plant, the district court held that the confidential witness failed to meet either prong of reliability under Zucco Partners and dismissed the power plant claims. Id. at 1202.

The Tenth Circuit

In Mishkin v. Zynex Inc., 2011 WL 1158715 (D. Colo. Mar. 30, 2011), the plaintiffs, investors in Zynex, Inc. ("Zynex"), brought a class action complaint against Zynex, a manufacturer of medical devices, alleging that it participated in a scheme to over-bill insurance companies for its products. Id. at *2. According to the plaintiffs, Zynex reported its revenue based on the amount it billed rather than the amount collected, thereby artificially inflating its revenue. Id. When it announced a restatement to reflect a decrease in revenue, the price of its shares declined by over 50 percent. Id. The defendants moved to dismiss, arguing that the plaintiffs' reliance on confidential witnesses ("CWs") undermined its allegation of facts in support of a strong inference of scienter because (1) none of the CWs were involved in Zynex's accounting and therefore had no personal knowledge of facts relating to the defendants' purported scienter; and (2) "allegations based on statements by confidential witnesses are subject to a steep discount when evaluating the sufficiency of a complaint." Id. at *6.

The district court stated that the "pitch of the discount accorded to confidential witnesses varies with the specificity and consistency of the allegations in the complaint." Id. (citing Adams v. Kinder Morgan, Inc., 340 F.3d 1083, 1102 (10th Cir. 2003)). Concluding that the CWs' statements—which showed personal knowledge of facts relating to the alleged fraud during the relevant period—were sufficiently specific to support an inference of scienter and entitled to significant weight, the district court denied the motion to dismiss. Id. at *6-7.

The Eleventh Circuit

In City of Pontiac Gen. Emp. Ret. Sys. v. Schweitzer-Mauduit Int'l, Inc., 806 F. Supp. 2d 1267 (N.D. Ga. 2011), the district court granted the defendants' motion to dismiss the plaintiffs' putative class action, which alleged violations under Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The plaintiffs were shareholders in Schweitzer-Maduit International, Inc. ("Schweitzer"), which supplied tobacco products to tobacco companies internationally. Id. at 1270. The plaintiffs alleged that the company and two of its directors and officers engaged in a fraudulent scheme to artificially inflate the company's stock price by misleading the market about: (1) Schweitzer's relationship with one of its largest customers; (2) the strength of Schweitzer's intellectual property protections; and (3) pressures Schweitzer faced from European competitors. Id.

The district court held that an inference of scienter was not warranted where a confidential witness, a former lab tester employed by Schweitzer, alleged in relevant part that "there was talk" among employees that the company's contract with a major client was coming to an end before it was publicly revealed by the company. Id. at 1296. The district court noted that reliance on a confidential witness is permissible only if the plaintiffs unambiguously provided in a "'cognizable and detailed way the basis of the whistleblower's knowledge.'" Id. at 1296-97 (quoting Mizzaro v. Home Depot, Inc., 544 F.3d 1230, 1239 (11th Cir. 2008)). Since the plaintiffs provided no basis for the lab tester's specialized knowledge of the company's contract, the district court concluded that the statements were mere "speculation or hearsay" and did not support an inference of scienter. Id. at 1297.

In In re HomeBanc Corp. Sec. Litig., 706 F. Supp. 2d 1336 (N.D. Ga. 2010), the district court granted the defendants' motion to dismiss the plaintiffs' putative class action for violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The plaintiffs, investors in HomeBanc Corporation ("HomeBanc"), a real estate investment trust in the business of investing in and originating residential mortgage loans, alleged that the defendant officers of HomeBanc omitted facts and made numerous false and misleading statements regarding HomeBanc's lending practices that artificially inflated its stock value and damaged the plaintiffs when HomeBanc ultimately filed for bankruptcy. Id. at 1341-42.

The plaintiffs pleaded scienter by reference to twelve confidential witnesses who were former employees of HomeBanc. Id. at 1349. The district court held that the plaintiffs provided an adequate foundation for the court to consider the confidential witness statements because the complaint identified the positions held by each witness, the time periods in which they were employed, and the basis for their knowledge. Id. However, the district court found these statements "severely diluted" in relation to scienter because the plaintiffs did not plead facts establishing that the defendants supported or endorsed the confidential witnesses' assessments of HomeBanc. Id. at 1350. Thus, the district court held that the statements were no more than the "opinions and accusations" of former employees who disagreed with management's decisions. Id.

3

Materiality, Safe Harbor, and Loss Causation

Pleading Materiality

To state a viable claim under Section 10(b) of the Exchange Act, a plaintiff must plead a *material* misstatement or omission. See Matrixx Initiatives, Inc. v. Siracusano, 131 S. Ct. 1309 (2011). The materiality requirement is satisfied when there is "a substantial likelihood that the disclosure of the [truth] would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." Id. at 1318 (quoting TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)). This standard, evaluated by reference to the theoretical "reasonable investor," is objective in nature. TSC Indus., 426 U.S. at 445.

Although litigants often contest materiality by emphasizing the magnitude of the market's reaction to alleged corrective disclosures, courts have repeatedly rejected such an approach in favor of a multi-faceted, "fact-specific" inquiry incorporating both qualitative and quantitative factors. See, e.g., Matrixx, 131 S. Ct. at 1321; Litwin v. Blackstone Grp., L.P., 634 F.3d 706, 717 (2d Cir.), cert. denied, 132 S. Ct. 242 (2011). Considerations of continuing relevance to the materiality analysis include: (1) the tone and specificity of the challenged statements, e.g., FindWhat Investor Grp. v. FindWhat.com, 658 F.3d 1282, 1306 (11th Cir. 2011); City of Monroe Emps. Ret. Sys. v. Bridgestone Corp., 399 F.3d 651, 671 (6th Cir. 2005); (2) the relative importance to the defendant's business of the activity underlying the challenged statements, e.g., Blackstone, 634 F.3d at 722; (3) other publicly-available sources of information on the topic at issue, e.g., Plumbers & Pipefitters Local Union No. 630 Pension-Annuity Trust Fund v. Arbitron Inc., 741 F. Supp. 2d 474, 485 (S.D.N.Y. 2010); In re Merck & Co. Sec., Deriv. & "ERISA" Litig., 2011 WL 3444199, at *17 (D.N.J. Aug. 8, 2011); (4) the scope of any prior public statements on the topic at issue, e.g., In re Sanofi-Aventis Sec. Litig., 774 F. Supp. 2d 549, 568-69 (S.D.N.Y. 2011); and (5) in omissions cases, whether the defendant had a duty to disclose the omitted information in the first place, e.g., Hill v. Gozani, 651 F.3d 151, 152 (1st Cir. 2011); In re Cutera Sec. Litig., 610 F.3d 1103, 1109 (9th Cir. 2010).

The Supreme Court

In Matrixx, the Supreme Court affirmed the Ninth Circuit's affirmance of the district court's denial of the defendants' motion to dismiss the plaintiffs' securities fraud class action brought pursuant to Section 10(b) of the Exchange Act and Rule 10b-5. 131 S. Ct. at 1314. The plaintiffs alleged that the defendants, a pharmaceutical company and three of its executives, made material omissions by commenting on revenues and product safety while failing to disclose reports of adverse events that the company's product, Zicam, possibly caused loss of smell. Id. at 1313-14. The defendants moved to dismiss for failure to adequately plead materiality and scienter. Id. at 1313.

The Supreme Court disagreed with the district court's holding that the alleged omissions were not material because they did not relate to a statistically significant number of adverse events. Id. at 1317. Instead, the Supreme Court held that materiality "cannot be reduced to a bright-line rule." Id. at 1314. Following Basic, the Court held that "assessing the materiality of adverse event reports is a 'fact specific' inquiry," and the "question remains whether a *reasonable* investor would have viewed the nondisclosed information 'as having *significantly* altered the total mix of information made available.'" Id. at 1321 (quoting Basic Inc. v. Levinson, 485 U.S. 224, 232, 236 (1988)) (emphasis added). The Supreme Court explained that medical professionals and the Federal Drug Administration concluded that Zicam products may pose a serious risk to consumers "on the basis of evidence of causation that is not statistically significant," and thus, "it stands to reason that in certain cases reasonable investors would as well." Id. at 1320-21. Affirming the holding in Basic, the Supreme Court held that under the "total mix" standard, the plaintiffs adequately pleaded materiality despite their failure to cite a statistically significant number of adverse events requiring disclosure. Id. at 1322.

The First Circuit

In Hill v. Gozani, 651 F.3d 151 (1st Cir. 2011), plaintiff shareholders petitioned the First Circuit for rehearing en banc after it dismissed the plaintiffs' putative class action. The plaintiffs brought suit against a medical device manufacturer and three of its officers alleging violations of Section 10(b) of the Exchange Act and Rule 10b-5.

The plaintiffs claimed that the First Circuit's decision in their case was inconsistent with Matrixx. In Matrixx, the Supreme Court held that the materiality inquiry is a fact-specific one and rejected the defendant's proposed bright-line rule that, in the pharmaceutical context, only statistically significant adverse events were material. 131 S. Ct. at 1322. Notably, the Supreme Court stated in Matrixx that Rule 10b-5 does not create a duty to disclose all material information and "[e]ven with respect to information that a reasonable investor might consider material, companies can control what they have to disclose under these provisions by controlling what they say to the market." Id. at 1321-22. The First Circuit held that the dismissal of the plaintiffs' claims was not inconsistent with the Supreme Court's decision in Matrixx because: (1) Matrixx focused on the question of when undisclosed facts were material; (2) the actual statements made by the companies in each case differed in ways that affected the duty to disclose; and (3) there was no similarity between the facts omitted by the companies. Hill, 651 F.3d at 152-53. The First Circuit ruled that when the company revealed potential risks with respect to reimbursement, it was not required to disclose internal disagreement regarding practices. The First Circuit denied the petition for rehearing. Id. at 153.

The Second Circuit

In Litwin v. Blackstone Grp., L.P., 634 F.3d 706 (2d Cir.), cert. denied, 132 S. Ct. 242 (2011), the Second Circuit vacated and remanded the district court's dismissal of claims brought pursuant to Sections 11, 12(a)(2), and 15 of the Securities Act.[70] The plaintiffs alleged that the defendants, Blackstone Group, L.P. ("Blackstone") and its executives, omitted material information and made misstatements in Blackstone's initial public offering registration statement and prospectus. Id. at 708. According to the plaintiffs, Item 303 of SEC Regulation S-K required Blackstone to disclose the "'trends or uncertainties'" in the real estate market of which it was aware that would materially affect the revenues of two of its portfolio companies, FGIC Corporation ("FGIC") and Freescale Semiconductor, Inc. ("Freescale"), as well as its Real Estate investment segment, which were experiencing problems that would materially affect future revenues. Id. at 710, 716.

The Second Circuit held that following SEC Staff Accounting Bulletin No. 99, both qualitative and quantitative factors must be considered in assessing an item's materiality. Id. at 717; see also 64 Fed. Reg. 45, 151 (Aug. 19, 1999). Blackstone allegedly failed to disclose that (1) FGIC, a monoline financial guarantor in which Blackstone had a 23% equity interest, was exposed to billions of dollars in non-prime mortgages, and (2) Freescale, a company in which Blackstone's Corporate Private Equity segment made its single largest investment, lost an exclusive manufacturing agreement with its largest customer. Blackstone, 634 F.3d at 710-11. Although Blackstone's investments in FGIC and Freescale fell below the presumptive 5% threshold of materiality, the Second Circuit held that Blackstone's failure to disclose these facts was nonetheless qualitatively material because "a reasonable investor would almost certainly want to know" information related to a "particularly important segment" that Blackstone reasonably expected to have a material adverse effect on its future revenues. Id. at 720. Because these events suggested a change in earnings or other trends, the Second Circuit held that Blackstone could not mask these negative events in its segments by aggregating "negative and positive effects" on its performance fees, or by focusing solely on its firm-wide financial results. Id. at 719-20.

Regarding Blackstone's Real Estate segment, which constituted 22.6% of its total assets, Blackstone allegedly failed to disclose the details of its real estate investments and that the deteriorating residential real estate markets could result in the claw back of its performance fees, while misrepresenting the problems in the housing market. Id. at 712. The Second Circuit held that the alleged misstatements and omissions were qualitatively material because they masked the potential change in earnings or trends in violation of

[70] Although the Blackstone plaintiffs did not assert 10b-5 claims, Blackstone's discussion of materiality could nonetheless impact future 10b-5 cases in the Second Circuit.

Item 303. Id. at 722. The Second Circuit explained that Blackstone's residential real estate holdings might constitute as much as 15% of its Real Estate segment, and that a collapse in the residential real estate market would plausibly also impact Blackstone's more substantial commercial real estate investments. Id. at 721. The Second Circuit reasoned that "[a] reasonable Blackstone investor may well have wanted to know of any potentially adverse trends concerning a segment that constituted nearly a quarter of Blackstone's total assets under management." Id. at 722. Thus, the Second Circuit vacated the district court's dismissal for failure to plead materiality and remanded. Id. at 723.

In In re Sanofi-Aventis Sec. Litig., 774 F. Supp. 2d 549 (S.D.N.Y. 2011), the district court granted in part and denied in part the defendants' motion to dismiss the plaintiffs' claims for violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The plaintiff investors alleged that the defendants, Sanofi-Aventis SA ("Sanofi"), a pharmaceutical company, and seven of its executives, made materially misleading statements regarding the commercial viability of rimonabant, an obesity drug. Id. at 556. The United States Food and Drug Administration ("FDA") directed the defendants to assess the link between rimonabant and suicidality, and the information obtained eventually led to the FDA Advisory Committee's recommendation that the FDA deny Sanofi's New Drug Application, which Sanofi withdrew before it was denied. Id. at 558-59.

The district court held that the plaintiffs adequately alleged two materially misleading statements. During a conference call with investors, an individual defendant made statements concerning an FDA letter that directed Sanofi to obtain a formal, independent assessment of the link between rimonabant and suicidality. Id. at 558, 564. The defendant stated that the letter requested "no additional trial in obesity." Id. at 564. The district court held that this statement was materially misleading because it could have led an investor to believe that the FDA had made no requests with respect to rimonabant as an obesity drug and that "the FDA approval process was on track without any major concerns." Id. at 564-65.

In addition, after the defendants complied with the request in the FDA's letter and obtained an independent suicidality assessment, one of the defendants made statements during a conference call with investors that the FDA's letter "did not ask for new additional clinical trials" and that Sanofi did not submit new data. Id. at 568. However, the plaintiffs alleged facts showing that the defendants had submitted additional new data at the FDA's request—the results of the independent suicidality assessment—and that the assessment showed a statistically significant link between rimonabant and suicidality. Id. The district court held that after choosing to comment on Sanofi's additional data submissions, the defendants could not provide a truthful and complete response without conveying to the public that additional material data had been requested and submitted. Id. at 568-69.

In Plumbers & Pipefitters Local Union No. 630 Pension-Annuity Trust Fund v. Arbitron Inc., 741 F. Supp. 2d 474 (S.D.N.Y. 2010), the lead plaintiff asserted securities fraud allegations against Arbitron, Inc. ("Arbitron"), a firm engaged in audience measurement services for radio stations, as well as Arbitron's CEO and CFO (collectively, the "defendants"). The complaint alleged that between July 19, 2007 and November 26, 2007, the defendants made false and materially misleading statements or omissions about Arbitron's planned rollout of its Portable People Meter ("PPM"), an electronic device that identifies the radio broadcasts one is listening to, in violation of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Id. at 477. The defendants moved to dismiss the complaint for failure to state a securities fraud claim. Id. at 492.

The district court held, inter alia, that the plaintiffs had adequately pleaded materiality for purposes of Section 10(b). Id. at 484. The plaintiffs argued, among other things, that the defendants made false and misleading statements during the class period about Arbitron's ability to gather information during its PPM testing phase from minority demographics. Id. at 483. The plaintiffs pleaded that "the PPM allegedly had trouble measuring minority audiences due to small sample sizes," and that this sampling problem led "to substantial criticism in mid-2007" by the leading accrediting agency for audience measurement research, the New York City Council and the National Association of Black Owned Broadcasters ("NABOB"). Id. at 484. The district court noted that Arbitron reported publicly during this period that it was satisfied with the minority data provided by the PPM, sometimes "explicitly stating that the PPM was performing well in the area of minority measurement." Id. Such positive statements, the district court noted, "flew in the face of the alleged inadequacies of the PPM in measuring minority audiences . . . ." Id.

The district court concluded that "[a] reasonable investor could reasonably take Arbitron's statements to be assurances that there was nothing to NABOB's public criticism of the PPM, and that Arbitron found that there were no significant problems with the PPM's performance among minority demographics." Id. at 484-85. Applying the Second Circuit's standard for materiality, the district court ruled defendants' misstatements actionable because "'there [wa]s a substantial likelihood that a reasonable person would consider [the assurances] important in deciding whether to buy or sell shares of stock.'" Id. at 485 (citing Operating Local 649 Annuity Trust Fund v. Smith Barney Fund Mgmt. LLC, 595 F.3d 86, 92-93 (2d Cir. 2010)). The district court rejected the defendants' argument that "the total mix of information available to the reasonable investor included NABOB's [public] criticisms." Id. The district court found "[t]his type of 'truth-on-the-market' defense" to be "intensely fact-specific" and "rarely an appropriate basis for dismissing a Section10(b) complaint for failure to plead materiality." Id. at 485-86 (citing Ganino v. Citizens Utils. Co., 228 F.3d 154, 167 (2d Cir. 2000)).

In Defer LP v. Raymond James Fin., Inc., 2010 WL 3452387 (S.D.N.Y. Sept. 2, 2010), the plaintiffs, investors in auction rate securities ("ARS"), sued a financial services firm and its two wholly owned subsidiaries, alleging violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The plaintiffs alleged that the defendants "engaged in a scheme to defraud ARS purchasers by knowingly misrepresenting the securities as highly liquid investments." Id. at *1.

More specifically, one named plaintiff ("Rubin") alleged that, some time prior to April 2003, she had been encouraged to invest in ARS as "'safe, short-term investments'" by her financial advisor at Raymond James Financial Services, Inc. ("RJFS"). The other named plaintiff ("Gold") similarly alleged that a financial advisor from Raymond James &

Associates ("RJA") recommended ARS to him in January 2008 as "a safe and liquid investment." Id. at *3. The plaintiffs contended that the financial advisors made these representations "when, in fact, the ARSs' liquidity was a façade and wholly dependent on auction dealer intervention in the market." Id. at *2. The defendants moved to dismiss the complaint for failure to state a claim. The district court dismissed certain claims but allowed the claims against RJA for misrepresentations made between November 2007 and February 2008 to proceed. See id. at *13.

After determining that scienter had been adequately pleaded only as to RJA from November 2007 to February 2008, the district court considered whether RJA's allegedly false and misleading statements to Gold in January 2008 were actionable. The district court determined that RJA had a duty to disclose "that the ARS—supposedly liquid investments—were liquid only because auction brokers routinely intervened in the auctions to ensure their success," because "it would have been important to a reasonable investor, in deciding whether to buy or sell ARS." Id. at *10. The district court further found that a disclosure on RJA's website informing investors that ARS were subject to failed auction risk could not be considered "adequate cautionary language" rendering alleged misrepresentations immaterial because the website did not disclose the specific risk at the core of the plaintiffs complaint, i.e., that the ARS were only liquid because of extensive broker intervention. Id. at *11 (quoting Rombach v. Chang, 355 F.3d 164, 173 (2d Cir. 2004)).

The Third Circuit

In In re Merck & Co. Sec. Litig., 432 F.3d 261 (3d Cir. 2005), the plaintiffs brought claims against Merck & Co. ("Merck") for statements made surrounding the revenue accounting practices of Merck's wholly owned subsidiary Medco Health Solutions, Inc. ("Medco") in violation of Section 10(b) of the Exchange Act and Section 11 of the Securities Act. The district court granted Merck's motion to dismiss on materiality grounds.

The Third Circuit affirmed and dismissed the plaintiffs' claims for failure to sufficiently plead materiality. Noting that it had "one of the 'clearest commitments' to the efficient market hypothesis," the Third Circuit stated that, in determining whether a misstatement is material, it looks to the movement in the price of the company's stock "in the period *immediately following disclosure*." Id. at 268-69 (emphasis added). The Third Circuit noted that when Merck initially disclosed that Medco was improperly accounting for revenue there was no drop in Merck's stock price. Merck's alleged misrepresentations were thus immaterial as a matter of law. Id. at 269. Plaintiffs responded, however, that Merck's initial disclosure, which failed to quantify the impact of improper accounting on company revenue, was not the appropriate time to measure materiality. Id. According to the plaintiffs, the appropriate time to measure materiality was two months later when an article in *The Wall Street Journal* quantified the amount of revenue misstated. Id. at 269-70. The Third Circuit disagreed, holding that, even though the initial disclosure did not quantify the amount, Merck provided all of the necessary data to determine the actual amount; and the mathematical proficiency required to calculate the revenue figure was minimal. Id. at 270-71. Further, the Third Circuit found that the market was not "in the dark" on the actual figures, even if Merck did not disclose the actual figure, especially considering the numerous financial analysts covering Merck. Id. at 271. Thus, the Third Circuit dismissed the plaintiffs' Section 10(b) claim, holding that the plaintiffs failed to show that the alleged misstatements were material because they failed to demonstrate a decrease in Merck's stock price after the initial disclosure of improper accounting recognition. Id. at 276.

In Steamfitters Local 449 Pension Fund v. Alter, 2011 WL 4528385 (E.D. Pa. Sept. 30, 2011), the lead plaintiff brought a securities fraud class action for violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 on behalf of all persons and entities that purchased publicly traded securities of Advanta Corp. ("Advanta"), an issuer of credit cards to small businesses. The plaintiff alleged that it purchased shares after the defendants artificially inflated Advanta's stock price by making material misstatements about the credit quality of Advanta's customers, its delinquency and charge-off rates, and a re-pricing scheme to raise interest rates and minimum payments. Id. at *1-3. The defendants included Advanta's officers ("management defendants") and directors ("outside director defendants"); John F. Moore, the president of an Advanta subsidiary; and Christopher J. Carroll, who initiated the internal audits of Advanta's delinquency practices and reported the company to the Federal Deposit Insurance Corporation ("FDIC"). Id. at *1. The district court granted motions to dismiss by the outside director defendants and the defendants Moore and Carroll but denied in relevant part the management defendants' motion to dismiss. Id.

The district court held that the plaintiff adequately alleged material misstatements and omissions by the management defendants. Id. at *6-7. The management defendants' statements regarding the average FICO score of certain new customers was "the type of statement upon which reasonable investors might rely in making investment decisions," and were not mere puffery. Id. at *6. Further, the district court concluded that statements about FICO scores did not constitute forward looking statements. Id. Although the scores were used to predict credit-worthiness, the actual data collected about the credit quality of Advanta's customers was not forward looking, and "the truth of the statements about credit quality was knowable at the time the statements were made." Id.

Regarding the alleged re-pricing scheme, plaintiffs contended that the management defendants omitted to state that they were adversely adjusting pricing even for those customers who did not pose a risk of nonpayment, which led credit-worthy customers to close their accounts at Advanta. Id. at *7. The district court found this omission material, inferring that the scheme had a negative financial impact on Advanta in the long term. Id. Regarding the misreporting of delinquency rates, the district court held that understating credit losses by at least $25.2 million was material, emphasizing that the practices of the collections department spurred two internal audits and an FDIC investigation. Id.

In In re Merck & Co. Sec., Deriv. & "ERISA" Litig., 2011 WL 3444199 (D.N.J. Aug. 8, 2011), the district court granted in part and denied in part the defendants' motions to dismiss the plaintiffs' putative securities fraud class action. The plaintiffs, investors, alleged that the defendants, Merck & Co. ("Merck") and several of its officers, made materially misleading statements and omissions regarding the commercial viability of a prescription arthritis medication, Vioxx, leading up to and following its withdrawal from the market. Id. at *1. The defendants allegedly downplayed the possible link between Vioxx and an increased risk of heart attack or other cardiovascular ("CV") events, which inflated the stock price and harmed the plaintiffs when the truth about the risks of Vioxx emerged. Id.

The plaintiffs alleged that the defendants made numerous material misrepresentations and omissions about (1) Vioxx's safety profile, (2) the results of a study of Vioxx, and (3) the cause of Vioxx's withdrawal from the market. First, the district court held that the defendants' public discussion of Vioxx's safety profile created an affirmative duty to disclose information about the link between Vioxx and adverse effects such as an increased risk of heart attacks, and that the defendants' failure to disclose such information rendered their prior statements about Vioxx's safety misleading. Id. at *9. Second, the district court held that the defendants misrepresented the results of a study conducted by Merck (known as the "VIGOR" study), which revealed that patients taking Vioxx experienced four times as many heart attacks and other adverse CV events than patients taking naproxen. Id. at *7, *13. The district court held that the defendants' statements attributing the results to the preventative effects of naproxen were actionable because the defendants had no reasonable basis for their assertions regarding naproxen and were aware that the VIGOR study outcomes were not due to any such effects. Id. at *14-15. Third, the district court held that the defendants' statements on the day Vioxx was withdrawn from the market, which minimized Vioxx's CV risks, were not material because investors were fully aware on this date that Vioxx was no longer commercially viable because of its dangers. Id. at *17.

The Fourth Circuit

In Greenhouse v. MCG Capital Corp., 392 F.3d 650 (4th Cir. 2004), investors sued MCG Corp. ("MCG") after MCG's CEO made a statement that he had finished college when, in reality, he had only completed three years. After the truth was revealed, MCG's stock price fell. Id. at 653. Investors sued the corporation under Sections 11 of the Securities Act and 10(b) of the Exchange Act.

The district court dismissed the complaint and held that the CEO's education was immaterial as a matter of law. Id. The Fourth Circuit upheld the district court's decision and agreed that the CEO's education was an immaterial fact under the securities laws. Id.

The plaintiffs argued on appeal that the CEO's education and integrity was "material." The Fourth Circuit concluded that the real issue was "whether the actual fact misrepresented—that is the basis for this suit and that caused investors to question management's integrity—was, in and of itself, material." Id. at 659. The Fourth Circuit found that the CEO's failure to complete college did not "alter the total mix of information [available] to a reasonable investor." Id.

The Fourth Circuit reasoned that "it [was] *not* substantially likely that reasonable investors would devalue the stock knowing that [he] skipped out of his last year at Syracuse. That is, if one imagines a parallel universe of affairs where the one and only thing different was that MCG's filings made no mention of [his] education (or, instead, said simply that he 'attended' Syracuse or 'studied economics' there), we find it incredible to believe that MCG's stock would be worth even a penny more to a reasonable investor." Id. at 661. The Fourth Circuit thus affirmed the district court's ruling.

In In re Constellation Energy Grp., Inc. Sec. Litig., 738 F. Supp. 2d 614 (D. Md. 2010), investors brought a class action against the company and its directors and officers alleging violations of Sections 10(b) and 20(a) of the Exchange Act and Sections 11, 12(a)(2), and 15 of the Securities Act. Id. at 619. Constellation was involved in energy trading that required the company to post large amounts of collateral. Id. at 620. Due to an error in a computer program, Constellation incorrectly stated the amount of collateral it would need in the event of a credit downgrade, and that error was incorporated into the company's Form 10-Q. Id. at 621. When Lehman Brothers filed for bankruptcy one month later, Constellation revealed that Lehman was a counter-party to some of its transactions. Id. at 622. These two events provided the basis for most of the plaintiffs' claims.

The district court analyzed materiality under Sections 11 and 12(a)(2) of the Securities Act, using reasoning that it later applied to the plaintiffs' 10b-5 claims. Id. at 624, 634. The district court found that the company's collateral calculations in the event of a downgrade were not forward-looking statements because they were specifically calculated based on the obligations that existed as of a specific date, March 31, 2008. Id. at 626. Further, the district court stated that the estimates could not be immaterial as a matter of law because liquidity was an important element of Constellation's business, and therefore significant to the overall mix of information provided to investors. Id. Lastly, the district court explained that the absence of a significant price drop after the collateral calculation was disclosed might counsel against a finding of materiality, but was not dispositive. Id. at 627. The defendants' motion to dismiss claims related to the collateral estimates was denied. Id.

The Fifth Circuit

In Plotkin v. IP Axess Inc., 407 F.3d 690 (5th Cir. 2005), the plaintiffs, purchasers of IP Axess ("IP") stock, appealed the district court's decision to dismiss their securities fraud complaint for failure to state a claim. The plaintiffs alleged that IP made false or misleading statements in two press releases made on May 25, 2000 and one made on August 18, 2000 that induced the plaintiffs to buy large amounts of IP stock. The Fifth Circuit affirmed dismissal of the claims regarding the August 18 release, but reversed the dismissal of the claims regarding the May 25 press releases.

The plaintiffs alleged that the May 25 releases announcing a letter of intent and a multi-million dollar purchase order involving two other companies (Lynxus and AGPI) omitted material information that rendered the releases misleading. Both deals "failed quickly and spectacularly." Id. at 694. The company did not publicly admit the failure of both deals until February 2001. Id. In a shareholder letter published around that time, IP asserted that the purchase order fell through because one of Lynxus' customers delayed payment, but failed to mention that Lynxus had gone bankrupt three weeks earlier. Id. The Fifth Circuit found that "[a] fair reading of the May 25 press releases would reasonably induce investors to believe that [IP] had a legitimate expectation of revenues from the agreements it had just struck with AGPI and Lynxus." Id. at 697. "A reasonable investor reading the releases would also have formed the impression that AGPI and Lynxus were significant international companies which could serve as credible business partners to [IP]." Id.

The Sixth Circuit

In City of Monroe Emps. Ret. Sys. v. Bridgestone Corp., 399 F.3d 651 (6th Cir. 2005), the plaintiffs, investors in Bridgestone Corporation ("Bridgestone"), appealed the district court's complete dismissal of their securities fraud class action complaint against Bridgestone and its subsidiary Bridgestone/Firestone, Inc. ("Firestone"), Bridgestone's CEO and Executive Vice President and Firestone's CEO. The plaintiffs alleged violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5.

On appeal, the Sixth Circuit recognized that, to be actionable, a misrepresentation or omission must pertain to material information which the defendant had a duty to disclose. Id. at 669. An affirmative duty to disclose may arise when there is an inaccurate, incomplete, or misleading disclosure. Id. The Sixth Circuit explained that whether a statement is material is a fact-intensive test that depends on the significance a reasonable investor would place on the information, distinguishing between "hard" and "soft" information: hard information is objectively verifiable and is actionable if it is false and material, while soft information includes predictions and matters of opinion and is only actionable if it is "virtually *as certain* as hard facts." Id. (emphasis added) (citation omitted).

In partially reversing the district court's decision, the Sixth Circuit discussed each of the statements that the plaintiffs allegedly relied upon, finding that, with one exception, all of the statements about the quality or safety of Firestone's ATX Tires were immaterial puffery. Id. at 671. The Sixth Circuit described the statements as "loosely optimistic statements insufficiently specific for a reasonable investor 'to find them important to the total mix of information available.'" Id. at 671 (citation omitted). However, the Sixth Circuit found that Firestone's August 1, 2000 statement regarding objective data supporting the safety of their tires was actionable. The Sixth Circuit noted that Firestone did not point to any evidence that supported its "objective data" statement. Id. at 672. "[O]nce Firestone elected to make statements such as the statement regarding the 'objective data,'" the court concluded, "it was required to qualify that representation with known information undermining (or seemingly undermining) the claim." Id. at 673 (citation omitted).

The Sixth Circuit also addressed the claims of material misstatements in financial statements included in Bridgestone's annual reports for fiscal years 1996-1999. The Sixth Circuit agreed with the district court that the claims concerning the financial statements from fiscal years 1996-1998 were not actionable, but also found that statements regarding Bridgestone's financial statements from fiscal year 1999 were actionable, and thus, the district court erred in dismissing them. Id. at 676-77. The Sixth Circuit highlighted two statements that a reasonable juror might conclude were material misrepresentations: (1) that "no impairment of Bridgestone's corporate assets was substantially certain to occur through problems arising from customers or regulators' actions"; and (2) that "there were no actual, material losses connected to the lawsuits and responses to the regulatory scrutiny of the ATX tires." Id. at 677.

In In re United Am. Healthcare Corp. Sec. Litig., 2007 WL 313491 (E.D. Mich. Jan. 30, 2007), the plaintiffs, purchasers of securities issued by United American Healthcare Corp. ("UAHC"), brought a class action against UAHC and certain of its directors and officers, alleging that the defendants made misleading statements and omissions in violation of Section 10(b) of the Exchange Act and Rule 10b-5. The plaintiffs claimed that the defendants violated Rule 10b-5 by failing to disclose that the company had materially breached an agreement and were at risk of losing significant revenue as a result. Id. at *1.

The district court noted that "'[b]efore liability for non-disclosure can attach, the defendant must have violated an affirmative duty of disclosure.'" Id. at *6 (quoting Murphy v. Sofamor Danek Grp., Inc., 123 F.3d 394, 400 (6th Cir. 1997)). The district court stated that such a duty of disclosure "arises if '(1) created by SEC statute or rule; (2) there is insider trading; or (3) there was a prior statement of material fact that is false, inaccurate, incomplete or misleading in light of the undisclosed information.'" Id. (quoting In re Ford Motor Co., Sec. Litig., 184 F. Supp. 2d 626, 631-32 (E.D. Mich. 2001), aff'd, 381 F.3d 563 (6th Cir. 2004)). The plaintiffs argued that because defendants made prior statements about the agreement, they had an independent duty to fully disclose the risk that the contract may be terminated and the possible consequences to avoid misleading investors. However, the district court held that the defendants' prior statements about the agreement did not give rise to a duty to disclose because they were "merely accurate reports of historical fact that are not contradicted . . . . [N]o further disclosure is necessary to prevent them from becoming misleading under the circumstances." Id. at *10.

Further, the district court also held that the defendants did not have a duty to disclose "soft" information concerning the alleged breach of the agreement. The district court noted Sixth Circuit precedent holding that soft information must be disclosed only if it is as virtually as certain as hard facts, but found that the plaintiffs failed to allege facts demonstrating that the company had breached the agreement or that a breach of the agreement was "virtually as certain as hard facts." Id. at *13. The district court further noted that the determination as to whether a breach had occurred, and any penalties imposed therefore, was entirely at the discretion of the state of Tennessee, and as such, the company had no duty to accuse itself of wrongdoing or speculate as to the consequences of the alleged breach. Id.

The Eighth Circuit

In Minneapolis Firefighters' Relief Ass'n v. MEMC Elec. Materials, Inc., 641 F.3d 1023, 1027 (8th Cir. 2011), the lead plaintiff appealed the district court's dismissal of the plaintiff's Rule 10b-5 claim for failure to plead a material omission.

The lead plaintiff, a shareholder in a consolidated class action suit, brought claims against MEMC Electronic Materials, Inc. ("MEMC"), a silicon-wafer manufacturer, for violations of Section 10(b) and Rule 10b-5. Id. at 1025. Over the course of nearly a year, MEMC had repeatedly filed 8-K forms disclosing interruptions in its production at or near the time of the relevant incidents causing the disruption. However on one occasion, MEMC disclosed an interruption approximately six weeks after the disruption. Id. at 1025-26. The plaintiff claimed that the defendant's repeated disclosures created a duty to continue disclosing disruptions in production as they occurred. Id. at 1028. The Eighth Circuit disagreed, affirming the district court's dismissal and noting that acceptance of such an argument "could encourage companies to disclose as little as possible." Id. at 1029.

The Ninth Circuit

In In re Cutera Sec. Litig., 610 F.3d 1103 (9th Cir. 2010), plaintiffs brought a Section 10(b) claim alleging that Cutera failed to adequately disclose the poor performance of its junior sales force, and that the non-disclosure of this material information led to inflation in the company's stock price and misled investors. Plaintiffs claimed that when information regarding the poor performance of the junior sales force was eventually disclosed, the company's earnings estimate decreased and its shares lost value. Id. at 1107.

The Ninth Circuit affirmed the district court's decision to dismiss the complaint for failure to plead the materiality of Cutera's disclosures regarding its sales force. The Ninth Circuit observed that under the PSLRA investors must (1) specify each allegedly misleading statement or omission, (2) explain why the statement or omission is misleading, and (3) state with particularity all facts on which that belief is formed. Id. at 1109. In addition, the Ninth Circuit noted that Rule 10b-5 only prohibits misleading and untrue statements, not incomplete statements, though it does consider a statement misleading when the statement would give a reasonable investor an impression of a state of affairs that differs in a material way from the one that actually exists. Id. (citing Brody v. Transitional Hosps. Corp., 280 F.3d 997, 1006 (9th Cir. 2002) and Berson v. Applied Signal Tech., Inc., 527 F.3d 982, 985 (9th Cir. 2008)).

The Ninth Circuit conceded that the plaintiffs established a factual basis for the weakness of Cutera's sales force in January 31, 2007 by the testimony of a confidential witness who informed the court that the company was firing its junior sales force, in contrast with a statement made in Cutera's 2006 Form 10-K that the company believed its "employee relations are good." Id. at 1111. However, the Ninth Circuit held statements such as these were "non-actionable puffery." Id.; see also In re Syntex Corp. Sec. Litig., 855 F. Supp. 1086, 1095 (N.D. Cal. 1994), aff'd, 95 F.3d 922 (9th Cir. 1996) (holding as non-actionable puffery the phrases: "we're doing well and I think we have a great future"; "business will be good this year . . . we expect the second half of fiscal 1992 to be stronger than the first half, and the latter part of the second half to be stronger than the first . . . ."; "everything is clicking [for the 1990s] . . . new products are coming in a wave, not in a trickle . . . old products are doing very well"; and "I am optimistic about Syntex's performance during this decade"). As a result, the Ninth Circuit affirmed the district court's dismissal for failure to adequately plead materiality. Id.

In Livid Holdings Ltd. v. Salomon Smith Barney, Inc., 416 F.3d 940 (9th Cir. 2005), the plaintiffs appealed the district court's decision dismissing its complaint with prejudice for failure to state a claim. The district court found that the plaintiffs failed to adequately plead that the notice statement that they relied upon to buy stock in Purely Cotton, Inc. ("PCI") was a material misrepresentation. Id. at 945. The district court also found that the plaintiffs' complaint did not meet the PSLRA's pleading standards for scienter. The Ninth Circuit reversed, holding that the district court erred in concluding that the contested statement was immaterial and that the plaintiffs did not adequately plead scienter. Id. at 949, 951.

The plaintiffs' claims arose from a $10 million purchase of PCI stock in December 1999. Id. at 944. In January 1999, Schroders & Co. helped PCI arrange a private placement of $25 million of its stock by creating a confidential offering memorandum (the "Memorandum"). Id. at 944. The plaintiffs alleged that a third-party company, UAE, agreed to buy 98% of the offering and directors and/or officers of Schroders agreed to buy the remaining 2%. Id. at 945. In September 1999, PCI asked Schroders for more copies of the Memorandum and the Schroders director in charge of the offering attached a notice to the Memorandum stating in relevant part that "[t]his document has not been updated or amended to reflect any events that have occurred since January 1999. As such, it does not reflect the fact that the above-mentioned $25 million private equity fund raising has been completed." Id. (emphasis omitted). The plaintiffs contended that the notice "implie[d] that the proceeds of the initial $25 million sale had been received by PCI, but that the Memorandum had not yet been updated to reflect this additional capital." Id. At the time the notice was written, UAE and defendants had paid PCI less than $2 million. Id.

The plaintiffs also alleged "that additional payments on UAE's balance were conditional on UAE's approval of a PCI business plan and a new [CEO]," and that the defendant directors and/or officers were subject to the same payment arrangement. Id. Therefore, the plaintiffs claimed, Schroders knew the offering was incomplete when the notice was attached to the Memorandum. Id.

The Ninth Circuit concluded that the plaintiffs "sufficiently pled materiality by raising a substantial likelihood that a reasonable investor would not have purchased $10 million worth of PCI stock after learning that the company had $25 million less in cash than [the investor] was led to believe." Id. at 946-47.

The Tenth Circuit

In Andropolis v. Red Robin Gourmet Burgers, Inc., 505 F. Supp. 2d 662 (D. Colo. 2007), the City of Philadelphia Board of Pensions and Retirement, the lead plaintiff in the consolidated class action, brought claims under Section 10(b) of the Exchange Act and Rule 10b-5 against a company and its senior officers for allegedly materially false and misleading statements or omissions. The lead plaintiffs' allegations included the failure to disclose information relating to personnel changes within the company allegedly as a result of an internal investigation into various violations of company policies. Id. at 681. The plaintiff also alleged that the company failed to disclose the reasons for the prior CFO's departure, as well as the fact that the company had terminated its controller, both of which would have revealed violations of the company's travel expense policies. Id. at 687.

The district court found that both alleged omissions were immaterial and did not support a cause of action. Id. at 688. First, the district court held that "[a]bsent an allegation of a [sic] some known and markedly significant wrongdoing by [the former

CFO] that led to his replacement," it could not find that the fact that some undocumented travel expenses occurred under his watch would be "'important' to a 'reasonable investor' in her decision of whether to buy or sell [the company's] stock." Id. at 687. Regarding the second alleged omission, the district court held that the plaintiff failed to allege sufficient facts to support a finding that it was material. Id. at 688. Rather than allege that the controller was terminated based on the company's knowledge of significant failures for which he was responsible, the plaintiff assumed that the controller was involved in violations of company policies because the company's internal investigation occurred contemporaneously with his termination. Id. at 687. Thus, the district court stated it had no basis to conclude that, had the company disclosed the reasons for the controller's termination, a "reasonable investor" would have considered this disclosure important in her decision of whether to buy or sell the company's stock. Id. at 688.

The Eleventh Circuit

In FindWhat Investor Grp. v. FindWhat.com, 658 F.3d 1282 (11th Cir. 2011), the plaintiffs brought a class action for violation of Section 10(b) of the Exchange Act and Rule 10b-5 against an internet commerce company that offered "pay-per-click" online advertising services. Advertisers pay for such services only when a user "clicks" on an online advertisement, and the revenue is split between the internet commerce company and the websites on which the advertisement was displayed, or the "distribution partners." Id. at 1291. The plaintiffs alleged that the defendants, the internet commerce company and three of its principal officers, committed securities fraud by making several materially false and misleading statements and omissions that inflated the price of the defendant company's stock. Id. at 1291-94. The plaintiffs alleged that they were damaged when the company's stock price dropped after the defendants revealed that the company's revenue was based in part on the "click fraud" of its distributors, i.e., clicking on an online advertisement for the sole purpose of forcing the advertiser to pay for the click. Id. at 1291.

The Eleventh Circuit affirmed the district court's dismissal, holding that the misstatements were not materially false or misleading. Id. at 1306. The plaintiffs alleged that the defendant chief operating officer held a public conference call and made a misleading statement that the company's revenue had been increasing, which was factually accurate, without also mentioning that the revenue stream included proceeds from the illicit click fraud. Id. at 1304-05. The Eleventh Circuit noted that a statement is only misleading if it would have misled a reasonable investor exercising due care in light of all the facts existing at the time the statement was made. Id. at 1305. The Eleventh Circuit ruled that the statement was not misleading because "[n]o reasonable investor would believe that a conclusory, but apparently accurate, report of company-wide revenue growth naturally implied that all was well within every component of the company that could possibly affect revenue in the future." Id. at 1306.

In Phila. Fin. Mgmt. of San Francisco, LLC v. DJSP Enter., Inc., 2011 WL 4591541 (S.D. Fla. Sept. 30, 2011), the district court granted the defendants' motion to dismiss the plaintiffs' putative class action for violations of Sections 10(b) and 20(a) of the

Exchange Act and Rule 10b-5. The defendants included DJSP Enterprises, Inc. ("DJSP"), a publicly traded company that provided processing services for residential mortgage foreclosures and related matters, and two officers. Id. at *2. The plaintiffs, investors in DJSP, alleged that the defendants made numerous material misrepresentations regarding their business operations and financial prospects, which harmed them when DJSP's stock value dramatically declined. Id. at *7.

The district court held that the defendants' statements about their business practices—i.e., that DJSP employed "rigorous" processes to ensure the "efficient" and "accurate" handling of foreclosures—were not material, but were merely non-actionable puffery. Id. at *17. The statements referred primarily to DJSP's use of technology to streamline foreclosure processing, as well as to the DJSP's hiring and training of its employees. Id. The district court concluded that these terms did not "assert specific, verifiable facts that reasonable investors would rely on in deciding whether to buy or sell DJSP's securities." Id. at *14. Further, the district court noted that the plaintiffs failed to allege that DJSP did not use its technological processes to improve efficiency and accuracy in processing foreclosures. Id. Accordingly, the district court held that the plaintiffs failed to adequately plead that DJSP made materially false or misleading statements about the company's business practices. Id. at *18.

In In re HomeBanc Corp. Sec. Litig., 706 F. Supp. 2d 1336 (N.D. Ga. 2010), the district court granted the defendants' motion to dismiss the plaintiffs' putative class action for violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The plaintiffs, investors in HomeBanc Corporation ("HomeBanc"), a real estate investment trust in the business of investing in and originating residential mortgage loans, alleged that the defendants, officers of HomeBanc, omitted facts and made numerous false and misleading statements regarding HomeBanc's lending practices that artificially inflated its stock value and damaged the plaintiffs when HomeBanc filed for bankruptcy. Id. at 1341-42.

The district court held that, to the extent the defendants were not shielded by the PSLRA's safe harbor provision for their forward-looking statements, the defendants' statements were not materially misleading because all of the statements at issue were followed the next day by an opening stock price that was lower than the prior day's closing price. Id. at 1353. Although the district court acknowledged that the defendants failed to cite any cases holding that the alleged false statements must cause an increase in the issuer's stock price in order to be actionable, the district court reasoned that "logic would suggest that such a factor is relevant" to the materiality analysis. Id. In addition, the district court rejected the plaintiffs' conclusory allegations of falsity which, without establishing any contrary true facts, also undercut their claims that the defendants made material misstatements and omissions and further rendered their claim non-actionable. Id.

In Waterford Twp. Gen. Emps. Ret. Sys. v. BankUnited Fin. Corp., 2010 WL 1332574 (S.D. Fla. Mar. 30, 2010), the district court granted the defendants' motion to dismiss the plaintiffs' putative class action for violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The lead plaintiffs, purchasers of common stock of BankUnited Financial Corporation ("BankUnited"), alleged that the defendants, three senior executive officers of BankUnited, and its primary subsidiary, BankUnited FSB, made numerous false and misleading representations to conceal unsound lending practices. Id. at *1. Specifically, the plaintiffs alleged that BankUnited relied on limited or no documentation loans, made an aggressive push to increase the volume of risky option adjustable rate mortgage loans, failed to adequately reserve for probable loan losses, and asserted pressure to approve overstated appraisals. Id. at *11. The bank was eventually closed by the Office of Thrift Supervision and the Federal Deposit Insurance Corporation was appointed as receiver. Id. at *5.

The district court held that numerous alleged misrepresentations were not actionable because they were general, vague, and unverifiable statements, and thus were not material. Id. at *8. The district court likewise held the defendants' description of BankUnited's "underwriting, appraisal, and credit standards as 'strict,' 'stringent,' 'conservative,' and 'strong'" immaterial because "these commonplace statements of corporate puffery could not influence a reasonable investor's investment decision." Id. (citations omitted). In addition, the district court concluded that the plaintiffs failed to adequately plead the falsity of the defendants' statements regarding BankUnited's underwriting practices. Id. at *11-13. Although the plaintiffs alleged that the OTS in conjunction with a cease and desist order concluded that BankUnited's lending practices were "unsafe and unsound," the district court held that the plaintiffs failed to allege that any of the defendants' statements regarding their particular lending practices were misleading or false. Id. at *5, *13. The district court further ruled that the plaintiffs failed to adequately allege that they were misled, or that the defendants fraudulently omitted any material facts in the defendants' statements regarding BankUnited's practice of underwriting mortgage loans on a less than fully documented basis. Id. at *13-14.

Falsity Distinguished

The cases discussed thus far in this Chapter have addressed the question of *materiality*, i.e., whether the magnitude of a false or misleading statement is so great that it would significantly alter the "total mix" of information on which a reasonable individual would base his or her decision to invest. See Matrixx, 131 S. Ct. at 1318 (quoting TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)). In contrast, the cases below focus on the issue of *falsity*, i.e., whether the challenged statement, regardless of magnitude, was untrue or misleading in the first place. Although courts frequently collapse these two issues into an analysis of whether a plaintiff made "materially misleading statements," the two concepts are distinct—and equally necessary to support a 10b-5 claim grounded in affirmative misstatements.

It is worth noting, however, that where a claim is based primarily on *omissions*, courts will not require a plaintiff to establish the falsity of the omitted statements; rather, "[a]ll that is necessary is that the facts withheld be material." Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128, 153-54 (1972). This makes intuitive sense, since it is nonsensical to assert liability for failure to disclose a false statement.

The Second Circuit

In Fait v. Regions Fin. Corp., 655 F.3d 105 (2d Cir. 2011), the plaintiff sued Regions Financial Corporation ("Regions"), Regions Financing Trust III (the "Trust"), individual defendants, including members of Regions' board of directors, and Regions' independent public accountant Ernst & Young ("E&Y") under Sections 11(a), 12(a)(2) and 15 of the Securities Act. Id. at 107-09. The plaintiff claimed, inter alia, that the registration statement and prospectus (the "Offering Documents") for a 2008 registered public offering of Trust securities, which incorporated Regions' 2007 10-K, contained false and misleading statements because "Regions failed to write down 'goodwill' and to sufficiently increase 'loan loss reserves'" despite Regions' acquisition of another bank holding company and adverse trends in the housing market. Id. at 108. The defendants moved to dismiss the complaint. The district court granted the motion, concluding that the defendants' statements regarding goodwill and the adequacy of loan loss reserves were non-actionable matters of judgment and opinion. Id. Reviewing the district court's dismissal de novo, the Second Circuit affirmed. Id. at 109.

The Second Circuit considered whether the defendants' statements regarding "goodwill" and the adequacy of its "loan loss reserves" in its Offering Documents constituted "an untrue statement of a material fact" or an omission necessary for liability under Sections 11 and 12(a)(2) of the Securities Act. Id. The Second Circuit affirmed the district court's determination that "[e]stimates of goodwill" and the "adequacy of loan loss reserves" depend on "management's opinion or judgment" and "are not matters of objective fact." Id. at 110, 113. The Second Circuit applied the Supreme Court's standard articulated in Virginia Bankshares for discerning a defendant's liability for statements of opinion and belief: "although not statements of facts in and of themselves . . . such statements may be actionable if they misstate the opinions or belief held, or, in the case of statements of reasons, the actual motivation for the speaker's actions, *and* are false or misleading with respect to the underlying subject matter they address." Id. at 111 (citing Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1091-96 (1991)).

The Second Circuit noted that the plaintiff "relie[d] mainly on allegations about adverse market conditions" to support its claim that the defendants overstated goodwill in the Offering Documents and the plaintiff failed "to point to an objective standard for setting loan loss reserves" in contesting the adequacy of those reported by the defendants. Id. at 112-13. In addition, the Second Circuit held that the plaintiff failed to "plausibly allege that the defendants did not believe the statements regarding goodwill [and loan loss reserves] at the time they made them." Id. at 112. The Second Circuit held that because the plaintiff failed to allege that the defendants' opinions "were both false and not honestly believed when they were made," the plaintiff failed to allege material misstatements or omissions under Sections 11 and 12 of the Securities Act. Id. at 112-13.

In In re Sturm, Ruger & Co. Sec. Litig., 2011 WL 494753 (D. Conn. Feb. 7, 2011), investor plaintiffs brought an action against defendant company Sturm Ruger ("Sturm") alleging violations of Section 10(b) of the Exchange Act and Rule 10b-5. Sturm, a company with declining profits, hired a new CEO who sought to transition to a new manufacturing model. Although share prices rose at first, third quarter sales fell sharply because the company announced that it had reduced its inventories of component parts "too deeply." Id. The district court denied defendant's motion to dismiss. Id. at *2.

The defendant argued that several of the misstatements alleged were not actionable because they were accurate statements of historical fact. Id. at *6. However, rather than claiming that these statements were entirely inaccurate, the plaintiffs argued that additional information should have been disclosed in order to put the figures provided into context. Id. The district court recognized that statements may be viewed as misleading without being technically false when they omit material facts, reiterating that "'[t]he veracity of a statement or omission is measured not by its literal truth, but by its ability to accurately inform rather than mislead prospective buyers.'" Id. (citing In re MBIA, Inc. Sec. Litig., 700 F. Supp. 2d 566, 578 (S.D.N.Y. 2010) and quoting Operating Local 649 Annuity Trust Fund v. Smith Barney Fund Mgmt. LLC, 595 F.3d 86 (2d Cir. 2010)). The district court thus held that several of the statements in question were misleading, and defendant's motion to dismiss was denied. Id. at *6, *9.

The Ninth Circuit

In Reese v. BP Exploration (Alaska) Inc., 643 F.3d 681 (9th Cir. 2011), the plaintiffs, investors in BP Exploration (Alaska), Inc. ("BPXA") and its parent company BP p.l.c., brought a class action suit in the district court for the Western District of Washington, alleging violations of Rule 10b-5. Id. at 683-84. Specifically, the plaintiffs alleged that "BPXA made false and misleading statements through the public SEC filings of the BP Prudhoe Bay Royalty Trust (the 'Trust')." Id. at 685. BPXA established the Trust with the Standard Oil Company ("Standard Oil") "for the purpose of distributing a [r]oyalty [i]nterest derived from oil production at Prudhoe Bay[, Alaska] to purchasers of [t]rust units, which [were] traded on the New York Stock Exchange." Id. Pursuant to the trust agreement governing the Trust (the "Trust Agreement"), BPXA was responsible for all filings on behalf of the Trust to the SEC. Id. BPXA and Standard Oil also entered into a private contract agreement (the "Standard Oil Agreement") in which BPXA prospectively contracted to operate Prudhoe Bay according to a "Prudent Operator Standard." Id. at 685-86. In its SEC filings, the Trust attached the Trust Agreement and the Standard Oil Agreement. Id. at 686.

Following the discovery of an oil-pipeline leak in Prudhoe Bay, BPXA temporarily shut down its pipelines and oil production, which plaintiffs allege caused a decline in BP p.l.c.'s stock price. Id. at 684-85. The plaintiffs argued that the Trust Agreement established that the Trust's SEC filings were statements by BPXA and that the repeated filing of the Standard Oil Agreement "represented to the public that BPXA was maintaining its contractual obligations to operate in accordance with the Prudent Operator Standard." Id. at 686. The defendants moved to dismiss, which the district court denied in relevant part. Id.

On appeal, the plaintiffs argued that: (1) BPXA's statement of future compliance with the Prudent Operating Standard was transformed into a false statement of current and ongoing compliance due to its repeated filing by the Trust with the SEC; and (2) "that BPXA had a duty to correct the false impression by disclosing that it was not in compliance with the Prudent Operating Standard." Id. at 691. The Ninth Circuit rejected the plaintiffs' arguments and found that a forward-looking promise in a private contract does not constitute a misrepresentation in a fraud action, both as a general matter and under the PSLRA. Id. The Ninth Circuit continued, noting that "to be actionable, a statement or omission must have been misleading at the time it was made; liability cannot be imposed on the basis of subsequent events." Id. at 693 (quoting In re NAHC, Inc. Sec. Litig., 306 F.3d 1314, 1330 (3d Cir. 2002)). The Ninth Circuit concluded by holding that "the public filing of a contract containing a promise of future compliance did not, upon the contract's breach at a time after execution, provide an actionable misrepresentation for the purposes of a private damages action for securities fraud." Id. at 693-94.

In Philco Invs., Ltd. v. Martin, 2011 WL 500694 (N.D. Cal. Feb. 9, 2011), the plaintiffs brought a claim under Section 10(b) of the Exchange Act alleging that defendants Elan Corporation and select directors and officers, including Messrs. Martin and Cooke, misled investors in its public statements regarding Tysabri, a multiple sclerosis drug it was developing. On July 30 and 31, 2008, the defendants revealed that Tysabri was not safe, causing (in conjunction with additional news regarding another drug) a large fall in the stock price of defendant Elan Corporation. Id. at *1. Tysabri had previously been removed from the market in 2005 after two patients taking the drug died of the rare neurological disorder PML, although after a safety evaluation the FDA approved its reintroduction to the market. Id. at *3. On June 11, 2008, defendant Martin made public statements on behalf of the company regarding added sales and profits in connection with Tysabri. On July 24, 2008, defendant Cooke, acting on behalf of the company, reported that, "neurologists and their MS patients were confident that Tysabri was safe when used on its own" and specifically mentioned that "there were no additional confirmed cases of PML" despite the fact that at some point prior to this date, twelve suspected cases of PML had been privately reported to the FDA. Id. at *4. Six days later, Elan reported that there were two new cases of PML that were "confirmed to [them] very recently." Id.

The district court held that none of the statements made by Elan regarding Tysabri met the Section 10(b) falsity requirement. Although Elan was aware of suspected cases, these were not the same as confirmed cases. Id. at *5. In addition, the Plaintiffs did not identify the amount of patients taking Tysabri which, for the district court, cast doubt as to whether or not twelve suspected cases was medically or statistically significant. Id. The district court also observed that the complaint made no indication as to the likelihood that a suspected PML case would result in a confirmed case. Id. Finally, the district court noted that the plaintiffs made no connection between the twelve suspected cases known before July 24, 2008 and the confirmed cases announced on July 30 and 31, 2008. Id. In the absence of sufficiently particularized facts, the district court held that the plaintiffs failed to allege falsity. Id.

In In re Rigel Pharm., Inc. Sec. Litig., 2010 WL 8816155 (N.D. Cal. Aug. 24, 2010), plaintiffs brought an action under Section 10(b) alleging that defendants made material misrepresentations when they disclosed clinical trial results for R788, a drug developed by Rigel to treat rheumatoid arthritis. The alleged misrepresentations were disclosed in a press release, press conference, a Form 424B5 Prospectus, and other public statements made on behalf of the corporation. The plaintiffs alleged false statements by the defendants in connection with their reporting of allegedly false results from drug trials and the use of misleading terms of art such as "moderate" or "greater" in a misleading fashion that resulted in an interpretation that there were no lesser undisclosed side effects from the use of the drug. Id. at *11.

The district court dismissed the Section 10(b) claim for failure to plead that the defendants had made a false or misleading statement. In response to plaintiffs' contention that Rigel reported statistically improper results, the district court held that "disagreements over study design and statistical analysis are insufficient to allege a materially false statement." Id. As to plaintiffs' claim that the terms "moderate" or "greater" were terms of art, the district court disagreed, holding that "by labeling the disclosed side effects as those of moderate severity, it would have been clear to reasonable investors, as well as the general public, that there may have also been side effects of lesser severity that had not yet been disclosed. Moderate severity or greater are not technical terms of art." Id. at *12.

In In re REMEC Inc. Sec. Litig., 702 F. Supp. 2d 1202 (S.D. Cal. 2010), investor plaintiffs brought a class action based on Section 10(b) of the Exchange Act and Rule 10b-5 against defendant corporation ("REMEC"), its CEO, and its CFO, accusing defendants of materially overstating their financial results by failing to disclose substantial losses related to goodwill impairment. Id. at 1213. The defendants moved for summary judgment.

The district court noted that projections and expressions of optimism may be actionable under 10(b) in the Ninth Circuit when one of three assertions are deemed inaccurate: that (1) the statement is believed, (2) there is basis for belief, or (3) the speaker is not aware of information that would tend to undermine the statement in question's accuracy. Id. at 1228 (citing In re Apple Computer Sec. Litig., 886 F.2d 1109, 1113 (9th Cir. 1989) and Hanon v. Dataproducts Corp., 976 F.2d 497, 501 (9th Cir. 1992)). The district court noted that the Ninth Circuit had generally held that misleading opinions must be objectively and subjectively false or misleading in order to be actionable under the federal securities laws. Id. at 1229 (citing Rubke v. Capitol Bancorp, Ltd., 551 F.3d 1156, 1162 (9th Cir. 2009)). The statement in question referred to defendants' assertion that REMEC would likely achieve its goal of returning to profitability partially as a result of a recent acquisition. Id. at 1230. Although defendants contended that these statements contained the type of "soft information" predicting the future that is not actionable as a matter of law, the district court determined that the record contains forecasts that cast doubt on the CEO's optimism. Id. at 1229-30. "The interpretation of the financial forecasts may be open to debate," the district court stated, "but Plaintiffs present evidence that REMEC had internally forecast large losses just three days before [the CEO] predicted the company would show a profit at the end of FY04." Id. at 1230-31. Thus, the district court denied defendants' motion for summary judgment with respect to the issue as to whether the statement in question was false or misleading. Id. at 1229.

The Eleventh Circuit

In In re BankAtlantic Bancorp, Inc. Sec. Litig., 2010 WL 6397500 (S.D. Fla. Aug. 18, 2010), the district court granted in part and denied in part the defendants' motion for summary judgment, and granted the plaintiffs' motion for partial summary judgment. The plaintiffs, a class of investors in BankAtlantic Bancorp, Inc. ("BankAtlantic"), the publicly traded parent company of a federally chartered bank, alleged that BankAtlantic and its insiders and directors violated Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Id. at *1-2. The defendants allegedly misrepresented and concealed the true value of the company's "land loans" that were made for the acquisition and development of land for residential building. Id. at *1. The plaintiffs alleged that the truth about BankAtlantic's lending practices—that it made misleading statements about the credit quality of certain land loans and failed to follow conservative lending practices, that it failed to timely disclose that the credit quality of the land loan portfolio had deteriorated, and that it misrepresented that its reserves for loan losses were adequate—was revealed in April and October of 2007 and caused the stock price to decline. Id. at *2.

The plaintiffs sought partial summary judgment with respect to the falsity of several statements made by the defendant executive during a conference call allegedly misrepresenting: (1) that the defendants were concerned about the performance of only a portion of the residential land loan portfolio, the builder land bank loans ("BLB")—which were extended to investors who used loan proceeds to purchase land for infrastructure development and sale, rather than the entire residential land loan portfolio, and which also included loans for land acquisition, development, and construction; and (2) that the non-BLB land loan portfolio had always performed well and continued to perform well despite the fact that the entire land loan portfolio had deteriorated significantly. Id. at *29. The district court granted partial summary judgment for the plaintiffs on the issue of falsity. Id. at *31. The district court concluded that there was no genuine issue of material fact as to whether the defendant's statements were false at the time they were made because the evidence showed the defendants were concerned with the performance of the entire land loan portfolio, and that the portion of the portfolio discussed by the defendant in a positive light had not performed well. Id. at *30-31.

The PSLRA's Safe Harbor For Forward Looking Statements

The PSLRA provides a safe harbor from liability for certain "forward-looking" statements. Under the PSLRA, a person "shall not be liable with respect to any forward-looking statement . . . to the extent that" the statement is:

1. identified as a forward-looking statement, and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement; or
2. immaterial; or
3. plaintiff fails to prove that the statement was made with actual knowledge that it was false or misleading.

See 15 U.S.C. § 78u-5(c)(1). The PSLRA defines the term "forward looking statement" to mean:

a. a statement containing a projection of revenues, income (including income loss), earnings (including earnings loss) per share, capital expenditures, dividends, capital structure, or other financial items;

b. a statement of the plans and objectives of management for future operations, including plans or objectives relating to products and services of the issuer;

c. a statement of future economic performance, including any such statement contained in a discussion and analysis of financial condition by the management or in the results of operations included pursuant to the rules and regulations of the Commission;

d. any statement of the assumptions underlying or relating to any statement described in subparagraph (A), (B), or (C);

e. any report issued by an outside reviewer retained by an issuer, to the extent that the report assesses a forward-looking statement made by the issuer; or

f. a statement containing a projection or estimate of such other items as may be specified by rule or regulation of the Commission.

15 U.S.C. § 78u-5(i)(1).

Projections "are a classic forward-looking statement under the PSLRA's Safe Harbor provision." Inst'l Investors Grp. v. Avaya, Inc., 564 F.3d 242, 273-74 (3d Cir. 2009). Pursuant to the safe harbor provision, a corporation may avoid liability for a forward-looking statement that later proves false if the statement is "accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement." 15 U.S.C. 78u-5(c)(1)(A)(i); see, e.g., In re Cutera Sec. Litig., 610 F.3d 1103, 1111 (9th Cir. 2010) (finding forward-looking revenue statements accompanied by sufficient cautionary language to invoke safe harbor, since the defendant corporation's alleged misstatements were directly addressed by accompanying cautionary language).

However, even if the forward-looking statement has no accompanying cautionary language, "[t]he safe harbor is written in the disjunctive; that is, a defendant is not liable if the forward-looking statement is identified and accompanied by meaningful cautionary language *or* is immaterial *or* the plaintiff fails to prove that it was made with actual knowledge that it was false or misleading." Slayton v. Am. Express Co., 604 F.3d 758, 766 (2d Cir. 2010). A plaintiff must prove that the defendant made the statement with actual knowledge that it was false and misleading. See 15 U.S.C. 78u-5(c)(1)(B); see also Slayton v. Am. Express Co., 604 F.3d at 758, 773 (2d Cir. 2010) ("because the safe harbor specifies an 'actual knowledge' standard for forward-looking statements, 'the scienter requirement for forward-looking statements is stricter than for statements of current fact. Whereas liability for the latter requires a showing of either knowing falsity or recklessness, liability for the former attaches only upon proof of knowing falsity.'") (quoting Avaya, 564 F.3d at 274).

The Second Circuit

In Slayton v. Am. Express Co., 604 F.3d 758 (2d Cir. 2010), plaintiff investors appealed the district court's dismissal of claims alleging violations of Sections 10(b) and 20(a) of the Exchange Act against defendants, the American Express Company and several of its directors and officers. In its first quarter 2001 Form 10-Q, American Express disclosed losses related to investments in high-yield debt securities, mentioning that these losses would likely be significantly lower for the remainder of the fiscal year but that the projections were "'subject to risks and uncertainties'" and factors could "'cause actual results to differ materially from these forward-looking statements.'" Id. at 764. In July of 2001, American Express later announced that its high-yield debt portfolio had suffered significant losses—requiring the Second Circuit to consider whether cautionary language published in the 10-Q's management discussion and analysis ("MD&A") section should be excluded from safe harbor protection. Id. Reasoning that "Congress understood financial statements and MD&As to be distinct," the Second Circuit ultimately determined that the statements in question should not be excluded from the PSLRA's safe harbor provision. Id. at 767.

Despite rejecting the contention that forward-looking statements must be specifically labeled as such, the Second Circuit determined that the cautionary language in question was too vague to protect the statements under the PSLRA's safe harbor provision because the same statements had been used in the defendant corporation's previous 10-Q filings and "verge[d] on the mere boilerplate." Id. at 771-72. However, in considering whether the statements were made with actual knowledge that they were false or misleading, the Second Circuit determined that the weighing-of-inference analysis articulated by Tellabs (which asks whether "'*all* of the facts alleged, taken collectively, give rise to a strong inference of scienter'") was applicable. Id. at 774 (quoting Tellabs, 551 U.S. at 322-23). Conducting this analysis, the Second Circuit determined that the non-culpable inference that the defendants "did not know the extent of the deterioration" in the relevant securities and "subjectively believed that the extent of the deterioration would lead to losses . . . substantially less than [experienced]" was more likely than any inference of scienter. Id. at 776.

In Gissin v. Endres, 739 F. Supp. 2d 488 (S.D.N.Y. 2010), the putative class action plaintiffs brought claims against senior executives and directors of VeraSun Energy Corp. ("VeraSun"), a bankrupt ethanol producer, alleging that the defendants made false and misleading statements about VeraSun's pricing and hedging practices from March 12, 2008 to September 16, 2008, in violation of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Specifically, the plaintiffs contended that during the class period the defendants were aware that VeraSun was suffering massive liquidity problems but nonetheless publicly stated that VeraSun had sufficient cash to meet its financial obligations. Id. at 499. The district court granted the defendants' motion to dismiss, finding that any alleged misstatements were protected by the PSLRA's safe harbor for forward-looking statements and, in any event, plaintiffs failed to adequately plead scienter.

The plaintiffs argued that the defendants could not avail themselves of the PSLRA's safe harbor provision because the defendants' public statements contained false assurances about VeraSun's present liquidity. Id. at 505. The district court disagreed, finding that public statements such as "'[b]ased on our *current* expectation of cash flows from operations . . . we feel we will be in a position to fund those capital investments for the year[,]'" did not make guarantees about the present but merely conveyed defendants' "educated guess about what the preceding quarter's financial data would mean for the Company's future." Id. at 506-07. Moreover, the defendants couched their predictive statements with cautionary language, warning investors about VeraSun's high level of debt, the uncertainty of cash flows from future operations, and the general risks VeraSun faced as it relied on uncertain commodity prices. Id. at 511. The district court reasoned that "[w]hen the statements at issue are read together with the cautionary language, there is no plausible indication that 'a reasonable investor could have been misled . . . .'" Id. at 510 (quoting In re Sierra Wireless, Inc. Sec. Litig., 482 F. Supp. 2d 365, 380 (S.D.N.Y. 2007)).

In Sgalambo v. McKenzie, 739 F. Supp. 2d 453 (S.D.N.Y. 2010), the lead plaintiff in a putative class action brought securities fraud claims against five former officers of Canadian Superior Energy Inc. ("Canadian Superior"), a company engaged in the acquisition and production of petroleum and natural gas. In February 2009, Canadian Superior's common stock, which traded on the American Stock Exchange, fell after the company announced that its interest in a joint venture drilling project was appointed to an interim receiver and that repayment had been demanded on its forty-five million dollar credit facility. Id. at 467. On March 6, 2009, Canadian Superior filed for bankruptcy protection under Canada's bankruptcy laws. Id. The lead plaintiff alleged that between January 14, 2008 and February 17, 2009 the defendants issued over twenty materially false and misleading statements, reporting positive test results of drilling projects, when in fact, the natural gas wells discovered were "sub-economic," failing to disclose that Canadian Superior was in violation of its joint venture agreement and would be unable to meet its joint venture obligations. Id. at 467-69.

The district court held that the defendants could not avail themselves of the PSLRA's safe harbor provision for forward-looking statements because "all statements in which [t]he [defendants] report being 'encouraged by' or 'pleased with' some aspect of the Joint Venture's progress are statements of [t]he [defendants'] present views." Id. at 478. Moreover, "[s]tatements reporting test results from the wells and predicting future well performance based on those results incorporate forward-looking aspects into statements of present fact." Id. As a result, the district court found, the PSLRA's safe harbor provision did not apply.

The Third Circuit

In In re Aetna, Inc. Sec. Litig., 617 F.3d 272 (3d Cir. 2010), investors brought a class action against Aetna, Inc., a medical insurance corporation, alleging fraud under

Section 10(b) of the Exchange Act. The plaintiffs claimed that the defendants misled them when they "falsely characterized Aetna's pricing of medical insurance premiums as 'disciplined'" within the health care industry. Id. at 274. The plaintiffs alleged that, in actuality, the defendants had relaxed their underwriting policy but publicly "touted" a "disciplined" policy. Id. The plaintiffs appealed the district court's dismissal of the action.

The Third Circuit noted that under the PSLRA, alleged misrepresentations are not actionable if they fall within the safe harbor for forward-looking statements, which applies to statements that are "(1) identified as such, and accompanied by meaningful cautionary statements; or (2) immaterial; or (3) made without actual knowledge that the statement was false or misleading." Id. at 278-79.

The Third Circuit applied Inst'l Investors Grp. v. Avaya, Inc., 564 F.3d 242, 255 (3d Cir. 2009) and held that the statements at issue were forward looking, as they were "vague and generalized statements about 'disciplined' pricing." Aetna, 617 F.3d at 280. And "to the extent that 'disciplined' pricing said anything about the current price of premiums, it did so in the form of a projection." Id. at 281.

The Third Circuit also found cautionary language in the defendants' statements that provided a "clear warning to investors that the accuracy of medical costs cannot be assured . . . ." Id. at 283. This language provided "meaningful, extensive, and specific caution directly related" to the statements at issue. Id.

Finally, the Third Circuit held that the safe harbor applied because the defendants' statements were not material, finding the statements "too vague to ascertain anything on which a reasonable investor might rely." Id. at 284. The Third Circuit affirmed the district court's dismissal.

In In re Lincoln Educ. Servs. Corp. Sec. Litig., 2011 WL 3912832 (D.N.J. Sept. 6, 2011), the district court granted the defendants' motion to dismiss the putative class action for violations of Sections 10(b) and 20(a) of the Exchange Act. The plaintiffs, shareholders, alleged that the defendants, Lincoln Educational Services Corp. ("Lincoln"), a for-profit school, the chairman of its board of directors, and two officers, misled investors concerning how the implementation of certain reforms to its admissions standards and protocols would affect the projected student enrollment growth rate. Id. at *1. The plaintiffs specifically challenged Lincoln's announced plans to limit its enrollment of "'ability to benefit'" ("ATB") students—i.e., students admitted to a secondary education program without a high school diploma, and who statistically were less likely to complete the program and pay back student loans. Id. The plaintiffs alleged that the defendants made misrepresentations about growth projections for newly starting students that led to a decline in Lincoln's stock value when the defendants announced that actual start rates would be "flat." Id. at *3.

The plaintiffs further alleged that the defendants knew or recklessly disregarded that Lincoln would be unable to achieve its full year and second quarter start rates while simultaneously implementing measures to reduce enrollment of ATB students, and that the defendants misrepresented and concealed how the ATB student start growth rates impacted their projections. Id. The district court held that the defendants' statements were non-actionable forward-looking statements accompanied by meaningful cautionary language. Id. at *6. In the Third Circuit, the district court noted, cautionary language must be "'extensive and specific,'" and it "'must be substantive and tailored to the specific future projections, estimates or opinions.'" Id. (quoting Inst'l Investors Grp. v. Avaya, Inc., 564 F.3d 242, 256 (3d Cir. 2009)). The district court concluded that the defendants expressly warned of the risk that materialized by mentioning in a conference call with investors that the restricted ATB student enrollment would have "some short-term impact on start growth." Id. at *7.

In addition, the district court pointed out that the defendants explained how their student start growth projections took into account more stringent entrance requirements for ATB students, which the district court considered a statement about Lincoln's assumptions underlying a projection of future economic performance and/or financial condition. Id. at *10. Such statements, the district court held, are expressly protected by the PSLRA's safe harbor provision. Id. The district court also criticized the plaintiffs for focusing on semantic differences in language and "snipping selective words from conference calls and manipulating them" to suggest that the defendants made material misrepresentations. Id. at *11. When read in their proper context, the district court explained, the defendants did not conceal any information or make any material misrepresentations. Id. at *8-9.

The Fourth Circuit

In City of Ann Arbor Emps.' Ret. Sys. v. Sonoco Prods. Co., 827 F. Supp. 2d 559 (D.S.C. 2011), the plaintiffs brought a 10b-5 class action against Sonoco for failing to disclose price concessions given to key customers and the loss of a major account. Id. at 562. The defendants moved for summary judgment on several issues, including that their forward-looking statements were protected by the PSLRA safe harbor provision. Id. at 573-74. The plaintiffs argued that defendants' forward-looking statements could not be protected by the safe harbor provision if the defendants knew that the potential risks stated in the cautionary language had already occurred. Id. at 576 (citing In re Nash Finch Co. Sec. Litig., 502 F. Supp. 2d 861 (D. Minn.), mot. to certify denied, 2007 WL 2226028 (D. Minn. July 31, 2007)). The district court agreed and found that the plaintiffs "presented evidence that Defendants knew of the price concessions and lost customer" and that there was a question of fact "concerning whether Defendants knew the 'potential' risks identified had already occurred." Id. Thus, the district court held that a question of fact existed concerning meaningfulness of the cautionary language accompanying the defendants' forward-looking statements. Id.

The Seventh Circuit

In Plumbers & Pipefitters Local Union No. 630 Pension-Annuity Trust Fund v. Allscripts-Misys Healthcare Solutions, Inc., 778 F. Supp. 2d 858 (N.D. Ill. 2011), investors brought a class action alleging violations of Sections 10(b) and 20(a) of the Exchange Act against the company and executive officers for alleged misstatements in connection with delayed release of a company software product. Id. at 863. The defendants moved to dismiss the amended complaint. Id. Under Section 10(b), the district court began, a defendant may not be held liable for forward-looking statements if the statements are accompanied by meaningful cautionary language. Id. at 874. The district court explained that cautionary statements are meaningful if they "point to the principal contingencies that could cause the actual results to depart from projections" and "if they put an investor on notice of the danger of investment" so that the investor can "make an intelligent decision about the investment." Id. at 874. This prong of the forward-looking statement analysis "does not require any consideration of a defendant's state of mind." Id. at 876-77. The district court concluded that the cautionary language accompanying the defendants' forward-looking statements was meaningful, pointing to "twenty-five separate business-specific risk factors" with descriptions and statements of potential impact. Id. at 875.

The Ninth Circuit

In In re Cutera Sec. Litig., 610 F.3d 1103, 1106 (9th Cir. 2010), the plaintiffs brought a Section 10(b) claim alleging that Cutera failed to adequately disclose the poor performance of its sales force, and that the non-disclosure of this material information led to inflation in the company's stock price and misled investors. Plaintiffs claimed that when information regarding the poor performance of the junior sales force was eventually disclosed, the company's earnings estimate decreased and its shares lost value. Id. at 1107.

The Ninth Circuit addressed plaintiffs' arguments that certain of the defendants' forward-looking statements regarding revenue and earnings projections were either: (1) not accompanied by necessary cautionary statements identifying factors that could cause actual results to differ materially from those statements; or (2) the speaker of each such statement knew of its falsity when made; and/or (3) each such statement was approved and/or authorized by an executive or corporate officer who knew it was false when made. Id. at 1112. The defendants invoked the safe harbor provision of the PSLRA, which provides that persons are not liable with respect to any forward-looking statements if the statement is accompanied by meaningful cautionary statements, or if a plaintiff fails to prove that the forward looking statement was known to be false by its speaker, or if made by a business entity, was made by or with the approval of an executive officer with knowledge that the statement was false or misleading. Id.

The Ninth Circuit noted at the outset that the alleged forward looking statements were accompanied by the requisite cautionary statements. Id. The plaintiffs asserted that the statute required a "conjunctive reading" of the safe harbor provision, under which a sufficiently strong inference of actual knowledge on the part of the individual or corporate speaker could overcome safe harbor protection—even when a statement is identified as forward looking and accompanied by meaningful cautionary language. Id. The Ninth Circuit rejected this interpretation, holding that the state of mind of the defendant is irrelevant to the safe harbor provision protecting forward looking statements identified with cautionary language, and noted that all other circuits (Fifth, Sixth, and Eleventh) to consider the issue also rejected plaintiff's proposed construction. Id. at 1113.

In Fosbre v. Las Vegas Sands Corp., 2011 WL 3705023, at *1 (D. Nev. Aug. 24, 2011), the plaintiff claimed that the defendants knowingly or recklessly made misrepresentations and omissions about Las Vegas Sands Corporation ("LVS"), its development plans, and its financial condition. Specifically, the plaintiff alleged that during the 2007-2008 financial crisis, LVS began to have serious liquidity problems and made allegedly false or misleading public statements regarding its development plans, liquidity, and equity offerings. Id.

The defendants sought dismissal on several grounds, including that the statements at issue were protected by the PSLRA's safe harbor for forward looking statements. Specifically, defendants asserted that statements related to (1) construction costs on foreign development and development plans, (2) future foreign market conditions, and (3) the company's financing plans, future cash flows, and future liquidity were non-actionable, forward looking statements. Id. at *6. In response, the plaintiffs argued that (1) the forward looking statements were not accompanied by cautionary language, (2) the statements cross-referenced other documents, (3) the statements used non-substantive "boilerplate," and (4) certain statements that were couched as forward-looking were meant to convey information regarding present-time business conditions. Id. at *7.

The district court initially cited the conditions for a statement to be protected under the PSLRA's safe harbor for forward-looking statements and therefore non-actionable: forward looking statements must (1) be forward-looking and be identified as such, and (2) be "'accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement.'" Id. at *6 (citation omitted). The district court also reiterated that cautionary statements must convey substantive information that could cause a difference in results, but need not include the specific factor that ultimately rendered the forward looking statement untrue. Id. at *7 (citing Helwig v. Vencor, Inc., 251 F.3d 540, 558-59 (6th Cir. 2001) (en banc) and In re Cytyc Corp. Sec. Litig., 2005 WL 3801468, at *21 (D. Mass. Mar. 2, 2005)).

At the outset, the district court held that defendants did provide meaningful cautionary statements as to certain forward looking statements made on calls, press releases, and other at-issue documents. Id. at *7. These statements provided descriptions of "'what kind of misfortunes could befall the company and what the effect would be.'" Id. at (quoting Harris v. Ivax Corp., 182 F.3d 799, 807 (11th Cir. 1999)). Further, the district court held that the defendants' cross-references to cautionary language in other documents were appropriate for the purposes of the PSLRA's safe harbor. Id. (citing Empl'rs Teamsters Local Nos. 175 & 505 Pension Trust Fund v. The Clorox Co., 353 F.3d 1125, 1133 (9th Cir. 2004) (holding that oral statements are considered accompanied by cautionary language if such language is contained in readily available written documents, including SEC filings)). The district court ultimately held that statements as to the timing and cost of planned construction projects, the availability of future funding, the implementation of foreign legal regimes, and the defendants' hopes for future performance in a foreign market were forward looking and protected under the PSLRA's safe harbor provision because the statements were accompanied by the requisite cautionary language and because their truth or falsity could not be determined at the time they were made. Id. However, the district court denied the defendant's motion to dismiss as to other statements for which truth or falsity could have been determined at the time they were made. Id. at *7-8.

In In re Bare Escentuals, Inc. Sec. Litig., 745 F. Supp. 2d 1052 (N.D. Cal. 2010), investors in Bare Escentuals, a mineral-based makeup company, brought a class action against the corporation, its current and former directors and executives, and its underwriters for violations of Sections 10(b) and 20(a) of the Exchange Act and Sections 11 and 12(a) of the Securities Act. Id. at 1057, 1064. The plaintiffs alleged that the Bare Escentuals defendants misrepresented or failed to disclose that the company's premium products were being distributed by discount retailers in violation of Bare Escentuals exclusivity contracts, that the company was failing to revitalize infomercial sales, and that revenues were likely to decrease based on problems with "club" sales. Id. at 1060.

The Bare Escentuals defendants moved to dismiss the 10(b) claims against them, arguing that their statements were forward-looking and protected by the PLSRA's safe harbor. Id. at 1079. The defendants asserted that their alleged misstatements were "accompanied by meaningful cautionary language." Id. The plaintiffs identified over ten instances where the defendants "provided future projections with regard to the Company's financial guidance and/or general future expenditures" in press releases and conference calls. Id. The district court held that the projections "easily meet the definition of a forward-looking statement." Id. at 1079-80. The district court found that the projections were accompanied by meaningful cautionary language that was "sufficiently specific," noting that the projections also pointed investors toward the company's 10-K with additional meaningful cautionary language. Id. at 1080. The district court therefore granted the defendants' motion to dismiss. Id.

In Allstate Life Ins. Co. v. Robert W. Baird & Co., 756 F. Supp. 2d 1113 (D. Ariz. 2010), the plaintiffs purchased bonds used to finance the construction of an event center in Prescott, Arizona. Id. at 1122. The bonds were issued pursuant to "Official Statements," which the plaintiffs alleged contained misstatements and omissions. Id. The plaintiffs brought a class action alleging various securities violations against (1) the underwriters, (2) the law firms that participated in drafting the Official Statements, (3) bond issuer the Development Authority of the County of Yavapai (the "Authority"), (4) the Prescott Valley Event Center ("PVEC"), (5) PVEC owners Global Entertainment Corporation (as well as Global Entertainments' owners), (6) PVEC owners Prescott Valley Signature Entertainment ("PVSE") and PVSE owners Fain Signature Group (the "Fain defendants"), and (7) the Town of Prescott Valley. Id. at 1123. The plaintiffs alleged that the Official Statements contained projections about the number of events and total expected attendance for the proposed event center and that defendants knew or should have known that these projections were false or misleading because of conflicting, non-disclosed information contained in previous feasibility reports. Id. at 1124.

The Fain defendants moved to dismiss the Section 10(b) claims against them arguing, inter alia, that the challenged statements were protected by the PSLRA's statutory safe harbor. Id. at 1137. However, the district court held the safe harbor "inapplicable to statements uttered by speakers that are not subject to the Exchange Act of 1934's registration and reporting requirements." Id. The district court explained that the bonds were issued by the Authority, which "does not appear to have been subject to the reporting requirements of the Exchange Act," and noted that the Official Statements made clear the bonds were not registered with the SEC. Id. The district court therefore ruled that the defendants' forward-looking statements did not fall under the safe harbor. Id. Accordingly, the defendants' motion to dismiss was denied. Id. at 1128.

The Eleventh Circuit

In Edward J. Goodman Life Income Trust v. Jabil Circuit, Inc., 594 F.3d 783 (11th Cir. 2010), the Eleventh Circuit affirmed the district court's dismissal of the plaintiffs' putative securities fraud class action. The plaintiffs, shareholders of a publicly traded electronics and technology company, alleged that the defendant company and its directors and officers violated Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Id. at 787. The defendants allegedly issued back-dated stock options and failed to properly record them as compensation expenses, thereby violating GAAP and overstating earnings. Id. at 788. The plaintiffs contended that the defendants' quarterly earnings projections, although accompanied by cautionary statements, should not be shielded by the PSLRA's safe harbor provision because the plaintiffs had alleged that the projections were made with actual knowledge of falsity. Id. at 794.

The Eleventh Circuit concluded that an allegation of actual knowledge of falsity will not deprive a defendant of protection by the PSLRA safe harbor if the forward-looking statements were accompanied by meaningful cautionary language. Id. at 795. When a forward-looking statement is accompanied by meaningful cautionary language, "an allegation that the speaker knew the statements were false does not convert those statements, mitigated by adequate warnings of risks, into actionable frauds." Id. at 796. Finding the defendants' statements shielded by the PSLRA safe harbor provision, the Eleventh Circuit affirmed the district court's dismissal of the plaintiffs' claim. Id.

In Phila. Fin. Mgmt. of San Francisco, LLC v. DJSP Enter., Inc., 2011 WL 4591541 (S.D. Fla. Sept. 30, 2011), the district court granted the defendants' motion to dismiss the plaintiffs' putative class action for violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The defendants included DJSP Enterprises, Inc. ("DJSP"), a publicly traded company that provided processing services for residential mortgage foreclosures and related matters, and two officers. Id. at *1. The plaintiffs, investors in DJSP, alleged that the defendants made numerous material misrepresentations regarding their business operations and financial prospects, which harmed them when DJSP's stock value dramatically declined. Id. at *2.

The district court held that the defendants' statements about their financial performance—including projections of DJSP's earnings, comments on management's plans and objectives for future operations, observations about the company's future economic performance, and assumptions underlying these predicted events—were shielded by the PSLRA's safe harbor provision. Id. at *15. To the extent the officers made forward-looking statements that were adequately pleaded and material, the district court found them accompanied by meaningful cautionary statements. Id. For example, the district court noted a slide presentation containing a disclosure that the projections were "'subject to risks and uncertainties, which could cause actual results to differ from the forward looking statements.'" Id. The defendants also tempered their projections by referencing the potential for "'legislation or other changes in the regulatory environment, particularly those impacting the mortgage default industry.'" Id.

The Bespeaks Caution Doctrine

The bespeaks caution doctrine pre-dates the safe harbor provisions of the PSLRA. The doctrine recognizes that, in certain instances, cautionary language that accompanies a related optimistic statement can render the optimistic statement immaterial as a matter of law. See In re Fannie Mae 2008 Sec. Litig., 742 F. Supp. 2d 382, 395 (S.D.N.Y. 2010) (citing Halperin v. eBanker USA.com, Inc., 295 F.3d 352, 357 (2d Cir. 2002)). Some circuit courts have recognized that meaningful warnings that accompany forward-looking statements make it impossible for a plaintiff to justifiably rely on those statements. See, e.g., Ill. State Bd. of Inv. v. Authentidate Holding Corp., 369 F. App'x 260 (2d Cir. 2010) (holding that a "no guarantee" warning in a press release was sufficient to prevent a reasonable investor from being misled into believing that the referenced agreement was certain to be reached).

The Second Circuit

In Ill. State Bd. of Inv. v. Authentidate Holding Corp., 369 F. App'x 260 (2d Cir. 2010), the Second Circuit considered the plaintiff organization's claims against the defendant holding company ("Authentidate") and associated individuals alleging violations of Section 10(b) of the Exchange Act and Rule 10b-5. The allegations concerned a statement issued by Authentidate in a press release regarding possible amendment of the performance metrics in an agreement with the United States Postal Service ("USPS"). Id. at 263. The defendant also asserted that in an accompanying conference call that the company was "'very confident we should have this amendment signed in the not too distant future.'" Id. The complaint alleged that the referenced agreement was not imminent and that the defendants' prior statements imposed a duty to update the public. Id.

The Second Circuit held that the "bespeaks caution" doctrine was directly applicable to the statements made at the press release, pointing to a "'no guarantee'" warning that it considered sufficient to prevent a reasonable investor from being misled. Id. (quoting Halperin v. eBankerUSA.com, Inc., 295 F.3d 352, 357 (2d Cir. 2002)). On the other hand, the Second Circuit held that the statements made during the conference call were not entitled to protection under the bespeaks caution doctrine—although these statements appeared to be forward looking, they communicated a high likelihood of a deal being struck imminently, and were not accompanied by sufficient cautionary language for the doctrine to apply. Id. Furthermore, with respect to certain statements regarding Authentidate's present performance, the Second Circuit emphasized that "misrepresentation of present or historical facts cannot be cured by cautionary language," Id. (quoting P. Stolz Family P'ship L.P. v. Daum, 355 F.3d 92, 96-97 (2d Cir. 2004) (holding that neither the bespeaks caution doctrine nor the PSLRA's safe harbor provision may apply)).

In In re Fannie Mae 2008 Sec. Litig., 742 F. Supp. 2d 382 (S.D.N.Y. 2010), the plaintiffs brought securities fraud claims against Fannie Mae ("Fannie"), four of Fannie's senior officers, and Fannie's external auditor Deloitte & Touche LLP ("Deloitte"), alleging violation of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The plaintiffs asserted three principal allegations under the Exchange Act: (1) that the defendants materially misrepresented Fannie's exposure to the subprime and Alt-A mortgage markets and its related risks; (2) that the defendants materially misrepresented the quality of Fannie's internal risk management and controls; and (3) that the defendants filed materially inaccurate financial statements and, in connection with those filings, Deloitte violated Generally Accepted Accounting Principles ("GAAP") and Generally Accepted Auditing Standards ("GAAS"). Id. at 397. The defendants moved to dismiss the plaintiffs' Exchange Act claims. The district court granted the defendants' motion as to the plaintiffs' first and third claims, but denied dismissal of the plaintiffs' second claim regarding alleged misrepresentation of Fannie's internal risk management and controls. Id. at 417.

The district court dismissed the plaintiffs' claim that the defendants materially misled investors regarding the extent of Fannie's exposure to high-risk mortgages because, among other reasons, Fannie's public filings contained cautionary language warning investors about the risks associated with Fannie's subprime and Alt-A mortgage investments. Id. at 399. As a preliminary matter, the district court explained that under the "bespeaks caution" doctrine, "statements . . . accompanied by adequate cautionary language," are rendered "immaterial" and therefore cannot support a securities fraud claim. Id. at 395 (citing Halperin v. eBanker USA.com, Inc., 295 F.3d 352, 357 (2d Cir. 2002)). The district court found that Fannie's annual SEC filings, made before and during the class period, contained language expressly disclosing Fannie's increased participation in the subprime mortgage markets and accompanying risks. Id. For instance, the district court highlighted Fannie's 2006 Form 10-K, which disclosed that between 2003 and mid-2006 the proportion of higher risk mortgage loans that were originated in the market increased significantly and, "'[a]s a result [Fannie's] purchase and securitization of loans that pose a higher credit risk . . . also increased . . . .'" Id. at 400 (citations omitted). The district court determined that Fannie's public filings "clearly contradicted" the plaintiffs' argument that Fannie "understated their degree of exposure to the subprime markets—and the risks this entailed." Id.

The Ninth Circuit

In Allstate Life Ins. Co. v. Robert W. Baird & Co., 756 F. Supp. 2d 1113 (D. Ariz. 2010), the plaintiffs purchased bonds used to finance the construction of an event center in Prescott, Arizona. Id. at 1122. The bonds were issued pursuant to "Official Statements," which the plaintiffs alleged contained misstatements and omissions. Id. The plaintiffs brought a class action alleging various securities violations against (1) the underwriters, (2) the law firms that participated in drafting the Official Statements, (3) bond issuer the Development Authority of the County of Yavapai (the "Authority"), (4) the Prescott Valley Event Center ("PVEC"), (5) PVEC owners Global Entertainment Corporation (as well as Global Entertainments' owners), (6) PVEC owners Prescott Valley Signature Entertainment ("PVSE") and PVSE owners Fain Signature Group (the "Fain defendants"), and (7) the Town of Prescott Valley. Id. at 1123. The plaintiffs alleged that the Official Statements contained projections about the number of events and total expected attendance for the proposed event center and that defendants knew or should have known that these projections were false or misleading because of conflicting, non-disclosed information contained in previous feasibility reports. Id. at 1124.

The defendants moved to dismiss the Section 10(b) claims against them based on the bespeaks caution doctrine, where forward-looking statements are not actionable if they are accompanied by sufficient cautionary language. Id. at 1136. The district court noted that "the bespeaks caution doctrine does not immunize forward-looking statements, even if accompanied by cautionary language, when a defendant asserts forward-looking statements with knowledge or awareness of their falsity." Id. The district court found sufficient the plaintiffs' allegations that at least some of the defendants knew the projections in the Official Statements were unreasonable, given previous feasibility reports. Id. The district court also found that a reasonable jury could determine from the undisclosed reports that the population of Prescott Valley could not generate the magnitude of events or attendance projected in the Official Statements, and that in spite of that, at least some of the defendants "inflated the number of events and attendance figures in a manner that would qualify the Bonds for an investment-grade rating." Id. at 1136-37.

Loss Causation

Prior to the passage of the PSLRA, most courts required plaintiffs to show loss causation in actions for alleged violations of the Exchange Act. The PSLRA codified this principle by expressly stating that "plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this chapter caused the loss for which the plaintiff seeks to recover damages." 15 U.S.C. § 78u-4(b)(4).

The Supreme Court

In Dura Pharm., Inc. v. Broudo, 544 U.S. 336 (2005), the plaintiffs, purchasers of Dura Pharmaceuticals, Inc. ("Dura") stock between April 15, 1997 and February 24, 1998, brought a securities fraud class action against Dura and certain of Dura's directors and officers. The plaintiffs alleged that Dura made false statements regarding Dura's drug profits and future Food and Drug Administration ("FDA") approval of its new asthmatic spray device. On the last day of the class period, Dura announced that its earnings would be lower than expected. Id. at 339. The following day, Dura's stock price fell to almost half of its value. Approximately eight months later, Dura announced that the FDA would not approve Dura's new asthmatic spray. Id. The following day, Dura's stock price fell, but almost fully recovered one week later. In their complaint, the plaintiffs alleged the following about economic losses attributable to the spray: "'[i]n reliance on the integrity of the market, [the plaintiffs] . . . paid artificially inflated prices for Dura securities' and the plaintiffs suffered 'damage[s]' thereby." Id. at 339-40 (citation omitted).

The district court held that the complaint failed to sufficiently allege the appropriate state of mind with regard to the drug-profitability claim and that the complaint failed to adequately allege "loss causation" with respect to the spray device claim. Id. The Ninth Circuit reversed, finding that the plaintiffs sufficiently pleaded loss causation because they were able to show that the price of the stock at the time of purchase was inflated due to a misrepresentation. Id. The U.S. Supreme Court granted Dura's petition for certiorari and reversed the Ninth Circuit's decision. Id. at 341.

The Supreme Court examined the Ninth Circuit's reasoning that "plaintiffs need only 'establish', i.e., prove, that 'the price *on the date of purchase* was inflated because of the misrepresentation.'" Id. at 342 (citation omitted). The Court disagreed with this statement of the law and explained that an inflated purchase price, by itself, does not constitute or proximately cause the relevant economic loss. Id. The Court reasoned that when a purchaser engages in a securities transaction, he or she has not suffered a loss because, at the moment of the transaction, the purchaser has the value of the purchase price. Id. The Court continued that if "the purchaser sells the shares quickly before the relevant truth begins to leak out, the misrepresentation will not have led to any loss." Id. The Supreme Court also stated that even if a purchaser sold its shares at a lower price after the truth leaked into the market, "that lower price may reflect, not the earlier misrepresentation, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events, which taken separately or together account for some or all of that lower price." Id. at 342-43. The Court surmised that, the longer the time between the purchase and sale, the more chance that factors other than the disclosure of the truth caused the loss. Id. at 343.

The Court also declared that the Ninth Circuit's rationale departed from common law roots of a securities fraud claim for fraudulent misrepresentation. Common law claims of fraudulent misrepresentation, the Court noted, require a plaintiff to show that had he "known the truth he would not have acted," and "that he suffered actual economic loss." Id. at 336, 344. The Court concluded that it could not reconcile the Ninth Circuit's ruling with the "contours of a judicially implied cause of action with roots in the common law." Id. at 345.

The Second Circuit

In In re Omnicom Grp., Inc. Sec. Litig., 597 F.3d 501 (2d Cir. 2010), the lead plaintiff in a putative class action appealed a district court decision granting summary judgment to defendant with respect to the plaintiffs' claims under Section 10(b) of the Exchange Act. Omnicom, a marketing and advertising holding company, had begun years earlier to use a subsidiary ("Communicade") to invest in various internet-based companies. Id. at 504. Omnicom entered into a transaction with a private equity firm in order to create a new company ("Seneca") into which Omnicom transferred the Communicade subsidiary along with $47.5 million, reporting that it would incur no gain or loss as a result of the transaction's status as a simple exchange. Id. Roughly a year later, the chair of Omnicom's Audit Committee resigned, sparking rumors in *The Wall Street Journal* and other publications about the firm's allegedly faulty accounting principles. Id. at 505. In the days following the publication of these articles, Omnicom's stock price dropped significantly, and the plaintiff class filed its action. Id. at 508.

The plaintiffs argued loss causation by claiming that the market reacted negatively to a corrective disclosure of Omnicom's fraud. Id. at 511. However, although *The Wall Street Journal* article raised questions about the company's accounting practices, none of the events relied on by the plaintiffs revealed any previously undisclosed facts concerning *specific* misrepresentations. Id. (citing In re Flag Telecom Holdings, Ltd. Sec. Litig., 574 F.3d 29, 40-41 (2d Cir. 2009)). The appellants also argued that, even if no new financial facts were revealed as a result of the media's belated interest in the Seneca transaction, the board member's resignation and the media attention which followed were sufficient to establish loss causation under materialization of the risk. Id. Although the Second Circuit recognized that the record showed that the board member's resignation—along with the subsequent decrease in Omnicom's share price—created a concern among investors that unknown problems were "lurking in Omnicom's past," it ultimately held that the appellants had not alleged that bad accounting practices had ever occurred specifically with regard to the Seneca transaction. Id. at 514. As a result, the Second Circuit determined that the "generalized investor reaction of concern causing a temporary share price decline . . . is far too tenuously connected . . . to the Seneca transaction to support liability." Id.

In Lentell v. Merrill Lynch & Co., 396 F.3d 161 (2d Cir. 2005), the Second Circuit considered among other things whether Merrill Lynch's Internet Group's publication of allegedly false and misleading research recommendations with respect to twenty-seven publicly traded internet companies proximately caused the class action plaintiffs' losses. According to the plaintiffs, the research reports touting "'ACCUMULATE' and 'BUY' recommendations" were "false and misleading, and failed to disclose that Merrill Lynch and Blodget [its former star analyst] 'had a policy and practice throughout the Class Period of never issuing . . . [a] rating or recommendation . . . other than 'BUY' or 'ACCUMULATE' because to do so 'would jeopardize Merrill Lynch's . . . ability to obtain underwriting or investment advisory engagements.'" Id. at 166.

The Second Circuit noted that to establish the causation element of a Rule 10b-5 claim, plaintiffs had to establish both transaction causation and loss causation. The Second Circuit noted that "[t]ransaction causation is akin to reliance, and requires only an allegation that 'but for the claimed misrepresentations or omissions, the plaintiff would not have entered into the detrimental securities transaction.'" Id. at 172 (quoting Emergent Capital Inv. Mgmt., LLC v. Stonepath Grp., Inc., 343 F.3d 189, 197 (2d Cir. 2003)).

Loss causation, on the other hand, required a showing of a '"causal link between the alleged misconduct and the economic harm ultimately suffered by the plaintiff.'" Lentell, 396 F.3d at 172 (citation omitted). The Second Circuit stated that, to establish loss causation,

> a plaintiff must allege . . . that the subject of the fraudulent statement or omission was the cause of the actual loss suffered, i.e., that the misstatement or omission concealed something from the market that, when disclosed, negatively affected the value of the security. . . . This Court's cases—post-Suez and pre-Suez—require both that the loss be foreseeable and that the loss be caused by the materialization of the concealed risk. . . . [O]ur precedents make clear that loss causation has to do with the relationship between the plaintiff's investment loss and the information misstated or concealed by the defendant . . . if the connection is attenuated, or if the plaintiff fails to demonstrate a causal connection between the content of the alleged misstatements or omissions and the harm actually suffered, a fraud claim will not lie.

Id. at 173-74 (internal quotation marks and citations omitted).

The Second Circuit concluded that the plaintiffs' allegations simply did not conform to existing Second Circuit precedent:

> It is alleged that Merrill's "buy" and "accumulate" recommendations were false and misleading with respect to 24/7 Media and Interliant, and that those recommendations artificially inflated the value of 24/7 Media and Interliant stock. However, plaintiffs do not allege that the subject of those false recommendations (that investors should buy or accumulate 24/7 Media and Interliant stock), or any corrective disclosure regarding the falsity of those recommendations, is the cause of the *decline* in stock value that plaintiffs claim as their loss. Nor do plaintiffs allege that Merrill Lynch concealed or misstated any risks associated with an investment in 24/7 Media or Interliant, some of which presumably caused plaintiffs' loss.

Id. at 175.

In Wilamowsky v. Take-Two Interactive Software, Inc., 2011 WL 4542754 (S.D.N.Y. Sept. 30, 2011), the plaintiff claimed that the defendants violated Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Id. at *1. The plaintiff, as a short seller, bet that the stock of Take-Two Interactive Software, Inc. ("Take-Two") was overvalued and would decrease in price. Id. Accordingly, the plaintiff borrowed and sold Take-Two's stock under an obligation to later purchase and deliver the stock to its owner. Id. The plaintiff claimed that before and after he made the short sales the defendants—Take-Two, Take-Two's founder, and Take-Two's former directors—made misrepresentations about Take-Two's stock option plans that artificially inflated Take-Two's stock price. Id. As such, the plaintiff contended that defendants' misrepresentations induced the plaintiff to cover short positions at higher prices than sale prices, resulting in economic harm. Id.

The defendants moved to dismiss arguing that the plaintiff failed to sufficiently plead loss causation. Id. at *5. The district court granted the defendants' motion to dismiss noting that the plaintiff failed to allege economic loss because the plaintiff did not cover purchases after a corrective disclosure. Id. at *5, 7. Rather, the plaintiff ended his transactions in Take-Two stock fourteen months before the relevant corrective disclosure. Id. at *9. Accordingly, the district court held that the plaintiff did not demonstrate how its losses were a result of the defendants' misstatements and omissions, rather than legitimate market circumstances "particularly [because] . . . the in-and-out stock transactions began after the stock price was already inflated, spanned an extended time period punctuated by constant legitimate market stimuli and repeated misstatements, and terminated more than a year prior to the corrective disclosure." Id. at *10.

In In re Sec. Capital Assurance Ltd. Sec. Litig., 2011 WL 4444206 (S.D.N.Y. Sept. 23, 2011), the plaintiff brought claims against Security Capital Assurance, Ltd. ("SCA") for violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Id. at *1-2. The plaintiff claimed that the defendants issued false or misleading statements or omissions about SCA's exposure to the subprime mortgage market, resulting in significant losses when SCA's stock value declined. The defendants moved to dismiss arguing that the plaintiffs failed to adequately plead loss causation. Id. at *1.

The plaintiff alleged that the defendants misstated the basis on which it calculated its subprime exposure in PowerPoint presentations and in its 2007 Form 10-K. Id. at *1. Although the defendants did not explicitly reveal any concealed facts, the plaintiffs argued that the alleged misstatements were "effectively revealed" to the market when: the defendant "announced that it would record steep 'mark-to-market' losses"; S&P announced that it downgraded the rating of securities backed by subprime collateral; S&P stated that SCA fell $2 billion short of adequate capital requirements for a AAA rating; and S&P stated that it contemplated downgrading SCA due to the results of updated stress tests on RMBS and CDO exposure. Id. at *4-5.

The plaintiffs claimed that these representations "signaled to the market that SCA's internal modeling was 'likely not as previously represented' and that the stock price declines that followed S&P's downgrades were 'attributable to the revelation that the ratings agencies themselves were in fact well ahead of SCA in assessing, modeling, and now downgrading the value of underlying assets in SCA's high risk portfolios.'" Id. The plaintiff further stated that investors "absorbed" these statements and began to understand that the defendants (1) misstated their definition of subprime, (2) underestimated their subprime exposure, and (3) had not relied on their own internal models when evaluating their subprime exposure. Id. at *5.

The district court found the plaintiffs arguments unconvincing, stating that these "'disclosures' cannot plausibly be interpreted as 'reveal[ing] some then-undisclosed fact with regard to the specific misrepresentations alleged in the complaint.'" Id. at *6 (quoting In re Omnicom Grp. Inc. Sec. Litig., 597 F.3d 501, 511 (2d Cir. 2010)). In fact, the district court noted, "[i]n cataloguing market events and ratings downgrades which affected *entire swaths* of the financial markets in addition to SCA, [the] [p]laintiff has failed to plead facts which would disaggregate the losses it contends were caused by [the] [d]efendants' misstatements from the losses attributable to other causes." Id. (emphasis added). The district court emphasized that "[b]ased on [the] [p]laintiff's own allegations, the ratings agency downgrades are . . . properly understood as having highlighted the magnitude of risk associated with SCA's known exposures. Those same downgrades cannot simultaneously be said to have disclosed previously unknown subprime exposures." Id. at *7. Accordingly, the district court granted the defendants' motion to dismiss for failure to state a claim. Id.

In In re Lehman Bros. Sec. & ERISA Litig., 799 F. Supp. 2d 258 (S.D.N.Y. 2011), the district court granted in part and denied in part the defendants' motion to dismiss. The plaintiffs, investors, brought a putative class action for violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5, among other claims, against the defendants, the former officers, and external auditor of Lehman Brothers Holdings Inc. ("Lehman"). Id. at 264. The plaintiffs alleged that the defendants made false and misleading statements and omissions in Lehman's offering materials and during conference calls relating to the company's liquidity, credit risks, and the value of its commercial real estate holdings. Id. The plaintiffs alleged that the defendants engaged in quarterly balance sheet manipulations to falsely present the company as being in a stronger financial position than it was through "Repo 105" transactions, which temporarily decreased the company's net leverage ratio at the end of each quarter until it was re-adjusted shortly after each quarter closed. Id. at 268-69.

The district court held that the plaintiffs adequately alleged loss causation. The court observed that loss causation may be established by alleging either (1) a corrective disclosure, or (2) a materialization of a concealed risk that causes a loss, where the loss was "foreseeable." Id. 304. "[M]arket-wide circumstances" that contributed to Lehman's demise did not preclude a finding of loss causation where the plaintiffs could show that they "'would have been spared all *or an ascertainable portion*'" of that loss absent the fraud. Id. at 305 (quoting Lentell v. Merrill Lynch & Co., 396 F.3d 161, 175 (2d Cir. 2005)). In accordance with Lentell, the district court ruled that the plaintiffs needed to allege that the materialization of the risk caused all or part of the their loss, but did not need to allege that the particular misstatements and omissions directly caused the alleged losses. Id.

The district court concluded that the complaint adequately alleged that the defendants overstated Lehman's financial strength, misstated and understated Lehman's leverage, misstated its risk management practices, and understated the exposure of its mortgage and real estate related assets, all of which created a "misleading picture" that "played a material part" in inflating Lehman's stock value. Id. at 306. The plaintiffs alleged that "it was the materialization of the risks thus concealed that ultimately killed Lehman." Id. The district court held that plaintiffs sufficiently alleged that these risks were foreseeable and that the defendants' minimization of these risks "destroyed whatever value remained in Lehman's shares." Id.

In In re Manulife Fin. Corp. Sec. Litig., 276 F.R.D. 87 (S.D.N.Y. 2011), plaintiffs, U.S. purchasers of defendant insurer's ("Manulife") common stock during the class period, alleged violations of Section 10(b) of the Exchange Act and Rule 10b-5. The plaintiffs contended that Manulife and the individual defendants emphasized the company's conservative risk management policies and portfolio diversification, misleading investors and artificially inflating the value of Manulife stock. Id. at 92. Thus, according to these allegations, the price of Manulife common stock dropped significantly when the "truth" was revealed to the market. Id. The district court granted defendants' motion to dismiss.

In support of its position that loss causation had been established, plaintiffs asserted that the decline in price of Manulife common stock was due to the "revelation of a fraudulent scheme" on the part of Manulife and individual defendants in a series of corrective disclosures. Id. at 103. However, the plaintiffs did not "apportion this decline between the alleged scheme and any other salient factors, such as changed market conditions." Id. The district court noted that allegations pertaining to one such corrective disclosure relied on the contention that the company's share price fell when unspecified rumors about Manulife's need to raise capital were leaked to the market—a contention the court rejected because "the bare allegation that rumors were circulating in the market is not a 'well-pleaded' factual allegation." Id. Furthermore, with respect to the claim that the downgrade of Manulife's ratings by Fitch constituted a corrective disclosure revealing new information relating to the alleged fraud, the district court held that this downgrade was insufficient for loss causation purposes since it did not allege that any new material information was revealed to the market. Id. at 104. As such, the district court granted defendants' motion to dismiss. Id. at 105.

The Third Circuit

In In re Merck & Co., Sec., Deriv. & "ERISA" Litig., 2011 WL 3444199 (D.N.J. Aug. 8, 2011), the district court granted in part and denied in part the defendants' motions to dismiss the plaintiffs' putative securities fraud class action. The plaintiffs, investors, alleged that the defendants, Merck & Co. ("Merck") and several of its officers, made materially misleading statements and omissions regarding the commercial viability of a prescription arthritis medication, Vioxx, both leading up to and following its withdrawal from the market. Id. at *1. The plaintiffs alleged that the defendants made three corrective disclosures that caused Merck's stock price to decline: (1) publication of information indicating Vioxx raised the risk of heart attacks; (2) Merck's announcement that Vioxx was being pulled from the market because of an increased risk of cardiovascular ("CV") events; and (3) following Vioxx's withdrawal from the market, a news article describing internal communications and documents showing that Merck had been concerned that Vioxx was associated with an increased risk of heart attacks. Id. at *30. To satisfy loss causation, the district court recited, the plaintiff must show that the corrective disclosure was a "substantial factor" in causing the decline in the stock price. Id. at *29 (quoting McCabe v. Ernst & Young, LLP, 494 F.3d 418, 425-26 (3d Cir. 2007)). Following the approach set forth in In re Bradley Pharm., Inc. Sec. Litig., 421 F. Supp. 2d 822, 828-29 (D.N.J. 2006), the district court held that loss causation can be predicated on a series of partial corrective disclosures. Id. at *31.

The district court held that the first two allegedly corrective disclosures sufficiently plead loss causation because they both revealed that use of Vioxx was associated with an increased risk of heart attacks, thereby contradicting the defendants' allegations that Vioxx did not possess such "prothrombotic," or heart attack causing effects, and partially revealing the defendants' fraud. Id. at *30-32. The district court held that the third disclosure did not adequately plead loss causation because the CV risks associated with Vioxx had already been revealed after it was taken off the market. Id. at *33. Since the falsity of the defendants' prior statements had already been disclosed to the market, additional facts in the news article regarding the defendants' scienter and the quality of corporate management did not constitute corrective disclosures. Id. at *34.

The Fourth Circuit

In Katyle v. Penn Nat'l Gaming, Inc., 637 F.3d 462 (4th Cir.), cert. denied, 132 S. Ct. 115 (2011), shareholders in Penn National Gaming ("Penn") brought a 10b-5 class action alleging repeated omissions related to a Leveraged Buy Out ("LBO"). Id. at 466. Shareholders alleged that Penn withheld information that suggested the LBO would not happen and instead released a series of positive press releases about the company's progress toward the LBO. Id. at 467. The plaintiffs' Second Amended Complaint was dismissed for failure to adequately plead loss causation, and the district court denied the plaintiffs' request to file a Third Amended Complaint on the grounds that amendment would be futile. Id. at 466. On appeal of that denial, the Fourth Circuit reviewed the decision de novo. Id. at 471.

To show loss causation, the Fourth Circuit began, the plaintiffs must "sufficiently plead the first component . . . exposure of the relevant truth." Id. at 477. The plaintiffs identified six "partially corrective disclosures," including action (and inaction) of regulatory boards, suspension of coverage by a brokerage firm, and negative predictions about the LBO by a brokerage firm. Id. at 476. The plaintiffs argued that, taken collectively, the disclosures alerted the market that the LBO was not taking place, but the Fourth Circuit disagreed, deeming the plaintiffs' allegations of a downward trend in stock prices throughout the period of corrective disclosures insufficient. Id. The Fourth Circuit further stated that, at most, the disclosures "alerted investors to the ever-mounting risk that the deal was unlikely to close." Id. Even if the disclosures had revealed that the deal was not going to close, the Fourth Circuit held that the plaintiffs still needed to plead "something more" than "knowledge alone." Id. at 478. The Fourth Circuit ruled that the plaintiffs had to allege facts showing that "the disclosures revealed to the market something about the fraudulent nature of the press releases on which Plaintiffs purportedly relied to their detriment because only then could the press release have caused Plaintiffs' economic loss." Id. at 478. Since the plaintiffs failed to allege those facts, the Fourth Circuit affirmed the district court's denial of the right to amend. Id.

In Teachers' Ret. Sys. of Louisiana v. Hunter, 477 F.3d 162, 185-88 (4th Cir. 2007), the Fourth Circuit discussed the pleading standard for loss causation. The court noted that neither the PSLRA nor the Supreme Court had established whether loss causation was a sufficient part of an "averment of fraud" to fall within the requirements of Rule 9(b). Id. After considering the Supreme Court's decision in Dura, the Fourth Circuit held that "a plaintiff purporting to allege a securities fraud claim must not only prove loss causation—that the material misrepresentations or omissions alleged actually caused the loss for which the plaintiff seeks damages—but he must also plead it with *sufficient specificity* to enable the court to evaluate whether the necessary causal link exists." Id. at 186 (emphasis added).

The Fourth Circuit found the plaintiffs' allegations regarding loss causation insufficient to establish a causal link. Id. at 186-87. The plaintiffs alleged that a previous lawsuit brought by one officer of the corporation against another officer revealed the "'true facts' of the [the company's] fraudulent schemes over the years, causing the market to reduce its valuation of [the company's] shares." Id. at 186. The Fourth Circuit concluded that this theory of loss causation failed for two different reasons with regard to the two different fraudulent transactions alleged. For the first set of transactions, the court reasoned that the earlier complaint did not contain allegations of the relevant transactions and therefore could not have revealed the "true facts" of those transactions and could not have caused the plaintiffs' loss. Id. For the second set of transactions, the earlier complaint did contain allegations of those transactions, but because these facts had already been disclosed in public filings, the Fourth Circuit found that their revelation in the earlier complaint could not have caused the stock price to decline. Id. at 187.

The Sixth Circuit

In Haw. Ironworkers Annuity Trust Fund v. Cole, 2011 WL 1257756 (N.D. Ohio Mar. 31, 2011), mot. to certify denied, 2011 WL 1982714 (N.D. Ohio May 20, 2011), the plaintiff claimed violations of Section 10(b) of the Exchange Act, alleging that four of

Dana Corporation's ("Dana") former officers intentionally or recklessly engaged in misstatements and material omissions which were calculated to artificially boost Dana's stock price. Id. at *1. Although the automotive parts manufacturing industry was suffering adverse conditions, the defendants represented that the company was thriving. Id. After the company issued restatements to correct these errors the value of the company's stock declined. Id.

The defendants moved to dismiss arguing that the plaintiff did not adequately plead loss causation because the corrective disclosure revealed additional negative information about the corporation's finances that could have caused its stock to drop. Id. at *14. The district court struck down the defendants' argument, concluding that the complaint "need only show that the corrective disclosure was a substantial cause of the loss, not the only cause." Id. In fact, the district court held that the plaintiff adequately pleaded loss causation because the complaint alleged that the company's stock price declined after the company issued the corrective disclosures that referred to the improper accounting practices. Id. The district court further noted that "[w]here the defendant alleges the securities' decline in value is attributable to other intervening factors, the weight given to each cause is a matter for the damages inquiry, not a pleading requirement." Id.

The Seventh Circuit

In AnchorBank, FSB v. Hofer, 649 F.3d 610 (7th Cir. 2011), plaintiff AnchorBank brought claims against an employee and two alleged co-conspirators asserting violations of Sections 9(a) and 10(b) of the Exchange Act. Id. at 613. The plaintiffs alleged that Hofer created a collusive trading scheme, i.e., that by purchasing units in a fund that was part of the company's 401(k) plan, Hofer caused the fund trustee to sell shares of the company's common stock to maintain the cash-to-stock ratio, leading to drastic fluctuations in the stock price. Id. at 616. AnchorBank's claims were dismissed by the district court for failure to sufficiently plead loss causation. Id. at 613. AnchorBank appealed, and the Seventh Circuit reversed the dismissal and remanded the case for further proceedings. Id.

Since loss causation is an element of both Sections 9(a) and 10(b), the Seventh Circuit combined its analysis of the sufficiency of the plaintiff's claim. Id. at 616-17. The Seventh Circuit held that to survive a motion to dismiss, a plaintiff only has to plead that "defendant is at least one plausible cause of the economic loss." Id. at 618. Plaintiffs do not have to show that "*all* of its loss is necessarily attributed to actions of the defendant." Id. Hofer argued on appeal that the decrease in the company's stock price could have been the result of a general downturn in the economy and not the result of his allegedly manipulative purchases of units in the company's 401(k) fund. Id. The Seventh Circuit found that plaintiffs' allegations of thirty-six coordinated purchases of the company's 401(k) fund met the standard—i.e., that the defendant is at least one plausible cause of economic loss—and overturned the district court's dismissal of plaintiffs' claims for failure to plead loss causation. Id.

The Ninth Circuit

In WPP Luxembourg Gamma Three Sarl v. Spot Runner, Inc., 655 F.3d 1039 (9th Cir. 2011), cert. denied, 132 S. Ct. 2713 (2012), investors in a privately-held corporation brought suit against Spot Runner, its founders, and its general counsel, alleging that the defendants violated Section 10(b) as well as other Exchange Act provisions when they failed to disclose their sales of company stock. Id. at 1044. WPP Luxembourg Gamma Three Sarl ("WPP") invested $10 million in Spot Runner preferred shares. Id. at 1045. At the time of the investment, WPP contracted with the Spot Runner founders (the "Founders") for separate rights to "match offers to invest in Spot Runner and a right to receive notice if the Founders intended to transfer any of their shares." Id. at 1045. WPP alleged that after entering into this contract, the Founders sold their shares on several occasions without informing WPP, and that WPP lost all of the value in its shares when the Founders' actions were revealed. Id. at 1045-46, 1053. The district court dismissed the claims on several grounds, and the plaintiffs appealed. Id. at 1047.

On appeal, the defendants argued that WPP failed to adequately plead loss causation. Id. at 1053. The Ninth Circuit observed that plaintiffs usually plead loss causation by alleging a drop in share price after the truth is revealed, but with "a privately held company, a comparison of market stock price . . . has less relevance because market forces will less directly affect the sale prices of shares." Id. For a privately held company, the Ninth Circuit stated, plaintiffs may properly allege loss causation "by showing that a misrepresentation or omission caused him or her to engage in a transaction and the revelation of the truth is directly related to the economic loss alleged." Id. WPP alleged that its shares became worthless when it was revealed that the Founders were engaged in a "pump-and-dump scheme." Id. at 1054. The Ninth Circuit found these allegations sufficient, even without allegations of "detailed share prices, the number of shares currently held, or whether attempts to sell . . . the shares were made." Id. Based on these findings, the Ninth Circuit reversed the district court's dismissal of WPP's claims. Id.

In In re Oracle Corp. Sec. Litig., 627 F.3d 376, 383 (9th Cir. 2010), the plaintiffs alleged that defendants violated Section 10(b) of the Exchange Act and Rule 10b-5 by making false and misleading statements regarding the company's new software, its 2001 third quarter sales forecast, and its intra-quarter fiscal year financial results. The plaintiffs pleaded loss causation with regard to its new software claim by alleging that the "impact" of the fraud—Oracle missing its projections—caused its losses, as opposed to the fraudulent acts themselves. Id. at 392.

The Ninth Circuit, citing Dura, rejected the assertion that the effect of the fraud, and not the fraud itself, could show loss causation. Id. at 392 (citing Dura, 544 U.S. at 343 ("To 'touch upon' a loss is not to *cause* a loss, and it is the latter that the law requires.")). Even though plaintiffs conceded that the market was already aware of initial rollout issues with the software in question, they contended that Oracle's misrepresentations downplayed these problems and that the truth came to the market as a result of the missed earnings projection. Id. at 392-93. The Ninth Circuit cited numerous pieces of evidence disputing the plaintiffs' characterization of events, holding that the "overwhelming evidence produced during discovery indicates the market understood Oracle's earnings miss to be a result of several deals lost in the final weeks of the quarter due to customer concern over the declining economy." Id. at 393. Concluding that the plaintiffs could not show loss causation in the face of this overwhelming evidence, the Ninth Circuit affirmed the district court's grant of summary judgment to the defendants. Id. at 395.

In In re Apollo Grp., Inc. Sec. Litig., 2011 WL 5101787 (D. Ariz. Oct. 27, 2011), the plaintiffs brought a consolidated class action against Apollo Group, a company that owned and operated post-secondary educational institutions, for violations of Section 10(b) of the Exchange Act in connection with allegedly false and misleading statements regarding Apollo's financial condition, business focus, ethics, compensation and recruitment practices, and compliance with federal education regulations. Id. at *3. Apollo Group moved to dismiss the Section 10(b) claim for failure to adequately plead scienter, falsity, and loss causation. Id. at *2.

The district court granted the motion to dismiss and specifically rejected two of plaintiffs' arguments of first impression in the district. First, with regard to scienter, the plaintiffs relied on other lawsuits filed against Apollo Group, arguing that if given leave to amend, there were additional recently unsealed cases that would discredit arguments made in Apollo Group's motion. Id. at *10 n.5. The district court disagreed that the other lawsuits established scienter on their own, holding that the plaintiffs' attorneys had their own individual duty to "personally validate the truth and legal reasonableness of the papers filed [in another action] and to conduct a reasonable factual investigation," and that it would be impermissible to allow the plaintiffs to rely on the pleadings of another plaintiff to prove fraud. Id. at *10 n.5 (citing In re Connetics Corp. Sec. Litig., 542 F. Supp. 2d 996, 1005 (N.D. Cal. 2008) and Geinko v. Padda, 2002 WL 276236, at *6 n.8 (N.D. Ill. Feb. 27, 2002)).

Secondly, in what may have been dicta, the district court accepted the plaintiffs' argument that a corrective disclosure made by Apollo Group that revealed an informal inquiry by the SEC into Apollo's revenue recognition process resulted in a drop in the stock price, and therefore, demonstrated loss causation. Id. at *17. Acknowledging a split of authority with regard to whether the announcement of an investigation is sufficient to plead loss causation, the district court ultimately endorsed the views of courts in the First and Second Circuits, which hold that an alleged corrective disclosure is sufficient to establish loss causation provided plaintiffs also successfully plead scienter. Id. at *17 n.10; accord In re StockerYale, 453 F. Supp. 2d 345, 359 (D.N.H. 2006); In re Take-Two Interactive Sec. Litig., 551 F. Supp. 2d 247, 287 (S.D.N.Y. 2008).

In In re Nuveen Funds/City of Alameda Sec. Litig., 2011 WL 1842819 (N.D. Cal. May 16, 2011), the district court granted the defendants' motion for summary judgment because it found, inter alia, that the plaintiffs failed to raise a triable issue of fact regarding loss causation. Id. at *12.

The plaintiffs, investors in the City of Alameda's bond issuance, brought Rule 10b-5 claims against the city and a bond underwriter alleging the defendants issued inflated and unrealistic projections in order to sell the bonds. Id. at *1-2. The defendants moved for summary judgment, arguing among other things that the plaintiffs could not establish loss causation because the plaintiffs' expert "did not perform any meaningful analysis to support his conclusion that defendants' alleged fraud [was] responsible for 100% of plaintiffs' losses." Id. at *7. The plaintiffs argued that because the bonds traded in an inefficient market (they alleged only eighteen trades over nearly a three-year period), it was impossible to show the connection between the trading price of the bonds and the statements of the defendants. Id. at *7. Although the district court found the plaintiffs' arguments "persuasive," it also noted that: (1) the argument was contrary to controlling Ninth Circuit case law; (2) there was no controlling authority in support of the plaintiffs' proposition; and (3) the PSLRA provided no exception to the loss causation requirement for inefficient markets. Id. at *10 (citing In re Oracle Corp. Sec. Litig., 627 F.3d 376 (9th Cir. 2010)). The district court found that the plaintiffs' expert "did not perform any investigation or analysis to support his conclusion that plaintiffs' losses were caused by the defendants' fraud." Id. at *8. Accordingly, the district court granted the defendants' motion for summary judgment. Id. at *12.

The Eleventh Circuit

In FindWhat Investor Grp. v. FindWhat.com, 658 F.3d 1282 (11th Cir. 2011), the plaintiffs brought a class action for violation of Section 10(b) of the Exchange Act and Rule 10b-5 against an internet commerce company that offered "pay-per-click" online advertising services. Advertisers paid for such services only when a user clicked on an online advertisement, and the revenue was split between the internet commerce company and the websites on which the advertisement was displayed, or the "distribution partners." Id. at 1291. The plaintiffs alleged that the defendants, the internet commerce company and three of its principal officers, committed securities fraud by making several false and misleading statements and material omissions that inflated the price of the defendant company's stock. Id. at 1291-94. The plaintiffs alleged that they were damaged when the company's stock price dropped after the defendants revealed that the company's revenue was based in part on the "click fraud" of its distributors, i.e., clicking on an online advertisement for the sole purpose of forcing the advertiser to pay for the click. Id. at 1291. The plaintiffs further alleged that the defendant CEO misrepresented the extent of the click fraud problem and falsely stated in a conference call that the company removed distribution partners associated with the click fraud. Id. at 1307-08. In addition, the Form 10-K filing allegedly restated these fraudulent claims and falsely asserted that the company actively policed fraudulent clicks. Id. at 1308. The district court granted summary judgment despite finding the statements false because it concluded loss causation could not be established where the stock price was inflated both before and after the defendants made the actionable misrepresentations. Id. at 1306-07.

The Eleventh Circuit rejected the district court's conclusion, holding that:

> Defendants whose fraud *prevents* preexisting inflation in a stock price from dissipating are just as liable as defendants whose fraud introduces inflation into the stock price in the first instance. We decline to erect a per se rule that, once a market is already misinformed about a particular truth, corporations are free to knowingly and intentionally reinforce material misconceptions by repeating falsehoods with impunity.

Id. at 1317. The Eleventh Circuit stated that the relevant inquiry for loss causation in a fraud-on-the-market case was whether, even if the plaintiffs paid an already inflated price for the stock as a result of the fraud, the plaintiffs suffered losses when the relevant truth was eventually revealed. Id. at 1312. Accordingly, the Eleventh Circuit held that "confirmatory information that wrongfully prolongs a period of inflation—even without increasing the level of inflation—may be actionable under the securities laws." Id. at 1314. The Eleventh Circuit, ruling that the defendants did not get an "automatic free pass" because their alleged fraud propped up an already inflated stock price, remanded to the district court to consider whether triable issues of fact existed as to loss causation and damages. Id. at 1317.

In Meyer v. St. Joe Co., 2011 WL 3750324 (N.D. Fla. Aug. 24, 2011), the district court granted the defendants' motion to dismiss the plaintiffs' putative class action for violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The plaintiffs, investors, alleged that the defendants, a timber and paper company and five of its officers, intentionally deceived investors about the value of the company's residential real estate projects following the national real estate market crash. Id. at *1-2. The plaintiffs alleged that, despite the defendants' knowledge of a downturn in property values, the defendants failed to take appropriate "impairment charges" under Generally Accepted Accounting Principles ("GAAP") and SEC regulations, which would have properly reflected the decreased value of the properties and reduced earnings. Id.

The district court noted that, to plead loss causation the plaintiffs must allege that the defendants made a misstatement or omission that concealed information from the market which, when a corrective disclosure was made, negatively affected the value of the security. Id. at *3. The plaintiffs alleged that an investor in the company, David Einhorn, presented his research during a conference that showed the company impermissibly failed to take the necessary accounting impairment charges to its residential real estate projects in development, and that the stock price declined approximately 20% in the two days following the presentation. Id. at *2. The district court, however, held that this presentation was not a corrective disclosure because it relied solely on public information, which should have already been reflected in the stock's price. Id. at *3. Rather than adding significant original insight that revealed improper accounting practices, the district court found Mr. Einhorn's research a "mere re-characterization of previously disclosed facts." Id. at *6. Since Mr. Einhorn's presentation essentially offered his opinion on the company's accounting, the district court concluded that the decline in stock value could also have been attributed his predictions about future impairments, instead of improper past practices. Id. at *7. Thus, the district court ruled that the plaintiffs failed to plead a causal connection between Mr. Einhorn's presentation and the decline in the company's stock value. Id.

In In re Immucor, Inc. Sec. Litig., 2011 WL 2619092 (N.D. Ga. June 30, 2011), the district court granted the defendants' motion to dismiss the plaintiff's claims under Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The plaintiff alleged that the defendant company—a supplier of blood reagents (used to detect and identify certain properties of human blood) to hospital blood banks, clinical laboratories, and blood donation centers—made false and misleading statements regarding its compliance with FDA regulations and its participation in an illegal price-fixing scheme with its competitors. Id. at *1-2.

Although the district court held that the company made material misrepresentations, the district court dismissed the plaintiff's claims for failure to adequately plead loss causation. Id. at *4-5. The district court held that the plaintiff failed to allege that it owned the company's stock before the alleged disclosure that caused the stock price to drop, or that it sold the stock immediately following the disclosure. Id. at *4. The district court also took judicial notice of the company's stock prices, which further undermined loss causation because the prices quickly rebounded following each of the disclosures alleged by the plaintiff. Id. at *4 n.1. The district court was "unaware of any authority in which actual economic loss was found when the stock value returned to pre-disclosure prices and could have been sold at a profit just after the class period." Id. at *4 (quoting Ross v. Walton, 668 F. Supp. 2d 32, 43 (D.D.C. 2009)).

In Waterford Twp. Gen. Emps. Ret. Sys. v. SunTrust Banks, Inc., 2010 WL 3368922 (N.D. Ga. Aug. 19, 2010), the district court granted the defendants' motion to dismiss the plaintiffs' putative class action brought pursuant to Section 10(b) of the Exchange Act and Rule 10b-5. The plaintiffs, investors in the defendants, a holding company and a subsidiary that provided commercial banking services, and their executives, alleged that the defendants concealed the increased number of nonperforming loans in the holding company's loan portfolio by classifying some of its nonperforming loans as "in-process," which artificially inflated the stock price. Id. at *1.

The district court held in relevant part that the plaintiffs did not adequately plead loss causation. Id. at *4. The plaintiffs alleged that the defendants made a corrective disclosure in the bank's fourth quarter financial report on January 21, 2009 that revealed previously misrepresented figures relating to nonperforming loans, and which subsequently caused the stock price to drop nearly eleven percent. Id. The district court held that the contemporaneous financial crisis was likely the primary cause of the drop in stock price because: (1) the bank's stock price had dropped 66% over the course of the class period and fell nearly 75% from its class period high to its closing price on the day before the alleged corrective disclosure; and (2) the stock prices for the stock of Bank of America, Citibank, Regions Bank, US Bancorp, and Wells Fargo had similarly decreased on January 22, 2009. Id. The district court emphasized that the facts alleged by the plaintiffs did not apportion the loss among competing causes or support the inference that the defendants' misstatements, rather than "general market conditions," proximately caused the plaintiffs' loss. Id. at *6.

In In re BankAtlantic Bancorp, Inc. Sec. Litig., 2010 WL 6397500 (S.D. Fla. Aug. 18, 2010), the parties cross-moved for summary judgment. The plaintiffs, a class of investors in BankAtlantic Bancorp, Inc. ("BankAtlantic"), the publicly traded parent company of a federally chartered bank, alleged that BankAtlantic and its insiders and directors violated Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Id. at *1. The defendants allegedly misrepresented and concealed the true value of the company's "land loans" that were made for the acquisition and development of residential buildings. Id. at *1-2. The plaintiffs alleged that the truth about BankAtlantic's lending practices—i.e., that it made misleading statements about the credit quality of certain land loans and failed to follow conservative lending practices, that it failed to timely disclose that the credit quality of the land loan portfolio had deteriorated, and that it misrepresented that its reserves for loan losses were adequate—was revealed in April and October of 2007, causing the stock price to decline. Id. at *2.

The district court held that the plaintiffs raised a genuine issue of material fact as to loss causation regarding the decline in stock prices on April 26, 2007 and October 26, 2007, but not as to the decline on October 29, 2007. Id. at *26. In the absence of a corrective disclosure that expressly revealed the alleged fraud, the district court observed, the plaintiffs may also prove loss causation by showing "that the concealed risk materialized in a foreseeable way and that this 'materialization of the risk,' led to a decline in share price." Id. at *26 (quoting Lentell v. Merrill Lynch, Inc., 396 F.3d 161, 173 (2d Cir. 2005)). The district court held that the defendants' April 25 and 26, 2007 announcements disclosing the deteriorating credit quality of a portion of the land loan portfolio was a materialization of a previously undisclosed risk. Id. at *26. For summary judgment purposes, the district court explained, the decline in credit quality of the land loans following the defendants' failure to abide by their policies regarding conservative lending practices was within the "foreseeable zone of the alleged previously concealed risk." Id. Thus, a genuine issue of fact existed as to whether the subsequent stock price decline was caused "in significant part" by the announcements. Id. at *87.

The district court also held that the defendants' October 25 and 26, 2007 announcements regarding the deterioration of the entire land loan portfolio raised a genuine issue of fact as to whether the disclosure corrected the defendants' earlier statements that limited the exposure to only a portion of the land loan portfolio. Id. at 27. The evidence, including the proposed testimony of the plaintiffs' expert, to the district court raised a genuine issue of fact regarding whether the announcements were a "significant contributing cause" to the subsequent decline in stock price. Id.

BankAtlantic's stock price further declined on October 29, 2007 after the Fitch Ratings company downgraded BankAtlantic's stock, which the plaintiffs alleged constituted a further materialization of the previously concealed risk. Id. The district court, however, held that the downgrade was merely analysis or characterization of already public information, and that "the public discussion of information that is already available to the market" cannot constitute a corrective disclosure or a materialization of a previously concealed risk for loss causation purposes. Id. at 27-28.

In In re HomeBanc Corp. Sec. Litig., 706 F. Supp. 2d 1336 (N.D. Ga. 2010), the district court granted the defendants' motion to dismiss the plaintiffs' putative class action for violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The plaintiffs, investors in HomeBanc Corporation ("HomeBanc"), a real estate investment trust in the business of investing in and originating residential mortgage loans, alleged that the defendants, officers of HomeBanc, omitted facts and made numerous false and misleading statements regarding HomeBanc's lending practices that artificially inflated its stock value and damaged the plaintiffs when HomeBanc filed for bankruptcy. Id. at 1341-42.

The district court held that the plaintiffs failed to adequately plead loss causation. Id. at 1361-62. The plaintiffs alleged that "the putative class paid artificially inflated prices for their stock and that HomeBanc's collapse alone revealed the 'truth' so that

HomeBanc's public statements during the class period must have been false." Id. at 1361. The district court found that these conclusory allegations failed to show that the defendants' statements prior to HomeBanc's collapse were materially inaccurate or misleading. Id. Noting that HomeBanc's stock price declined throughout the class period (as did the stock of its competitors), the district court concluded that the plaintiffs failed to distinguish the losses caused by the defendants' alleged misrepresentations from losses caused by the coinciding "'marketwide phenomenon'" of the collapse of the mortgage industry as a whole. Id. at 1361-62 (quoting Lentell v. Merrill Lynch & Co., 396 F.3d 161, 174 (2d Cir. 2005)).

4 Liability Issues

Liability of Secondary Actors in Securities Markets

The Supreme Court

In Janus Capital Grp., Inc. v. First Deriv. Traders, 131 S. Ct. 2296 (2011), lead plaintiff First Derivative Traders, representing a class of purchasers of Janus Capital Group, Inc. ("JCG") stock, asserted claims against JCG and Janus Capital Management LLC ("JCM"), an investment adviser and wholly owned subsidiary of JCG, for violations of Section 10(b) and Rule 10b-5. Id. at 2299. JCG ran a family of mutual funds organized as a Massachusetts business trust, the Janus Investment Fund ("JIF"). Id. Although JIF was started by JCG, JIF is a separate legal entity and retained JCM as its investment adviser. Id. Through its business, JIF issued prospectuses that stated that Janus funds were not suitable for market timing. Id. at 2300. However, First Derivative alleged that JCM and JCG mislead the investing public concerning implementation of measures to curb market timing in response to a September 2003 complaint filed by New York's Attorney General. Id. The Fourth Circuit reversed the district court's dismissal of the complaint, holding that First Derivative had sufficiently alleged that "JCG and JCM, by participating in the writing and dissemination of the prospectuses, *made* the misleading statements contained in the documents." Id. at 2301 (citation omitted).

Although First Derivative alleged that JCM was not only "significantly involved in preparing the prospectuses [of JIF]," but that all of the officers of JIF were also officers of JCM, the Supreme Court ultimately determined that JCM could not be liable because "[a]lthough JCM, like a speechwriter, may have assisted [JIF] with crafting what [JIF] said in the prospectuses, JCM itself did not 'make' those statements for purposes of Rule 10b-5." Id. at 2305. In a 5-4 decision, the Court ultimately held that "[f]or purposes of Rule 10b-5, the maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it. Without control, a person or entity can merely suggest what to say, not "'make' a statement in its own right." Id. at 2302. Since JIF and JCM are separate legal entities and there was nothing on the face of the prospectuses to indicate attribution to JCM, the Court reversed the Fourth Circuit. Id. at 2304-05.

In his dissent, Justice Stephen Breyer illustrated the consequences of the majority's decision that liability of secondary actors for "making" statements was solely triggered by control, strong evidence of which is attribution.

> The possibility of guilty management and innocent board is the 13th stroke of the new rule's clock. What is to happen when guilty management writes a prospectus (for the board) containing materially false statements and fools both board and public into believing they are true? Apparently under the majority's rule, in such circumstances *no one* could be found to have "ma[d]e" a materially false statement--even though under the common law the managers would likely have been guilty or liable (in analogous circumstances) for doing so as *principals* (and not as aiders and abettors).

Id. at 2310.

In Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148 (2008), Stoneridge Investment Partners brought a securities fraud action alleging that Charter Communications, Inc. ("Charter"), ten of its executives, its outside auditor and two of its suppliers and customers, Scientific-Atlanta, Inc. ("Scientific") and Motorola, Inc. ("Motorola"), violated Section 10(b) of the Exchange Act and Rule 10b-5. The plaintiffs alleged that Charter entered into sham transactions with Scientific and Motorola that improperly inflated Charter's operating revenues and cash flows. Id. at 153-54. Although these transactions were not disclosed to the public, the plaintiffs alleged that Scientific and Motorola knew or recklessly disregarded the fact that the transactions would be used to inflate Charter's revenue and that the market would rely on Charter's falsified financial statements. Id. at 155.

The district court dismissed the claims against Scientific and Motorola and the Eighth Circuit affirmed, relying in part on Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164 (1994) (holding that there is no aiding and abetting liability under Section 10(b)). Stoneridge, 552 U.S. at 155-56. The Supreme Court granted certiorari. Id. at 156.

The Supreme Court affirmed the Eighth Circuit's decision and held that the implied right of action under Section 10(b) does not extend to "customer/supplier companies because the investors did not rely upon their statements or representations." Id. at 153. The Supreme Court explained that reliance "is an essential element of the § 10(b) private cause of action" and this element ensures that a defendant will only be held liable when there is a causal connection between a defendant's misrepresentation and a plaintiff's injury. Id. at 159. The Supreme Court rejected the plaintiffs' contention that Charter's false financial statement released to the public was a "natural and expected consequence of [Scientific and Motorola's] deceptive acts." Id. at 160. The Supreme Court recognized that the investors could be entitled to a rebuttable presumption of reliance under the fraud-on-the-market doctrine, but only if the defendants' actions had become public knowledge:

> [Scientific and Motorola's alleged] deceptive acts, which were not disclosed to the investing public, are too remote to satisfy the requirement of reliance. It was Charter, not [Scientific or Motorola], that misled its auditor and filed fraudulent financial statements; nothing [Scientific or Motorola] did made it necessary or inevitable for Charter to record the transactions as it did.

Id. at 161. Thus, the Court held that Scientific and Motorola were not liable for violations of Section 10(b).

The First Circuit

In SEC v. Tambone, 597 F.3d 436 (1st Cir. 2010), the Securities and Exchange Commission ("SEC") brought an enforcement action against certain senior executive officers of Columbia Funds Distributor, Inc., a company that underwrote and marketed mutual funds. The SEC sought to hold the underwriters responsible both as primary violators and as aiders and abettors of federal securities laws under Rule 10b-5. The district court granted the defendants' motion to dismiss, but the First Circuit subsequently reversed and remanded the case. Id. at 441. Later, the defendants' petition for en banc review was granted, and the First Circuit dismissed the action, holding that the SEC failed to allege that the defendants made false statements of material fact under Rule 10b-5. Id. at 438.

Given that the underwriter defendants disseminated financial information and documents, but did not author them, this case presented the question of whether the defendants actively "*made* untrue statements of material fact within the meaning of this rule." Id. at 442 (emphasis added). The First Circuit disagreed with the SEC's interpretation of the term "make," holding that it did not encompass defendants that use statements to sell securities when those statements were entirely crafted by others. Id. The First Circuit reasoned that the SEC's interpretation of the Rule was too broad, noting that while some securities law statutes include language imposing liability on those who "use" an untrue statement regardless of who created or composed it, the language of Rule 10b-5 does not track those statutes and imposes liability only on those who "make" untrue statements. Id. at 444.

The First Circuit also rejected the SEC's interpretation of the Rule because it would contravene Supreme Court precedent, citing Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164 (1994), where the Supreme Court did not define the term "make," but did limit the private right of action under 10b-5 to claims against "primary" violators only. Id. at 177-78. The First Circuit concluded that "[t]he SEC's position poses a threat to the integrity of this dichotomy" under Central Bank. Tambone, 597 F3d at 446. Because the First Circuit considered the defendants before it secondary violators, it refused to extend liability to them. Id.

The Second Circuit

In Pac. Inv. Mgmt. Co. v. Mayer Brown LLP, 603 F.3d 144 (2d Cir. 2010), cert. denied, 131 S. Ct. 3021 (2011), the Second Circuit considered the investor plaintiffs' securities fraud action against broker-dealer Refco, the attorney representing Refco, and the firm for which the attorney worked throughout the representation. The defendants allegedly violated Section 10(b) of the Exchange Act and incurred "scheme liability" under Rule 10b-5. Id. at 150. The plaintiffs further alleged that the defendant attorney helped Refco conceal large amounts of debt through sham balance sheet transactions and that the company's altered financial position was used by the attorney to issue statements regarding the company's health to investors and to the government. Id.

The plaintiffs and the SEC urged the Second Circuit to adopt a "creator" standard, under which a defendant may be held liable for a 10b-5 claim for "*creating* a false statement that investors rely on, regardless of whether that statement is attributed to the defendant at the time of dissemination." Id. at 154 (emphasis added). Although the Supreme Court had not yet directly decided that attribution is required in order for secondary actors to be held liable in a private 10b-5 suit, the Second Circuit found the Stoneridge decision instructive by suggesting that attribution is necessary to establish the existence of reliance. Id. at 155 (citing Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148 (2008)). In addition to its reliance on Stoneridge, the Second Circuit also cited its general preference for a "bright line" test to distinguish true 10b-5 violations from those alleging nothing more than aiding and abetting. Id. at 156-57. As a result, the Second Circuit elected to apply an attribution standard, finding that none of the alleged misstatements in Refco's public filings could be attributed to the defendant law firm or any of its attorneys. Id. at 148, 158.

In In re Optimal U.S. Litig., 2011 WL 4908745 (S.D.N.Y. Oct. 14, 2011), the plaintiffs claimed that the defendants violated Section 10(b) of the Exchange Act and Rule 10b-5. See id. at *9 n.2. The plaintiffs invested in the Optimal Strategic U.S. Equity fund ("Optimal U.S."), which invested all of its assets with Bernard L. Madoff and his firm, Bernard L. Madoff Investment Securities LLC ("BMIS"). Id. at *1. The plaintiffs claimed that they lost all of their investments in part because the defendants made misstatements and omissions related to the plaintiffs' purchases of Optimal U.S. shares. Id.

The district court granted the defendants' renewed motion to dismiss the Rule 10b-5 and Section 10(b) claims on the grounds that the plaintiffs failed to plead that the defendants were the makers of the allegedly misleading statements or omissions. Id.

The defendants argued that since the materially misleading statements and omissions in question were issued by Optimal Multiadvisors, Ltd. ("Multiadvisors"), and not the defendants, the claims should be dismissed in accordance with Janus. Id. The plaintiffs countered that Optimal U.S.'s investment manager, Optimal Investment Management Services, S.A. ("OIS"), had "ultimate authority" over the statements because (1) OIS wholly owned Multiadvisors; (2) OIS had the power to appoint Multiadvisor's directors; and (3) OIS's CEO was a Multiadvisors director. Id. at *4.

The district court struck down the plaintiffs' argument, which "ma[de] much of the fact that OIS owned one hundred percent of Multiadvisors" when in fact "it was the board of directors of Multiadvisors, not the shareholders, which had 'ultimate authority' to issue the [statements]." Id. at *5. In this case, the district court held that the plaintiffs had merely shown that OIS had the authority to select the board of Multiadvisors, rather than actually issue the statements. Id. at *5. Finally, the district court emphasized that, following Janus, "Rule 10b–5 liability for a one-hundred percent shareholder of an entity 'making' a misleading statement is inappropriate; rather, section 20(a) is the appropriate source of liability." Id. at *6. As such, the district court granted the defendants' motion to dismiss.

In City of Roseville Emps.' Ret. Sys. v. EnergySolutions, Inc., 2011 WL 4527328 (S.D.N.Y. Sept. 30, 2011), the plaintiffs purchased shares of EnergySolutions, Inc. ("ES") during its initial public offering ("IPO"). Id. at *9. The plaintiffs alleged that the defendants, ES, the directors and officers of ES, ENV, and three underwriters, issued false or misleading statements or omissions in its registration statements in violation of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Id. The defendants moved to dismiss the claims against ENV on the basis that the plaintiffs failed to allege ENV made any material misstatements or omissions. Id. at *1, 10.

ES provided engineering, fuel management, decontamination, and decommission services to nuclear power plants and other commercial facilities. Id. at *2. ES was formed by purchasing and integrating existing companies through a separate entity, ENV. Id. The district court found the registration statements clearly advised that ENV exerted control over ES. Id. at *18. First, ENV was the sole owner of the outstanding stock in ES during the IPO. Id. at *17. Second, ENV wholly owned ES. Id. at *17. Third, ENV was to retain a controlling interest in ES after the IPO. Id. at *17. As such, the district court noted that ENV's ultimate authority over the two offerings was "implicit from surrounding circumstances." Id. at *18 (quoting Janus, 131 S. Ct. at 2302). Accordingly, the district court denied the defendants' motion to dismiss against ENV on the basis that questions of fact existed as to whether ENV issued the statements in the Registration Statement.

In SEC v. Kelly, 817 F. Supp. 2d 340 (S.D.N.Y. 2011), the SEC brought a securities fraud action under Rule 10b-5 against former senior managers of a corporation and its successor, alleging that the defendants engaged in transactions that improperly allowed corporations to report over $1 billion in revenue from online advertising. Only two of the original defendants, Steven Rindner and Mark Wovsaniker, moved for judgment on the pleadings. The district court subsequently dismissed the 10b-5 action against the two moving defendants.

The defendants moved for judgment on the pleadings based on the Supreme Court's decision in Janus. The district court recognized that in Janus, the Supreme Court "announced a new test for interpreting the word 'make' in Rule 10b-5." Kelly, 817 F. Supp. 2d at 342. The district court noted that the SEC conceded "that Janus forecloses a misstatement claim against [the defendants] under subsection (b) of Rule 10b-5, because neither defendant 'made' a misleading statement under the new Janus standard. However, the SEC argues that Janus did not affect its ability to assert a 'scheme liability' claim under subsections (a) and (c) of Rule 10b-5." Id.

The district court declined to adopt the SEC's argument and dismissed the allegations against defendants under subsections (a) and (c) of Rule 10b-5. The district court found that although the Supreme Court did not address "scheme liability" in Janus, "where the primary purpose and effect of a purported scheme is to make a public misrepresentation or omission, courts have routinely rejected the SEC's attempt to bypass the elements necessary to impose 'misstatement' liability under subsection (b) by labeling the alleged misconduct a 'scheme' rather than a 'misstatement.'" Id. at 343. The district court stated that "to permit scheme liability 'to attach to individuals who did no more than facilitate preparation of material misrepresentations or omissions actually communicated by others . . . would swallow' the bright-line test between primary and secondary liability." Id. (quoting SEC v. PIMCO Advisors Fund Mgmt. LLC, 341 F. Supp. 2d 454, 467 (S.D.N.Y. 2004)). The district court held that the allegations against defendants must be dismissed, as neither defendant "made" a misstatement. Id. at 344.

In In re Lehman Bros. Sec. & ERISA Litig., 799 F. Supp. 2d 258 (S.D.N.Y. 2011), the district court granted in part and denied in part the defendants' motion to dismiss. The plaintiffs, investors, brought a putative class action for violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 against the defendants, the former officers and external auditor of Lehman Brothers ("Lehman"). Id. at 264. The plaintiffs alleged that the defendants made false and misleading statements and omissions in Lehman's offering materials and during conference calls relating to the company's liquidity, credit risks, and the value of its commercial real estate holdings. Id. The plaintiffs alleged that the defendants engaged in quarterly balance sheet manipulations to falsely present the company as being in a stronger financial position than it was through "Repo 105" transactions, which temporarily decreased the company's net leverage ratio at the end of each quarter until it was re-adjusted shortly after each quarter closed. Id. at 268-69.

The plaintiffs failed to plead an inference of scienter against Lehman's auditor, Ernst & Young ("E&Y"), because they failed to plead facts that E&Y did not hold the opinions expressed in its audits regarding Lehman's 2007 10-K and Form 10-Q reports for the second and third quarters of 2007 and the first quarter of 2008. Id. at 299, 303. In addition to several conclusory allegations that the district court held failed to state a claim, the plaintiffs alleged three "red flags" that E&Y ignored. Id. at 301. The district court found the first two red flags unavailing because they did not pertain to whether Lehman improperly increased its use of Repo 105 transactions at the end of each reporting period. Id. at 301, 304. The third red flag—that E&Y interviewed Lehman's senior vice president on June 12, 2008 and learned that the Repo 105 transactions temporarily removed $50 billion from Lehman's balance sheet at the end of the second quarter of 2008—was not actionable because the interview occurred after the relevant audit opinions were issued. Id. at 301-02.

However, regarding E&Y's audit of Lehman's Form 10-Q filing for the second quarter of 2008, the district court held that the third alleged red flag did create an inference of scienter. Id. at 304. E&Y represented that it was "'not aware of any material modifications that should be made to the consolidated financial statements.'" Id. at 299.

In light of the interview, the district court held that E&Y made a false or misleading statement by professing "ignorance of facts warranting material modifications to Lehman's balance sheet when in truth it had received information concerning Lehman's use of Repo 105s temporarily to move $50 billion of inventory off that balance sheet—information that cast into doubt the balance sheet's consistency with GAAP." Id. at 304. Thus, the district court denied the motion to dismiss on this ground.

In In re Tronox, Inc. Sec. Litig., 2010 WL 2835545 (S.D.N.Y. June 28, 2010), the district court considered the defendants' motion to dismiss the plaintiffs' class action claims alleging violations of Section 10(b) of the Exchange Act and Rule 10b-5. Lead plaintiffs were hedge funds that invested in Tronox common stock, and defendants were Tronox's pre-spinoff parent (KMG), Tronox's principal accountant and auditor (Ernst & Young), and various Tronox and KMG directors and officers. The plaintiffs alleged that oil and gas exploration company KMG created two subsidiaries, keeping its oil and gas assets separate from its liability-stricken chemical assets (held by Tronox). Id. at *2. As time progressed, the company made partial disclosures regarding the company's true financial condition, resulting in a decline in Tronox's stock price. Id. The plaintiffs alleged that these disclosures "'misled the market as to the true financial condition of Tronox and deprived investors of material information that was necessary to understand [Tronox's] financial condition.'" Id. at *3.

As to whether the allegedly fraudulent statements could be attributed to KMG, the district court cited the Second Circuit's recent statement that "a plaintiff's claim against a secondary actor must be based on that actor's own articulated statement, or on statements made by another that have been *explicitly* adopted by the secondary actor." Id. at *8 (citing Pac. Inv. Mgmt. Co. v. Mayer Brown LLP, 603 F.3d 144 (2d Cir. 2010), cert. denied, 131 S. Ct. 3021 (2011)). As such, the district court held the substantial assistance standard could no longer be applied. Id. at *7. The district court further observed that Pacific Investment provided a broad definition of the term "secondary actor," including "'any part[y] who [is] not employed by the issuing firm whose securities are the subject of allegations of fraud.'" Id. (quoting Pacific Investment, 603 F.3d at 148 n.1). The district court determined that KMG was a secondary actor because Tronox issued the relevant securities. Id. at *8. The district court further stated that allowing control over an issuing firm to turn a secondary actor into a primary actor would both "undermine the clear distinction between primary and secondary liability that the Supreme Court and the Second Circuit have sought to establish," and conflate Section 10(b) with an analysis more properly conducted under 20(a)'s theory of control person liability. Id. As such, the district court dismissed the plaintiffs' Section 10(b) claim.

The Third Circuit

In In re DVI, Inc. Sec. Litig., 639 F.3d 623 (3d Cir. 2011), investors brought a class action against multiple parties, alleging violations of Section 10(b) of the Exchange Act and Rule 10b-5. Investors claimed that the defendants "engaged in a scheme designed to artificially inflate the price of DVI [Diagnostic Ventures, Inc.] securities" and that DVI ultimately filed for bankruptcy protection when alleged misrepresentations were disclosed.

Id. at 628. Plaintiffs alleged that DVI's accountant, Deloitte, committed securities fraud by wrongfully issuing "clean" audit reports, "hiding DVI's improper accounting practices, and declining to force the company to disclose its fraudulent acts." Id. The district court granted class certification with respect to Deloitte, and Deloitte appealed. The plaintiffs also alleged that defendant Clifford Chance LLP ("Clifford Chance") committed securities fraud by "drafting fraudulent financial reports." Id.

The plaintiffs appealed the district court's denial of class certification with respect to Clifford Chance. They alleged violations of Rule 10b-5(a) and (c), claiming that Clifford Chance, lawyers for DVI, directed the company not to release a version of the 10-Q that disclosed weaknesses, and instead devised a "workaround" scheme to avoid such disclosures and defraud investors. Id. at 642. The plaintiffs further argued that Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148 (2008) created a "remoteness test" for assessing whether investors relied on fraudulent conduct of secondary actors. In re DVI, 639 F.3d at 646. The plaintiffs asserted that this test required courts to decide: (1) the level of the secondary actor's involvement in the scheme; (2) whether the misrepresentation was the "necessary or inevitable" result of the defendant's deceptive conduct; and (3) whether a defendant's conduct was in the "investment sphere" as opposed to conduct that was in the market for goods and services. Stoneridge, 552 U.S. at 161, 160, 166.

Following the Second Circuit, the Third Circuit held that a "plaintiff cannot invoke the fraud-on-the-market presumption of reliance in a private action . . . unless the deceptive conduct has been publicly disclosed and attributed to the actor." In re DVI, 639 F.3d at 649. Since the In re DVI plaintiffs did not argue that Clifford Chance's allegedly fraudulent conduct was disclosed to the public, the Third Circuit ruled that the plaintiffs could not invoke the presumption, and the claim against the law firm could not be certified as a class action.

In In re Merck & Co. Sec., Deriv. & "ERISA" Litig., 2011 WL 3444199 (D.N.J. Aug. 8, 2011), the district court granted in part and denied in part the defendants' motions to dismiss the plaintiffs' putative securities fraud class action. The plaintiffs, investors, alleged that the defendants, Merck & Co. ("Merck") and several of its officers, made materially misleading statements and omissions regarding the commercial viability of a prescription arthritis medication, Vioxx, both leading up to and following its withdrawal from the market. Id. at *1. The defendants allegedly downplayed the possible link between Vioxx and an increased risk of heart attack or other cardiovascular ("CV") events, which allegedly inflated the stock price and harmed the plaintiffs when the truth about the risks of Vioxx emerged. Id.

The district court held that the plaintiffs adequately pleaded a strong inference of scienter against one Merck executive defendant who allegedly sent internal emails indicating he was aware of Vioxx's CV risks. Id. at *26. The district court rejected this defendant's argument that the misleading statements, even though attributable to him, did not give rise to liability because he did not have "'ultimate authority'" over them. Id. at *24 (quoting Janus, 131 S. Ct. at 2302). The district court explained that Janus defined the maker of a statement for Rule 10b-5 purposes as the person or entity with ultimate authority over the statement, distinguishing those that merely aided and abetted the maker.

Id. at *25. The district court concluded that the defendant took the Janus holding "out of context" because Janus did not restrict primary liability for Rule 10b-5 claims against corporate officers where the plaintiffs prove that the officer, as opposed to the corporation itself, had ultimate authority over the statement. Id. "Janus does not alter the well-established rule that 'a corporation can act only through its employees and agents.'" Id. (quoting Suez Equity Investors, L.P. v. Toronto-Dominion Bank, 250 F.3d 87, 101 (2d Cir. 2001)). Here, the district court held, the plaintiffs adequately alleged that the defendant actually "made" the statements at issue pursuant to his responsibility and authority to act as an agent of Merck. Id. at *25.

The Fifth Circuit

In Affco Invs. 2001, L.L.C. v. Proskauer Rose, L.L.P., 625 F.3d 185 (5th Cir. 2010), the plaintiffs claimed that the defendant, Proskauer Rose L.L.P., was subject to primary liability under Sections 10(b) and 20(a) of the Exchange Act because the defendant provided tax opinions that were part of a fraudulent scheme. Id. at 188. KPMG allegedly solicited participation in a fraudulent tax scheme by stating that "'several major national law firms'" approved the investment instruments through independent tax opinions. Id. But KPMG's marketing scheme did not specifically attribute the tax opinions to the defendant. Id. at 192. Accordingly, the district court found that the plaintiffs failed to sufficiently plead reliance, and the plaintiffs appealed. Id. at 189.

The plaintiffs argued that the defendant was subject to primary liability arising from its creation of tax opinions that investors relied upon, regardless of whether those tax opinions were attributed to the defendant at the time the plaintiffs invested. Id. at 193. The Fifth Circuit observed that the Supreme Court had not specifically ruled on whether a secondary actor can be liable as a primary violator under Section 10(b) for deceptive conduct not attributed to it before the investor decided to invest. Id. However, the Fifth Circuit found the Supreme Court's decision in Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148, 159 (2008) instructive for rejecting "scheme liability" where the investing public did not have knowledge of the actors deceptive conduct at the relevant times. The Fifth Circuit noted that the Affco plaintiffs did not allege "they ever saw or heard any Proskauer work product before making their decision, nor do they explicitly allege that the promoters specifically identified Proskauer as one of the 'major national law firms.'" Affco, 625 F.3d at 195. Concluding that the plaintiffs must explicitly attribute a false or misleading statement to the defendant at the time the plaintiffs decided to invest to show reliance under Section 10(b), the Fifth Circuit affirmed the district court's dismissal for failure to meet this requirement. Id. at 194-95.

The Sixth Circuit

In La. Sch. Emps.' Ret. Sys. v. Ernst & Young, LLP, 622 F.3d 471 (6th Cir. 2010), the plaintiffs claimed that the defendant violated Section 10(b) and Rule 10b-5. Id. at 477-78. The plaintiffs purchased securities from Accredo Health, Inc. ("Accredo"). Id. at 474-75. The defendant, Ernst & Young ("E&Y"), provided accounting services to Accredo, until Accredo fired E&Y for alleged malpractice. Id. The plaintiffs filed suit against E&Y claiming that it disseminated a false audit opinion concerning Accredo's financial disclosures, which permitted Accredo to engage in an acquisition that induced the plaintiffs to purchase shares in Accredo. Id. at 475. The plaintiffs alleged that E&Y's fraudulent scheme and course of business defrauded Accredo's shareholders, deceived the investing public about Accredo's financial results, and artificially inflated the price of Accredo's publicly traded securities. Id. at 477. The district court granted E&Y's motion to dismiss, finding that the plaintiffs failed to allege facts with sufficient particularity that give rise to a strong inference of scienter as required under Tellabs. Id. at 476. The plaintiffs appealed. Id. at 477.

On appeal the plaintiffs argued that: (1) the defendant knowingly used stale and incorrect data in preparing its audit opinion; (2) there were numerous red flags that should have placed the defendant on notice about financial improprieties; (3) the magnitude of E&Y's accounting violations raised the inference that E&Y acted knowingly or recklessly in ignoring the company's financial misstatements; and (4) the defendant was in a position to profit if the company finalized the proposed acquisition. Id. at 480.

The Sixth Circuit affirmed the district court's finding and noted that "[t]he standard of recklessness is more stringent when the defendant is an outside auditor." Id. at 479. As such, the Sixth Circuit stated 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. The Sixth Circuit reiterated 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. (citation omitted). The Sixth Circuit also confirmed that neither the magnitude of an accounting error nor the receipt of audit fees are sufficient to establish an inference of scienter against an auditor. Id. at 484. On the facts before it, the Sixth Circuit found that the plaintiffs merely provided generalized allegations that did not raise an inference of fraud. Id. at 484-85. The court characterized such allegations as equivalent to "'the classic fraud by hindsight case.'" Id. at 484 (citation omitted). The Sixth Circuit therefore ruled that the plaintiffs failed to provide particularized facts showing that the defendant either knew or recklessly disregarded the falsity of its own statements at the time the statements were made. Id.

In Haw. Ironworkers Annuity Trust Fund v. Cole, 2011 WL 3862206 (N.D. Ohio Sept. 1, 2011), the plaintiff claimed violations of Section 10(b) of the Exchange Act, alleging that four of Dana Corporation's ("Dana") former officers intentionally or recklessly engaged in misstatements and material omissions which were calculated to artificially boost Dana's stock price. Id. at *1. The plaintiff alleged that although the automotive parts manufacturing industry was suffering adverse conditions, the defendants fraudulently represented that the company was thriving. Id. After the company issued restatements to correct these errors the value of the company's stock declined. Id.

The defendants moved to dismiss the claim, arguing that since they never made any statements to the investing public they could not be liable as primary participants. Id. The district court denied the motion, noting that the financial statements were created based on the false information provided by the defendants, and that the defendants were therefore not just incidentally involved in presenting the false statement to the public. Id.

The defendants filed a motion for reconsideration following the Supreme Court's opinion in Janus. Id. The plaintiffs argued that Janus did not apply because Janus involved a separate legal entity, whereas the Haw. Ironworkers defendants were corporate insiders. Id. at *3. The district court disagreed with the plaintiffs argument, noting that Janus adopted a rule that "'[f]or Rule 10b-5 purposes, the maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it.'" Id. (quoting Janus, 131 S. Ct. at 2302). The district court reasoned that the Supreme Court did not limit its key interpretation of the phrase "to make . . . a statement" to legally separate entities. Id. Assessing the facts before it, the district court concluded that the defendants did not have ultimate authority over the financial statements because (1) the defendants sent the financial results that upper management pressured them to send and (2) Dana's CEO, CFO, and Board of Directors had discretion to alter the results that defendants sent. See id. at *5. Since the defendants did not have ultimate authority over the contents of the financial statements, the district court held that the defendants could not be subject to primary liability, and partially reversed its earlier opinion. Id. at *5, *7.

The Seventh Circuit

In Pugh v. Tribune Co., 521 F.3d 686 (7th Cir. 2008), plaintiff purchasers of Tribune Company ("Tribune") common stock brought a 10b-5 action against Tribune, its executive officers, and employees of two of its subsidiary newspapers, alleging that the subsidiaries "falsely boosted" circulation numbers, leading to inflated revenues for Tribune. Id. at 690. The district court dismissed the complaint with prejudice, and the plaintiffs appealed. Id. at 692.

With regard to defendant Louis Sito—Vice-President for Circulation at one of the newspapers—the plaintiffs asserted "'scheme liability,'" alleging that Sito's admitted participation in the underlying scheme to falsely inflate the circulation data created a strong inference of scienter against him in the 10b-5 action. Id. at 696. The Seventh Circuit noted that the Supreme Court considered this issue in Stoneridge where business partners with no role in making or distributing the financial statements at issue perpetuated a fraud that was later reflected in Charter's revenue figures. Id. (citing Stoneridge Inv. Partners, LLC v. Scientific–Atlanta, Inc., 552 U.S. 148, 159-61 (2008)). The plaintiffs in Stoneridge argued that public disclosure was the expected consequence of the business partners' allegedly deceptive acts and therefore sufficient to create liability under 10b-5, but the Supreme Court disagreed, finding the plaintiffs' theory insufficient to meet the reliance requirement of Section 10(b). Id. (citing Stoneridge, 552 U.S. at 159-61).

The Seventh Circuit applied Stoneridge, finding that the defendant "may have foreseen (or even intended) that the advertising scheme would result in improper revenue for [the newspapers], which would eventually be reflected in Tribune's revenues and finally published in its financial statements. But Stoneridge indicates that an indirect chain to the contents of false public statements is too remote to establish primary liability." Id. at 697. Thus, the plaintiffs failed to satisfy the pleading requirements for scienter and the dismissal was affirmed. Id. at 698, 702. This holding can be read as extending Stoneridge's application to secondary actors within a corporation's subsidiaries.

In Rosenbaum v. Seybold, 2011 WL 3843946 (N.D. Ind. Aug. 30, 2011), investors in an LLC real estate investment vehicle that went bankrupt brought a 10b-5 action against the two attorneys who performed legal work for the deal organizer, Chad Seyhold. Id. at *1. One attorney, Beaman, organized the Seyhold Investment Companies and created loan and subscription documents for Seyhold. Id. at *3-4. Beaman's partner White also attended an investor meeting to explain some of the legal issues of the deal, including limited liability corporations, SEC regulation, and conflicts of interest. Id. at *5. Investors sued Beaman and White, alleging that their failure to explicitly state that they represented Seyhold and the LLC (as opposed to the individual investors) was a material omission that created liability under Rule 10b-5. Id. at *19. The defendant attorneys moved for summary judgment on the issue of their liability. Id.

Relying on Supreme Court precedent in Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164 (1994), and Janus, the district court held that no private right of action exists for parties who "contribute substantial assistance" to the making of a material statement or omission because it would amount to a claim for secondary liability or aiding and abetting, which are not permitted under Section 10(b). Rosenbaum, 2011 WL 3843946, at *19. As such, to survive a motion for summary judgment, the district court ruled that the plaintiffs were required to "show a genuine issue of material fact with respect to the statements or omissions that can be directly attributed to the Defendants." Id. Given the total mix of information—including Seybold's statements, multiple written agreements, and a certification that the investors read the agreement and had the chance to consult legal counsel—the district court found that no reasonable investor would have considered the attorneys' failure to clarify their roles as material. Id. at *20.

In Puskala v. Koss Corp., 799 F. Supp. 2d 941 (E.D. Wis. 2011), Koss Corp.'s principal accounting officer and vice president of finance, Sujata Sachdeva, pleaded guilty to embezzling $30 million dollars from the corporation for personal luxury items. Id. at 944. The scheme was hidden through false accounting entries, which made all public disclosures and SEC filings materially false. Id. at 944-45. Investors brought a class action for violations of Section 10(b) and Rule 10b-5 against Sachdeva, Koss Corp., Michael K. Koss, and the company's accounting firm, Grant Thornton LLP ("Grant Thornton"). Id. at 945. All defendants except for Sachdeva moved to dismiss. Id.

The plaintiffs alleged that Grant Thornton acted recklessly in certifying the company's financial statements. Id. at 953. The district court began by noting that recklessness is sufficient to show scienter in the Seventh Circuit, but that on a motion to dismiss the "plaintiff must show that at the time of the certifications [the accounting firm] was in possession of facts that would have caused a reasonable person in its position to recognize a substantial risk that the financial statements did not fairly present" the company's financial position. Id. The fact that a fraud occurred is not sufficient to prove recklessness, the district court explained, especially when someone within the company is taking steps to cover up the fraud. Id. Further, the district court found plaintiffs' alleged "red flags" "nothing more than aspects of the fraud," and held that alleged facts showing a negligent audit are not sufficient to plead recklessness. Id. Because the plaintiffs were unable to allege more than that the fraud occurred under Grant Thornton's watch during what was at most a negligent audit, the district court dismissed the claims against Grant Thornton for failure to plead scienter. Id.

The Ninth Circuit

In N. M. State Inv. Council v. Ernst & Young, LLP, 641 F.3d 1089 (9th Cir. 2011), the plaintiffs brought a claim under Section 10(b) and Rule 10b-5 claiming that Ernst & Young ("E&Y"), as the outside auditor for Broadcom (a semiconductor company), knew or was deliberately reckless in not knowing that a 2005 audit opinion it gave Broadcom was materially false and misleading due a stock option backdating scheme at Broadcom. The Ninth Circuit, following Tellabs and other Ninth Circuit case law, conducted a two-part inquiry for scienter—first determining whether any of the allegations, standing alone, were sufficient to create a strong inference of scienter, and secondly, if no individual allegation was sufficient, whether a holistic review of the same allegations combined to create the requisite strong inference. Id. at 1095.

The Ninth Circuit discussed at length the difficulty in pleading scienter against an outside auditor, who has more limited information than company executives who oversee the audit and who must make "'complex and subjective professional judgments that courts are not ideally positioned to second guess.'" Id. at 1097 (quoting In re Countrywide Fin. Corp. Sec. Litig., 588 F. Supp. 2d 1132, 1197 (C.D. Cal. 2008)). Ultimately, the Ninth Circuit held that potential red flags—including the interaction of auditors with company executives and the breadth and scope of the auditor's deviation from Generally Accepted Accounting Principles ("GAAP") or Generally Accepted Accounting Standards ("GAAS")—should be examined in determining whether an outside auditor possessed the requisite level of scienter. Id. at 1098 (citing In re Enron Corp. Sec., Deriv. & ERISA Litig., 235 F. Supp. 2d 549, 673-85 (S.D. Tex. 2002)). The Ninth Circuit further held that to plead scienter against an outside auditor in connection with GAAP violations, the violations need to be more than minor or technical, involving failure to check information the auditor had a duty to check or ignorance of obvious signs of fraud. Id. (quoting Novak v. Kasaks, 216 F.3d 300, 308-09 (2d Cir. 2000)). Lastly, the Ninth Circuit noted that allegations of scienter via GAAS violations require the plaintiffs to show more than a "poor audit" by the outside auditor. Id. (citing Ezra Charitable Trust v. Tyco Int'l, Ltd., 466 F.3d 1, 12 n.10 (1st Cir. 2006)).

The Ninth Circuit reversed the district court's grant of Ernst & Young's motion to dismiss, holding that plaintiffs' allegations were sufficient to support an inference of scienter individually, even without a holistic review. Id. at 1095, 1102-03. With respect to each individual allegation, the Ninth Circuit made the following holdings:

1. E&Y engaged in an "intense discussion" regarding the May 2000 option grants and potential violations of GAAP with Broadcom executives, but failed to do any follow-up after that discussion, relied on oral representations regarding the options, and failed to receive or rely on any documents before signing off on the grant, in violation of GAAP. Id. at 1097. The option grant program was the largest in the company's history and had a potential material impact on the

company's earnings, but E&Y did not take steps to verify the accuracy of the grant. Id. at 1098. Despite E&Y's assertion of a more compelling innocent inference that Broadcom prepared fraudulent documents and lied to E&Y, the Ninth Circuit focused on E&Y's failure to receive or review any documents, finding an inference of scienter as to the allegation that E&Y knew the material consequences of the May 2000 backdated option grant. Id. at 1099.

2. Broadcom's compensation committee possessed the sole authority to issue stock option grants, and a quorum of two members was required. Id. at 1100. In July 2001, the committee was composed of two members; when one died, the committee was left without its required quorum until the appointment of a replacement in February 2002, which was backdated to be effective October 2001. Id. The complaint alleged that E&Y, during a time when the committee only had one member, accepted fabricated, unsigned draft minutes and documentation that it knew could not have possibly been valid. Id. As a result, the Ninth Circuit found an inference of scienter at least as compelling as the innocent inference offered by E&Y. Id.

3. Broadcom, in June 2003, changed its option practices in order to "prevent and detect any future instances of improper accounting for equity awards" and E&Y participated in these corrective reforms, thereby obtaining knowledge of irregularities in the option granting process prior to June 2003. Id. at 1101 (citation omitted). Despite this knowledge, E&Y did not investigate such questionable option grants, did not encourage Broadcom to release a restatement of its earnings, and continued to issue unqualified audit opinions that validated earlier years where improperly granted options would have had a material effect on the company's earnings. Id. The Ninth Circuit held that E&Y's knowledge and inactions supported an inference of scienter sufficient to survive a motion to dismiss. Id.

4. The Ninth Circuit found that the final three allegations (knowledge of insufficient documentation for backdated options, knowledge of weak internal controls at the company, and the ignoring of red flags) substantially overlapped with the prior three allegations, resulting in a sufficient inference of scienter as to them as well. Id. at 1102. With regard to these three allegations, the Ninth Circuit also noted E&Y's ignoring of the number, magnitude, and multi-year financial impact of the backdated option grants and referenced numerous red flags, including "the deceased member of the compensation committee, option grant dates that were sporadic, suspiciously long delays between the award of stock options and the [unanimous written consents] approving the grant, and option grant dates set at or near the low stock price for the quarter in which the options were granted followed by a typical price surge soon after the dates of the option awards" in support of its finding. Id.

Lastly, despite noting that a holistic review was unnecessary after its evaluation of the individual allegations, the Ninth Circuit also found a strong inference of scienter when viewing the complaint holistically. Id. at 1102-03.

In In re Coinstar Inc. Sec. Litig., 2011 WL 4712206 (W.D. Wash. Oct. 6, 2011), a retirement fund brought suit against Coinstar Inc. ("Coinstar") and five of its executives alleging misstatements and omissions concerning Coinstar's subsidiary Redbox, a discount movie rental company. Id. at *1. The defendants moved to dismiss the claims, arguing that the plaintiffs failed to adequately allege materiality and scienter. Id. at *3, 9. While the district court found many of the allegations protected by the PSLRA's forward-looking statement safe harbor provision, it did find the plaintiffs' allegations sufficient as to the falsity of statements by certain individual defendants at an investor conference. Id. at *7. The individual defendants not alleged to have made those statements argued that the claims against them should be dismissed. Id. at *10. In assessing this argument, the district court summarized the recent Supreme Court decision in Janus as holding that "liability does not expand beyond the person or entity that ultimately has authority over a false statement or omission." Id. (citing Janus). The district court concluded that Janus controlled whether individual defendants "may be held liable for the misstatements of their co-defendants." Id. Since the statements at issue were made by individual defendants at various conferences and were not part of any public disclosure that would require approval or collective action by directors and officers, the district court found that the other defendants could not be held liable for statements that they did not make. Id. (distinguishing In re BP Prudhoe Bay Royalty Trust Sec. Litig., 2007 WL 3171435 (W.D. Wash. Oct. 26, 2007) because the allegedly false statements in that case did not appear in annual reports or press releases). The district court further held that the other defendants' attendance at the relevant investor conferences did not make them liable. Id. at *11. For those defendants who were not alleged to have made misstatements, the motion to dismiss was granted. Id. at *12.

The D.C. Circuit

In Dolphin & Bradbury, Inc. v. SEC, 512 F.3d 634 (D.C. Cir. 2008), the underwriter of a bond offering and its principal petitioned for review of an SEC order holding them liable for violation of multiple securities laws, arguing that they lacked scienter. The D.C. Circuit reviewed the petition under the substantial evidence standard—i.e., whether "'a reasonable mind might accept [the] evidentiary record as adequate to support [the Commission's] conclusion'"—and upheld the SEC's order. Id. at 639 (quoting Dickinson v. Zurko, 527 U.S. 150, 162 (1999)).

The D.C. Circuit held that "substantial evidence supports the Commission's conclusion that [the defendant's] cautionary statements were so deficient [the defendant] must have known investors would be misled by the offering documents." Id. at 640. '"[C]autionary words about future risk," the court warned, "cannot insulate . . . the failure to disclose that the risk had already transpired.'" Id. (quoting Rombach v. Chang, 355 F.3d 164, 173 (2d Cir. 2004)) (internal quotation marks omitted). Emphasizing that the defendant had disclosed a known risk in its offering documents without disclosing that it had actual knowledge that the risk would materialize, the D.C. Circuit concluded that there was substantial evidence that the defendant acted with scienter. Id.

The D.C. Circuit also rejected the defendant's attempt to "hide his extreme recklessness by misstating the role of an underwriter." Id. at 639. The court recalled that underwriters are required to investigate and disclose material facts that are reasonably ascertainable in connection with an offering and "have a heightened obligation to ensure adequate disclosure." Id. at 641-42 (quoting Municipal Securities Disclosure, SEC Release No. 26100, 1988 WL 999989, at *21 & n.74 (Sept. 22, 1988)) (internal quotation marks omitted). Because the evidence suggested that the defendant had actual knowledge of material information that he failed to disclose to his attorneys, the D.C. Circuit rejected the defendant's argument that he lacked scienter because he relied on counsel to raise any disclosure issues. Id. at 642.

Control Person Liability

The Second Circuit

In Poptech, L.P. v. Stewardship Credit Arbitrage Fund, LLC, 792 F. Supp. 2d 328 (D. Conn. 2011), the district court denied the defendant's motion to dismiss the plaintiffs' claim under Section 20(a) of the Exchange Act. The plaintiff, an investor, asserted claims under Section 10(b) of the Exchange Act and Rule 10b-5 against the defendants, Stewardship Fund, Stewardship Investment Advisors, LLC, and Acorn Capital Group, LLC ("Acorn Capital"). Id. at 330. At issue was whether defendant Paul Seidenwar, the former President of Acorn Capital, was liable under Section 20(a) for violations of the corporate defendants. Id. These defendants allegedly made misleading statements to investors about the diversity of Acorn Capital's loan portfolio and due diligence procedures. Id. at 341-42.

The district court recited the elements for a Section 20(a) claim thus: (1) a primary violation by the controlled person; (2) control of the primary violator by the defendant; and (3) that the defendant was, in some meaningful sense, a culpable participant in the controlled person's fraud. Id. at 331. The district court assumed, without deciding, that a primary violation was committed by the corporate defendants. Id. at 330. Regarding the second prong, the district court held that the plaintiffs' allegations only needed to satisfy the pleading requirements of Rule 8(a), rather than the stricter requirements of Rule 9 and the PSLRA. Id. at 334. The district court held that the defendant's role at Acorn Capital afforded him control over the information that investors were receiving about Acorn Capital's lending procedures and the status of the loan portfolio because of his role in Acorn Capital (which approved the investor communications sent by the other entities) and because the three companies in fact acted as a single entity. Id. at 339-40.

Regarding the third prong, the district court recognized disagreement among district courts within the Second Circuit as to whether a plaintiff must allege culpable participation as a prima facie element in the complaint. Id. at 331-33. The district court "join[ed] with the other district courts in the Second Circuit that have concluded that 'to withstand a motion to dismiss a Section 20(a) controlling person liability claim, a plaintiff must allege some level of culpable participation at least approximating recklessness in the

Section 10(b) context.'" Id. at 333 (quoting Edison Fund v. Cogent Inv. Strategies Fund, Ltd., 551 F. Supp. 2d 210, 231 (S.D.N.Y. 2008)). The district court concluded that the defendant was a culpable participant in the fraud because the plaintiffs adequately alleged his (1) involvement in a secretive decision to make substantial loans to a single entity with lax due diligence, (2) failure to send promised audits, and (3) instructions to an employee not to comply with the procedures communicated to investors. Id. at 342. The district court thus found the defendant either actually knew about the misrepresentations made to the investors, or "purposefully buried his head in the sand" to avoid learning what the investors were being told by the other defendants. Id.

The Third Circuit

In In re Suprema Specialties, Inc. Sec. Litig., 438 F.3d 256 (3d Cir. 2006), the plaintiff investors asserted claims against Suprema's former directors and officers, its outside auditor, and several investment firms that served as underwriters for public stock offerings arising under Sections 11, 12(a)(2), and 15 of the Securities Act, Sections 10(b), 18, and 20 of the Exchange Act, and fraud and misrepresentation under state law. The Third Circuit found that the complaint contained sufficient allegations of the officers' control over the corporation's business and operations and that the other culpability in the fraud supported the Sections 15 and 20 claims against them and the district court should not have dismissed those claims. Id. at 286.

The plaintiffs' second amended complaint did not name Suprema as a defendant because of its bankrupt status. Id. at 285. The plaintiffs argued that Suprema's controlling persons should not escape liability under Sections 15 and 20 because "Suprema's underlying liability cannot be formally adjudicated due to its insolvency." Id. The Third Circuit agreed, explaining that "there is no requirement in the language of either statute that the controlled person be named as a defendant as a predicate to imposing liability upon the controlling individual defendants. A plaintiff need only establish the controlled person's liability." Id.

The Third Circuit found that the plaintiffs adequately alleged Suprema's primary violations of the Securities Act and the Exchange Act because they set forth in detail the specific allegations of Suprema's misstatements and expressly asserted that Suprema should be held primarily liable as a result under Sections 15 and 20. Id. at 286.

In Steamfitters Local 449 Pension Fund v. Alter, 2011 WL 4528385 (E.D. Pa. Sept. 30, 2011), the lead plaintiff brought a securities fraud class action for violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 on behalf of all persons and entities that purchased publicly traded securities of Advanta Corp. ("Advanta"), an issuer of credit cards to small businesses. The lead plaintiff alleged that it purchased shares after the defendants artificially inflated Advanta's stock price by making material misstatements about the credit quality of Advanta's customers, its delinquency and charge-off rates, and a re-pricing scheme to raise interest rates and minimum payments. Id. at *1-3. The defendants included Advanta's officers ("management defendants") and directors ("outside director defendants"); John F. Moore, the president of an Advanta subsidiary; and Christopher J. Carroll, who initiated the internal audits of Advanta's delinquency practices and reported the company to the Federal Deposit Insurance Corporation ("FDIC"). Id. at *1. The district court granted the motions to dismiss of the outside director defendants and defendants Moore and Carroll and denied in relevant part the management defendants' motion to dismiss. Id.

The lead plaintiff alleged that the defendants violated Section 20(a). Id. at *10. The district court noted that a Section 20(a) claim has three elements: "(1) an underlying violation by Advanta; (2) circumstances indicating control over the company's actions; and (3) culpable participation in the wrongful actions." Id. at *11. Although Advanta was not a named defendant because it filed for bankruptcy, the district court held that the lead plaintiff adequately pleaded Advanta's liability in making its Section 10(b) claims. Id. Further, the district court held that the lead plaintiff adequately pleaded a Section 20(a) claim against the management defendants because it alleged that they had the ability to exert control over Advanta and established their culpable participation by adequately stating a claim against them under Section 10(b). Id.

However, the district court dismissed the Section 20(a) claim against the defendant Carroll and the outside director defendants because the lead plaintiff did not plead their culpable participation in the wrongful actions. Id. Regarding the defendant Carroll, the district court emphasized that the lead plaintiff did not allege that Carroll made any misstatements, explaining that pleading "*knowledge* of the facts underlying the fraud, or even knowledge of the fraud itself, is simply not enough to establish culpable *participation* in the securities violation by an allegedly controlling person." Id. Further, the district court interpreted the fact that Carroll reported Advanta to the FDIC without correcting the very problems he helped identify as evidence of Carroll's "*inability* to exert control over the practices" of Advanta. Id. at *12. Although the district court recognized that Carroll engaged in suspicious stock sales, these sales were not sufficient to show culpable participation in light of his role in initiating two internal audits and an FDIC investigation of Advanta's delinquency reporting. Id.

The Sixth Circuit

In Frank v. Dana Corp., 646 F.3d 954 (6th Cir. 2011), the plaintiffs claimed violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5, alleging that two of Dana Corporation's chief corporate officers intentionally or recklessly engaged in misstatements and material omissions calculated to artificially boost Dana's stock price. Id. at 956-57. Despite alleged positive growth projections for Dana's automotive supplier business amid rising raw material costs, Dana eventually announced restated financial earnings and uncovered material weaknesses in internal controls. Id. at 957.

The plaintiffs alleged that Dana's two chief corporate officers acted as controlling persons during the Section 10(b) violation, claiming a separate violation of Section 20(a). Id. at 962. The district court dismissed the plaintiffs' Section 20(a) claims for failing to plead (1) the Section 10(b) underlying violation and (2) that defendants did not act in good faith. Id. The Sixth Circuit disagreed, finding that the district court incorrectly placed the burden on the plaintiffs to refute the defense that the defendants acted in good faith. Id. at 963. The Sixth Circuit recognized that it had not previously held that defendants bear the burden of showing good faith, but noted that many of its sister circuits had. Id. at 963 (citing Laperriere v. Vesta Ins. Grp., Inc., 526 F.3d 715, 721 (11th Cir. 2008); In re Stone & Webster, Inc., Sec. Litig., 424 F.3d 24, 26 (1st Cir. 2005); Southland Sec. Corp. v. INSpire Ins. Solutions, Inc., 365 F.3d 353, 384 (5th Cir. 2004); Dellastatious v. Williams, 242 F.3d 191, 194 (4th Cir. 2001); Donohoe v. Consol. Operating & Prod. Corp., 30 F.3d 907, 912 (7th Cir. 1994)). The Sixth Circuit also observed that the defendants bear the burden of establishing a good faith exception in the context of a director liability suit, which is similar to the Section 20(a) exception. Id. As such, the Sixth Circuit reversed the district court's decision, finding that the plaintiffs adequately pleaded a Section 20(a) claim. Id. at 964.

The Seventh Circuit

In Silverman v. Motorola, Inc., 772 F. Supp. 2d 923 (N.D. Ill. 2011), plaintiff investors brought a class action against Motorola and several of its directors, alleging misstatements and omissions relating to the company's launch of 3G phones. Id. at 925-26. Investors alleged that, despite known problems in the supply chain, Motorola made public statements and SEC filings that indicated the product portfolio was on track and made unrealistic earnings projections for the mobile division. Id. at 926. The plaintiffs further alleged that Motorola covered up the reduction in mobile earnings by executing highly profitable IP transactions. Id. Several of the defendants moved for summary judgment on grounds that no reasonable jury could find them liable under Section 20(a). Id.

The district court applied the Seventh Circuit's two-part test to determine control person liability: (1) "the control person must have *actually* exercised general control over the operations of the wrongdoer"; and (2) "the control person must have had the power or ability—even if not exercised—to control the specific transaction or activity that is alleged to give rise to liability." Id. at 927 (quoting Donohoe v. Consol. Operating & Prod. Corp., 30 F.3d 907, 911-12 (7th Cir. 1994)). While the district court noted that the Seventh Circuit recognized indirect influence for purposes of Section 20(a), the district court held that a defendant cannot be held liable for simply "being privy" to discussions about all aspects of the company's business. Id. at 928. Additionally, the district court determined that requirements imposed by ethics codes or codes of conduct were unconnected to control under Section 20(a). Id. at 932. The district court granted summary judgment as to the Section 20(a) claims against those defendants who only controlled divisions of the company not directly related to the alleged misstatements. Id. at 931, 934.

The Eighth Circuit

In Lustgraaf v. Behrens, 619 F.3d 867, 871-72 (8th Cir. 2010), the Eighth Circuit reversed in part the district court's dismissal of control person liability claims against a broker-dealer and its parent company.

The plaintiffs brought claims against Kansas City Life Insurance Company ("KCL"), its wholly owned broker-dealer subsidiary Sunset Financial Services, Inc. ("Sunset"), and Bryan Behrens—a registered representative of Sunset, a general agent of KCL, and the president and CEO of 21st Century Financial Group, Inc. (a branch office of Sunset). Id. at 871. The plaintiffs allegedly invested money with Behrens through

National Investments, Inc., a company that Behrens controlled. Id. at 871-72. Plaintiffs alleged no specific actions against KCL or Sunset, but sought relief from them based on control person liability. Id. at 872. The district court found that the plaintiffs had not established control person liability against Sunset because they did not allege facts demonstrating that Sunset exercised control over, or had the ability to control, Behrens. Id. at 875. The district court also dismissed the claims against KCL because the claims against its subsidiary Sunset were dismissed. Id. at 877.

The Eighth Circuit noted that while the first prong of control person liability—a violation of the Exchange Act—requires satisfaction of the heightened pleading standards of the PSLRA, the second and third prongs of the analysis concern control, not fraud, and are analyzed under the ordinary notice-pleading standard. Id. at 875. With regard to the control person liability claim against Sunset, the Eighth Circuit stated that because a broker-dealer provides its representatives access to the securities markets, it has a duty to monitor that representative's activities—even for transactions through entities with no affiliation with the broker-dealer. Id. at 876. Pointing to a circuit split on this issue, the Eighth Circuit rejected Sunset's argument that there must be "culpable participation" by a defendant to establish control person liability because the issue was clearly settled within the Circuit. Id. at 877. Accordingly, the Eighth Circuit reversed the district court's dismissal with respect to Sunset. Id.

With respect to KCL, the Eighth Circuit stated that to show control liability generally, a plaintiff must allege that the control person "'actually exercised' control over the primary violator's *general* operations." Id. at 878. The court concluded that because KCL was not a broker-dealer, it did not provide Behrens with access to the securities markets, and was therefore not under the same duty to monitor his activities. Id. at 885. Accordingly, the Eighth Circuit affirmed the district court's dismissal with respect to KCL. Id.

The Eleventh Circuit

In Laperriere v. Vesta Ins. Grp., Inc., 526 F.3d 715 (11th Cir. 2008), the Eleventh Circuit held that the proportionate liability scheme of Section 21(D)(f) of the Exchange Act, enacted as part of the PSLRA, did not alter the standard for liability under Section 20(a) of the Act, but that Section 21(D)(f) did affect the rubric for determining whether a controlling person is responsible proportionately or jointly and severally.

The Eleventh Circuit recited that Section 20(a) imposes liability on a controlling person "jointly and severally with and to the same extent as a controlled person . . . unless the controlling person can establish the affirmative defense of good faith and non-inducement." Id. at 721. The Eleventh Circuit found that the proportionate liability provisions of Section 21(D)(f) apply to Section 20(a) claims against controlling persons. Id. at 725. The Eleventh Circuit explained that Section 21(D)(f) did not "change the rules for determining who is liable for violating the securities laws," but did alter the allocation of damages once an individual is found liable as a controlling person. Id. at 727. If a controlling person is found by a fact finder to have *knowingly* violated the securities laws, the court continued, the controlling person is jointly and severally liable—whereas if "the fact finder does not specifically find a knowing violation" on the part of the controlling person, the controlling person will be liable for a *proportionate* amount of the damages only, "'based upon the fact finder's apportionment of responsibility.'" Id. at 728.

The D.C. Circuit

In In re Fed. Nat'l Mortg. Ass'n Sec., Deriv., & ERISA Litig., 503 F. Supp. 2d 25 (D.D.C. 2007), plaintiff shareholders of the Federal National Mortgage Association ("Fannie Mae") brought a securities class action lawsuit alleging that Fannie Mae, members of its Audit Committee, and certain former and current officers of the company violated Section 10(b) of the Exchange Act. The plaintiffs also alleged that three outside directors were liable as control persons under Section 20(a) of the Exchange Act.

The district court recognized a division of authority as to whether plaintiffs must plead "culpable participation" in the underlying primary securities violation when asserting a Section 20(a) claim, noting that some circuits only required plaintiffs to plead control and then shift the burden to the defendants to show that they did not participate in the fraud. Id. at 43-44. The district court ultimately held that the plaintiffs must plead culpable participation in the primary violation. Id. at 44.

The district court reasoned that "requiring culpable participation on the part of the allegedly controlling defendants is consistent with the purposes of the Exchange Act and the PSLRA." Id. The district court explained that the PSLRA was designed to make it more difficult for plaintiffs to bring securities fraud cases and thereby "relieve from the burdens of litigation any parties who as a matter of law did not belong in the action in the first place." Id. (internal quotation marks and citation omitted). If plaintiffs were not required to plead culpable participation, the district court surmised, any corporate officer could be brought into securities litigations simply by virtue of his controlling position in the company, which would contravene the intent of Congress in passing the PSLRA. Id.

The district court added that "plaintiffs must plead, at a minimum, 'particularized facts' of a defendant's culpable participation"—pleading that the defendants acted with mere negligence was insufficient. Id. at 45. The district court therefore dismissed the Section 20(a) claims against the individual defendants because the plaintiffs did not plead any specific facts indicating that the defendants culpably participated in the alleged fraud. Id. at 45-46.

5

Class Action Procedural Mechanisms

The Lead Plaintiff Provisions of the PSLRA

Under the PSLRA, the appointment of a "most adequate" or "lead" plaintiff is a prerequisite to the maintenance of any private securities class action. See 15 U.S.C. 78u-4. As a matter of procedure, the plaintiff who files the initial action must, within 20 days of filing, publish a notice to the class informing potential class members of: (1) the pendency of the action; (2) the claims asserted in the complaint; (3) the purported class period; and (4) the fact that, no later than 60 days after the date of publication of the notice, any member of the purported class can move the district court to serve as lead plaintiff. See 15 U.S.C. 78u-4(a)(3)(A)(i). Within 90 days after the publication of the notice, the district court shall appoint as lead plaintiff the member(s) of the class that the court determines to be the most capable of adequately representing the interests of the class members. See 15 U.S.C. 78u-4(a)(3)(B).

The PSLRA operates under the presumption that the "person or group of persons" with the largest financial interest in the relief sought by the class is the "most adequate" plaintiff, so long as that plaintiff satisfies the requirements of Fed. R. Civ. P. 23. See 15 U.S.C. 78u-4(a)(3)(B)(iii)(I). In some cases, courts will appoint a group of persons to act as "lead plaintiff" based upon "diversity of [their] experience and [the] interests of group members." In re Atlas Mining Co. Sec. Litig., 2008 WL 821756, at *5 (D. Idaho Mar. 25, 2008) (citation omitted).

In determining the most adequate plaintiff based upon the largest financial interest, the Southern District of New York looks to: (1) the total number of shares purchased during the class period; (2) the net shares purchased during the class period; (3) the net funds expended during the class period; and (4) the approximate losses suffered. Foley v. Transocean Ltd., 272 F.R.D. 126, 127-28 (S.D.N.Y. 2011) (citing Pirelli Armstrong Tire Corp. Retiree Med. Benefits Trust v. LaBranche & Co., 229 F.R.D. 395, 404 (S.D.N.Y. 2004), mot. to amend denied sub nom. In re NYSE Specialists Litig., 2004 WL 1656599 (S.D.N.Y. July 23, 2004)).

Other courts look to the PSLRA's purpose to prevent lawyer-driven litigation, requiring the proposed plaintiff's investors to have a pre-existing relationship prior to litigation when calculating the largest financial interest. See Niederklein v. PCS Edventures!.com, Inc., 2011 WL 759553 (D. Idaho Feb. 24, 2011). Likewise, the Southern District of New York weighs the following factors designed to curb lawyer-driven litigation when substituting a lead plaintiff: (1) whether the substitute lead plaintiff made a timely request for appointment; (2) whether the substitute lead plaintiff has the largest financial interest in the action; and (3) whether the substitute lead plaintiff otherwise satisfies the typicality and adequacy requirements Rule 23. See In re Smith Barney Transfer Agent Litig., 2011 WL 6318988, at *2-3 (S.D.N.Y. Dec. 15, 2011).
The "most adequate plaintiff" presumption may be rebutted "only upon proof by a member of the purported plaintiff class that the presumptively most adequate plaintiff[] will not fairly and adequately protect the interests of the class," or by proof that the presumptively most adequate plaintiff "is subject to unique defenses that render such plaintiff incapable of adequately representing the class." See 15 U.S.C. 78u-4(a)(3)(B)(iii)(II). The lead plaintiff must show a "'willingness and ability . . . to take an active role in and control the litigation and to protect the interests of absentees . . . .'" Feder v. Elec. Data Sys. Corp., 429 F.3d 125, 130 (5th Cir. 2005) (citation omitted).

Largest Financial Stake/Greatest Economic Loss

The Second Circuit

In Foley v. Transocean Ltd., 272 F.R.D. 126 (S.D.N.Y. 2011), three investors ("Johnson," "Danica," and "Virgin Islands") in the defendant corporation, alleging violations of Section 10(b) of the Exchange Act and Rule 10b-5, filed motions seeking appointment as lead counsel. In interpreting the PSLRA's "largest financial interest" criteria, the district court mentioned the Second Circuit's preferred application of the four-factor Lax Test. Id. at 127 (citing Lax v. First Merchs. Acceptance Corp., 1997 WL 461036, at *5 (N.D. Ill. Aug. 11, 1997)). "These factors include: (1) the total number of shares purchased during the class period; (2) the net shares purchased during the class period . . . ; (3) the net funds expended during the class period . . . ; and (4) the approximate losses suffered." Id. at 127-28 (citing Pirelli Armstrong Tire Corp. Retiree Med. Benefits Trust v. LaBranche & Co., 229 F.R.D. 395, 404 (S.D.N.Y. 2004), mot. to amend denied sub nom. In re NYSE Specialists Litig., 2004 WL 1656599 (S.D.N.Y. July 23, 2004)). Applying the "last in, first out" ("LIFO") methodology favored by the S.D.N.Y., the district court held that Danica had suffered greater losses by applying the PSLRA's 90-day "'lookback period,'" which states that damages should be awarded based on the difference between the price paid per share and the average trading price of the security in question during the 90-day period following the corrective disclosure. Id. at 130 (citation omitted). The district court also noted that Johnson lacked the necessary property interest in order to serve as lead plaintiff because he "appears to be an investment adviser lacking constitutional standing" under the Second Circuit's prevailing Huff standard. Id. at 128 n.2 (citing W.R. Huff Asset Mgmt. Co. v. Deloitte & Touche LLP, 549 F.3d 100 (2d Cir. 2008)). In all, as a result of the Lax factors and Johnson's inability to rebut the PSLRA's presumption that Danica would serve as lead plaintiff, the district court appointed Danica as lead plaintiff. Id. at 134.

The Seventh Circuit

In Bang v. Acura Pharm., Inc., 2011 WL 91099 (N.D. Ill. Jan. 11, 2011), the district court considered whether a group seeking to be appointed lead plaintiff in a securities class action "must have a pre-existing relationship with one another that is separate from their investment" and that started before the lawsuit. Id. at *2. The district court noted that the Seventh Circuit had not previously addressed this issue, but held that the primary inquiry is whether the proposed plaintiffs will fairly and adequately represent the class and not their pre-existing relationship. Id. at *3. The district court further permitted the proposed group of previously unrelated investors to aggregate their claims, resulting in an aggregate amount higher than another proposed lead plaintiff. Id.

The Ninth Circuit

In Neiderklein v. PCS Edventures!.com, 2011 WL 759553 (D. Idaho Feb. 24, 2011), two prospective plaintiffs sought appointment as lead plaintiff in a class action asserting claims under Section 10(b) of the Exchange Act and Rule 10b-5. The plaintiff with the largest financial interest, the Padgett Group, had no pre-existing relationship before bringing the class action and was allegedly formed only for the purpose of litigation against the defendant. Id. at *4. The other prospective plaintiff was an individual, Moustafa Salem.

The district court, appointing Salem lead plaintiff despite the Padgett Group's larger financial interest, first noted that the Padgett Group failed to submit any evidence demonstrating that the group was cohesive and not purely lawyer-driven. Id. at *4. Second, the district court pointed out that a purpose of the PSLRA was to prevent lawyer-driven litigation, which it reasoned would be undermined by allowing lawyers to designate prospective plaintiffs without any pre-existing relationship for purposes of litigation. Id. at *5. The district court further concluded that allowing plaintiff groups to aggregate losses defeated the purpose of choosing a lead plaintiff, and that a group formed in this manner would be unlikely to engage meaningfully in the litigation. Id. at *5. While recognizing that other courts within the Ninth Circuit had ruled differently, the district court nevertheless held that "[t]o remain consistent with . . . the PSLRA's lead plaintiff provisions . . . a pre-existing relationship or evidence of cohesion between or among members of the group seeking appointment . . . is essential." Id. at *7. In light of the Padgett Group's failure to show a pre-existing relationship or cohesion, the district court ultimately appointed Salem as lead plaintiff. Id. at *13.

Substitution of Lead Plaintiffs

The Second Circuit

In In re Smith Barney Transfer Agent Litig., 2011 WL 6318988 (S.D.N.Y. Dec. 15, 2011), putative class action plaintiffs asserted claims against Smith Barney Management

Limited, Citigroup Global Markets Inc., and Lewis Daidone under Section 10(b) of the Exchange Act and Rule 10b-5. Six years into the litigation, the lead plaintiff, an annuity trust fund, withdrew after disclosing that it never actually owned any of the funds at issue. The district court determined that renewed lead plaintiff motions were appropriate and five members of the plaintiff class moved for appointment. Id. at *1. In selecting the new lead plaintiff, the district court applied the S.D.N.Y.'s three-part test, evaluating "(1) whether the substitute lead plaintiff made a timely request for appointment; (2) whether the substitute lead plaintiff has the largest financial interest in the action; and (3) whether the substitute lead plaintiff otherwise satisfies the typicality and adequacy requirements" of Rule 23. Id. at *2. Weighing these factors, the district court prioritized the application of one plaintiff, who had properly sought lead plaintiff status at the outset of litigation, over applicants with a greater financial stake in the litigation because those applicants had not originally applied for lead plaintiff status and did not file their own lawsuits. Id. at *2-3. The district court added that this rule "further[ed] the PSLRA's policy favoring investor-driven rather than lawyer-driven securities litigation." Id. at *2.

The Third Circuit

In In re Herley Indus. Inc., Sec. Litig., 2010 WL 176869 (E.D. Pa. Jan. 15, 2010), Galleon Management, LP ("Galleon") was appointed lead plaintiff in a securities fraud class action. Id. at *1. However, during the pendency of the case, Galleon became defunct as a corporation, and the remaining class representative, Norfolk County Retirement System ("Norfolk"), sought appointment as lead plaintiff. Id. The district court held that Norfolk could be appointed as lead plaintiff.

The district court first addressed whether or not the defendants could challenge the replacement of a lead plaintiff. Id. at *2. The district court noted that there is no direct authority in the Third Circuit on this point, and that while some courts have allowed defendants to challenge the replacement of a lead plaintiff, others have expressed doubt as to the defendant's ability to do so. Id. (citing In re Impax Labs., Inc. Sec. Litig., 2008 WL 1766943 (N.D. Cal. Apr. 17, 2008) (allowing, without discussion, the defendants to challenge the substitute lead plaintiff); In re Initial Pub. Offering Sec. Litig., 214 F.R.D. 117, 121-22 (S.D.N.Y. 2002) (finding that it was not "clear whether defendants would be entitled" to challenge substitution of the lead plaintiff)). Citing the "potential for prejudice to defendants when lead plaintiffs are substituted after years of litigation," the district court allowed defendants to challenge the appointment. Id.

However, the district court found it unnecessary to reopen the appointment process for lead plaintiffs because (1) the defendants gave the court no adequate reason to do so, (2) Norfolk was the class member with the second largest loss during the period, and (3) the court found that Norfolk met all Rule 23 requirements during the original class certification process. Id. at *4. The district court also recognized that "Norfolk had been involved with this litigation since its inception in 2006." Id.

Class Certification Requirements under Rule 23

Rule 23(a) Requirements

In order to obtain class action certification, in a securities fraud case or any other purported class action, plaintiffs must meet the four threshold requirements of Fed. R. Civ. P. 23(a). Plaintiffs must demonstrate that: (1) the class is so numerous that joinder of all members is impracticable; (2) there are questions of law or fact common to the class; (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class; and (4) the representative parties will adequately protect the interests of the class. See Fed. R. Civ. P. 23(a). These requirements are commonly referred to as "the prerequisites of numerosity, commonality, typicality and adequacy of representation." Hodges v. Akeena Solar, Inc., 274 F.R.D. 259 (N.D. Cal. 2011). In 2011, the Supreme Court expanded the commonality inquiry to include a showing of both common questions and "the capacity of a classwide proceeding to generate common *answers* apt to drive the resolution of the litigation." Wal-Mart,[71] 131 S. Ct. at 2551. In addition, to satisfy the requirements of Rule 23(a), a plaintiffs must also establish at least one of the elements of Rule 23(b), which is discussed in the next section.

Numerosity

In In re HealthSouth Corp. Sec. Litig., 261 F.R.D. 616 (N.D. Ala. 2009), the district court found the numerosity requirement was satisfied, noting that the class of bondholders held both registered and unregistered bonds that were actively traded among hundreds of investors. Id. at 626. The district court specifically noted that "[t]he amount of debt securities offered to the market (over $3.4 billion), combined with the high trading volume of the debt securities, . . . the large number of market makers and dealers, and the preliminary identification of hundreds of class members, supports the conclusion that joinder of such a large group of investors is presumptively impracticable." Id. at 626 (citation omitted).

Commonality

The Supreme Court

Although Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 2541 (2011), does not mention Rule 10b-5, it has the potential to impact future 10b-5 cases. The three named plaintiffs in that case represented 1.5 million class members, each current or former female employees of Wal-Mart, asserting sexual discrimination in violation of Title VII of the 1964 Civil Rights Act. Id. at 2547. Specifically, the plaintiffs alleged that local managers' discretion over pay and promotions was exercised disproportionately in favor of men, leading to an unlawful disparate impact on female employees. Id. at 2548. The district court and Ninth Circuit each approved certification of the class. Id. at 2549-50.

[71] Note, Wal-Mart does not actually mention Section 10(b) or Rule 10b-5, but its relevance to securities class actions will be explained.

Reversing the judgment of the Ninth Circuit, Justice Scalia, in a 5-4 decision, determined that the central issue of the case concerned Rule 23(a)(2) commonality. Id. at 2550-51. Relying on Gen. Tel. Co. of the Sw. v. Falcon, 457 U.S. 147 (1982), Justice Scalia noted that plaintiffs could not satisfy Rule 23(a)(2), because they failed to allege any uniform employment practice and the allegations centered around local managers enacting local decisions. Wal-Mart, 131 S. Ct. at 2554. The Court noted that commonality does not merely require "the raising of common questions—even in droves—but, rather the capacity of a classwide proceeding to generate common *answers* apt to drive the resolution of the litigation." Id. at 2551. The Court held that the evidence presented could not generate such common answers, because the plaintiffs could not demonstrate a common method of exercising discretion that permeated the company. Id. at 2554-55.

The Second Circuit

In Pub. Emps.' Ret. Sys. of Miss. v. Merrill Lynch & Co., 277 F.R.D. 97 (S.D.N.Y. 2011), plaintiffs alleged violations of the Securities Act in connection with eighteen separate offerings of mortgage pass-through certificates pursuant to three distinct registration statements over a period of twenty months. In analyzing whether commonality was satisfied, the district court first expressed skepticism as to whether Wal-Mart actually heightened the commonality requirement. See id. at 105-06. Without resolving that question, the district court concluded commonality was met. Despite citing Wal-Mart for the notion that commonality depends on the presence of "common *answers* apt to drive the resolution of the litigation," the district court held that "the Supreme Court's clarifying language in Wal-Mart has no effect on the commonality determination in this case" because the common question of "whether the Offering Documents were false or misleading in one or more respects" was "clearly susceptible to common answers." Id. at 106. Additionally, the district court distinguished Wal-Mart on its facts, finding "a case in which three named plaintiffs sought to represent a class of 1.5 million women in an employment discrimination suit . . . entirely distinguishable from the facts of the instant securities class action." Id. at 106.

The Seventh Circuit

In Groussman v. Motorola, Inc., 2011 WL 5554030 (N.D. Ill. Nov. 15, 2011), ERISA plaintiffs alleged breaches of fiduciary duty in connection with the administration of a 401(k) plan. In denying certification, the district court rejected the argument that plaintiffs "need only show a common nucleus of operative facts among the claims of the proposed class members" as insufficient in light of Wal-Mart, and called into question the plaintiffs' use of pre-Wal-Mart cases. See id. at *3 ("Plaintiffs' argument that . . . all proposed class members were participants in the Plan and had invested in Motorola stock [relies on] the type of loose factual connections among class members that does not suffice under [Wal-Mart]."). Notably, the district court stated that commonality required that the proposed class be comprised of "individuals who uniformly invested in Motorola stock at a set time and suffered in a similar manner." Id. at *4. Specifically, in finding that commonality was not satisfied under Wal-Mart, the district court commented that the plaintiffs could "only hope and speculate that . . . they all individually happened to engage in similar trading patterns and used similar trading strategies, which would allow all claims to be efficiently dealt with in a class action format." Id.

Typicality

The Second Circuit

In In re Flag Telecom Holdings, Ltd. Sec. Litig., 574 F.3d 29 (2d Cir. 2009), plaintiffs sought to certify a class of investors alleging claims under Sections 11, 12(a)(2), and 15 of the Securities Act and Sections 10(b) and 20(a) of the Exchange Act, which arose out of Flag Telecom Holdings, Ltd.'s ("Flag") initial public offering in February 2000. By February 2002, Flag's business fortunes failed because of an oversupply of fiber optic capacity in the general market, and in April 2002 the Company filed a Chapter 11 bankruptcy petition. Id. at 32. The district court granted class certification, rejecting Flag's argument that there was a fundamental conflict between the Securities Act plaintiffs and the Exchange Act plaintiffs. Id. at 32-33. The district court also found that the class properly included purchasers who sold their Flag shares before February 13, 2002, the last day of the class period and the date on which Plaintiffs alleged Flag disclosed the truth behind the alleged misstatements to the public. Id. at 34.

On appeal, the Second Circuit first found that there was no "disabling" intra-class conflict between the Securities Act investors and the Exchange Act investors based upon the different standards for proving both loss causation under the Exchange Act and negative causation under the Securities Act. Id. at 35-37. "[I]t is not inconsistent with Dura to permit both the [Securities Act and Exchange] Act Plaintiffs to proceed as a single class in establishing that each of the misstatements alleged in the complaint was the proximate cause of some portion of Plaintiffs' losses." Id. at 36-37.

The Second Circuit, however, recognized that since class representative Norman Hunter sold all of his shares prior to the alleged corrective disclosures, he was therefore an "in-and-out trader" who could not conceivably prove loss causation as a matter of law. Id. at 40. The Second Circuit concluded that such "in-and-out" traders should not have been included in the certified class, noting that "'when a claim cannot succeed as a matter of law, the Court should not certify a class on that issue.'" Id. at 39 (citation omitted). The Second Circuit, contrasting cases from other circuits, noted that the issue before it was not one of predominance under Rule 23(b)(3), or a merits issue more suitable for summary judgment, but rather one implicating Rule 23(a)'s adequacy and typicality requirements. Id. at 37-38. The Second Circuit further noted that *any* plaintiffs who sold prior to the alleged curative disclosures should be eliminated from the proposed class, because they could not conceivably prove loss causation. Id. at 40.

In In re IMAX Sec. Litig., 272 F.R.D. 138 (S.D.N.Y. 2010), putative class action plaintiffs alleged that defendants IMAX Corporation ("IMAX"), individual defendants, and IMAX's external auditor issued materially false and misleading financial statements concerning IMAX's accounting of its theater system revenue. Id. at 143. Following appointment as lead plaintiff, Snow Capital Investment Partners, L.P. ("Snow Capital") moved to certify as a class those who acquired IMAX common stock on the NASDAQ between February 23, 2003 and July 27, 2007, and sought certification as class representative. Id. at 141-42. The district court denied Snow Capital's motion to be named class representative because Snow Capital failed to establish typicality under Fed. R. Civ. P. 23(a)(3) due to Snow Capital's inability to adequately plead loss causation. Id. at 155.

In order to be named class representative, Snow Capital had to show "by a preponderance of the evidence, that its claims [were] typical of the claims of the class, and that it [was] 'not subject to any unique defenses which threaten[ed] to become the focus of the litigation.'" Id. at 147 (quoting In re Flag Telecom Holdings, Ltd. Sec. Litig., 574 F.3d 29, 40 (2d Cir. 2009)). The defendants argued that Snow Capital did not satisfy Rule 23(a)'s typicality requirement because, among other reasons, Snow Capital could not establish loss causation. Id. Although the district court had previously held that the plaintiffs' complaint adequately pleaded loss causation for the putative class, it had not determined whether Snow Capital could adequately plead loss causation in its individual capacity. Id. at 148. The district court stated that the loss causation element required Snow Capital to allege that the subject of the defendants' misstatements caused a relevant economic loss to Snow Capital and that the market reacted negatively once a corrective disclosure was made. Id. at 148 (citing Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 342 (2005)). The district court determined that Snow Capital was unable to establish loss causation because Snow Capital had purchased its IMAX stock prior to the close of IMAX's fourth quarter 2005 and because the corrective disclosure upon which Snow Capital sought to rely did not correct any purported misstatements made prior to the fourth quarter of 2005. Id. at 154. Because Snow Capital was an "in and out" trader that could not establish loss causation, the district court found Snow Capital subject to "unique defenses" and declined to certify a class with Snow Capital as class representative. Id. at 155.

The Third Circuit

In Dodge v. Cambrex Corp., 2007 WL 608365 (D.N.J. Feb. 23, 2007), the plaintiffs brought a securities fraud action against the defendant, Cambrex Corporation ("Cambrex"), alleging two schemes of fraudulent activity: (1) the overstatement of financial results for the period of 1997 to 2001; and (2) failure to disclose and account for the loss of Cambrex's largest contract in 2003. Id. at *1. The former claim arose out of Cambrex's failure to correct a known accounting error, resulting in the improper inflation of net income. Id. When Cambrex ultimately announced its intended restatement of financials due to this error, Cambrex stock dropped. Id.

The latter claim arose out of Cambrex's manufacture of the active ingredient for a drug called Replagel for a company called Transkaryotic Therapies Inc. ("TKT"). Id. In early 2003, following the FDA's rejection of its application to produce Replagel, TKT terminated its contract with the defendant. Id. In spite of the loss of this contract, Cambrex issued a January 23, 2003 press release projecting 10-15% earnings growth. Id. Subsequently, Cambrex issued press releases reducing its expected growth rate, allegedly without disclosing the proper reason. Id. On July 24, 2003, Cambrex issued another press release, this time acknowledging the loss of the TKT contract and revising the expected growth rate to 0-3%. Id. The plaintiffs maintained that the defendants knew about the lost

TKT contract, but withheld the information and misstated projected growth in order to inflate the stock price, allowing the individual defendants to reap insider trading profits of over $16 million. Id.

The plaintiffs, Massachusetts Laborers Annuity Fund ("MLAF") and Greater Pennsylvania Carpenters Pension Fund ("GPCPF"), each moved to obtain certification of a plaintiff class of all purchasers of Cambrex securities between October 21, 1998 and July 25, 2003 and for appointment of MLAF and GPCPF as class representatives. Id. at *4. The district court considered typicality in light of the two separate incidents alleged by plaintiffs. Id. at *6.

MLAF's losses were only attributable to Cambrex's misstatement of financial results for the period of 1997 to 2003, as opposed to the terminated TKT contract. See id. The defendants argued this made MLAF atypical because MLAF did not have a claim based on the TKT incident as did other claimants. Id. The district court ruled that while MLAF did not have standing to prosecute the TKT fraud claim, "this does not bar MLAF from representing the class on the accounting misrepresentations . . . . These claims still stand and present common questions of law and fact." Id.

Additionally, because GPCPF purchased Cambrex stock after disclosure of the TKT contract cancellation, defendants contended that the timing of GPCPF purchases raised reliance issues that are arguably unique to GPCPF. Id. However, the district court maintained that purchases of stock by the class representative after negative announcements during the class period did not destroy typicality. Id. Furthermore, the district court concluded that "proposed class representatives who purchased shares mid-stream, i.e., during the course of a series of disclosures may satisfy the typicality test." Id. Accordingly, the district court held that MLAF and GPCPF together met the typicality requirement of Fed. R. Civ. P. 23(a).

The Fifth Circuit

In In re Seitel, Inc. Sec. Litig., 245 F.R.D. 263 (S.D. Tex. 2007), investors brought an action under Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 against Seitel, Inc. ("Seitel"), certain of its former officers and directors, and Ernst & Young, alleging fraudulent accounting practices and false statements regarding the timing of revenue recognition. The defendants argued against class certification and claimed that the plaintiffs did not satisfy the typicality requirements. Because the proposed class representatives bought stock at different times—one before Seitel's restatement and one after—the defendants argued that there was a conflict between the representatives as to the degree of artificial inflation of the stock price at the times of their respective purchases. Id. at 270-71.

The district court stated that "'certain minimal levels of antagonism must be tolerated'" between class interests in the securities fraud context. Id. at 271 (citation omitted). After finding that the proposed class representatives' claims arose from a similar course of conduct and were predicated on the same legal theory (i.e., that Ernst & Young materially misstated Seitel's results for the year 2000), the district court held that the typicality requirement was satisfied. Id. The factual differences relating to when the proposed class representatives purchased their shares and whether Seitel's restatements impacted each differently were not "at loggerheads with a finding of typicality." Id.

The Sixth Circuit

In In re Accredo Health, Inc. Sec. Litig., 2006 WL 1716910 (W.D. Tenn. Apr. 19, 2006), the district court certified an investment fund as lead class plaintiff. Id. at *1. The defendant argued the investment fund did not meet the typicality requirement of Rule 23(a) because it was subject to the unique defense that it relied on the advice of its investment managers in deciding to purchase the defendant's stock. Id. at *3. The district court rejected this argument as offending congressional intent in passing the PSLRA, which the court noted was designed to "'increase the likelihood that institutional investors will serve as lead plaintiffs.'" Id. at *4 (citation omitted).

The Eleventh Circuit

In In re Scientific-Atlanta, Inc. Sec. Litig., 2007 WL 2683729 (N.D. Ga. Sept. 7, 2007), the plaintiffs requested class certification for all persons who purchased or otherwise acquired the securities of Scientific-Atlanta ("SA"), or who sold put options of SA between January 18, 2001 and August 16, 2001. The district court held that class certification was warranted.

The district court found that the named class representatives satisfied the typicality requirement because the class representatives "rely on the same allegations of misrepresentations and omissions and share the same legal theory as those of the class they seek to represent." Id. at *5. Although the district court acknowledged that a "defense which is unique to the class representative" may destroy typicality by becoming the focus of the litigation, it concluded that this concern was not present on the allegations before it. Id. at *6.

In addition, the district court found the put option sellers were adequately represented by the proposed class representatives, stating that "a put options seller, upon proof of market efficiency in the underlying stock, is generally entitled to a rebuttable presumption of reliance." Id. at *8. For this reason, the district court held that the put option sellers did not have unique reliance defenses and that their claims were typical of those of the proposed class representatives.

However, the district court found that the plaintiffs who sold their SA stock prior to a July 19, 2001 partial curative disclosure made by the defendants were excluded from the class. The district court found no allegations in the complaint to support a finding of loss causation for plaintiffs who did not own stock after July 19, 2001. Therefore, the district court held that the claims of the class representatives were not typical of those proposed class members who sold their stock before July 19, 2001. Id. at *7.

Adequacy of Class Representation

The First Circuit

In In re Sonus Networks, Inc. Sec. Litig., 247 F.R.D. 244, 245 (D. Mass. 2007), lead plaintiff BPI Global Investments, Inc. ("BPI Global") brought a securities fraud class action against Sonus Networks, Inc. ("Sonus") and certain Sonus officers, alleging, inter alia, violations of Section 10(b) of the Exchange Act. Id. Specifically, BPI Global alleged that the defendants recorded revenue in quarters other than when earned, made false and misleading statements of finances in public filings, and knowingly engaged in improper accounting practices to create the illusion of steady, stable growth in revenue. Id. BPI Global was an investment advisor to several funds that purchased Sonus stock during the class period as well as general partner of several mutual funds for which it purchased Sonus stock. Id. at 245-246. BPI Global also invested large sums of its own money in these funds. Id.

The defendants objected to the adequacy of BPI Global as class representative based on three grounds: "(1) BPI Global does not have Article III standing because it is bringing claims on behalf of investors in funds for which it merely served as investment advisor, (2) BPI Global does not have statutory standing because it did not have unfettered discretion to buy securities under its agreement with BPI Capital and thus was not a 'purchaser' of Sonus stock under Section 10(b) of the Exchange Act, and (3) BPI Global is inadequate because it is a defunct entity with little or no oversight of the case." Id. at 249.

The district court disagreed, holding that BPI Global was an adequate class representative. Id. The district court noted that the First Circuit had applied a two-part test for adequacy: "'[t]he moving party must show first that the interests of the representative party will not conflict with the interests of the class members, and second, that counsel chosen by the representative party is qualified, experienced and able to vigorously conduct the proposed litigation.'" Id. (quoting Andrews v. Bechtel Power Corp., 780 F.2d 124, 130 (1st Cir. 1985)). The district court held that BPI Global met this standard, noting first that it had standing under both Article III and the Exchange Act. Second, the district court explained that BPI Global's subsequent merger with another firm and subsequent extinction as a formal entity did not mean that it had no incentive to litigate the case, nor did it show a lack of ability to exercise meaningful control over the litigation. Id. at 251-52. The district court stated that the merger agreement expressly provided that pending litigation would go on in BPI Global's name. Id. at 252. Furthermore, although BPI Global as an investment manager only had $66,000 in direct damages, it had fiduciary duties to investors for $5.3 million. Id. The district court found this stake "sufficiently tangible that [BGI Global] can be expected to litigate the interests of the class adequately." Id.

The Seventh Circuit

In In re Northfield Labs., Inc. Sec. Litig., 267 F.R.D. 536 (N.D. Ill. 2010), the plaintiffs moved to certify a class based on alleged misstatements regarding a clinical trial of the company's primary product, a blood substitute compatible with all blood types intended to treat life-threatening blood loss. Id. at 540. The defendants challenged the adequacy of the class representative based on the proposed lead plaintiff's lack of truthfulness in depositions. Id. at 542. The district court agreed that "a lack of honesty makes one an inadequate class representative." Id. The defendant presented inconsistent deposition testimony by one lead plaintiff about what documents he had with him, and the district court found this "false answer to a deposition question" sufficient to disqualify him as the class representative. Id. at 543.

The Eleventh Circuit

In In re Scientific-Atlanta, Inc. Sec. Litig., 2007 WL 2683729 (N.D. Ga. Sept. 7, 2007), the plaintiffs requested class certification for all persons who purchased or otherwise acquired the securities of Scientific-Atlanta ("SA"), or who sold put options of SA between January 18, 2001 and August 16, 2001. The district court held that class certification was warranted.

The district court found that the class representatives, all of whom purchased SA stock before a July 19, 2001 disclosure, adequately represented class members, including buyers and sellers of the SA security. The district court rejected the holding of In re Seagate Tech. II Sec. Litig., 843 F. Supp. 1341, 1358 (N.D. Cal. 1994), that the "interests of individuals who purchased and individuals who sold stock on the same day [are irreconcilable] because of the incentive to maximize one's own damages by maximizing price inflation on the date of purchase and maximizing loss on the date of the sale." Scientific-Atlanta, 2007 WL 2683729, at *11. Reasoning that any conflicts could be cured by creating subclasses for the purposes of damages, the district court held that the class representatives adequately represented both buyers and sellers of SA securities. Id. at *13.

Rule 23(b) Requirements

In addition to satisfying the requirements of Rule 23(a), to maintain a class action a plaintiff must also establish at least one of the elements of Rule 23(b), which requires that:

(1) prosecuting separate actions by or against individual class members would create a risk of:

- (A) inconsistent or varying adjudications with respect to individual class members that would establish incompatible standards of conduct for the party opposing the class; or
- (B) adjudications with respect to individual class members that, as a practical matter, would be dispositive of the interests of the other members not parties to the individual adjudications or would substantially impair or impede their ability to protect their interests;

(2) the party opposing the class has acted or refused to act on grounds that apply generally to the class, so that final injunctive relief or corresponding declaratory relief is appropriate respecting the class as a whole; or

(3) the court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other

available methods for fairly and efficiently adjudicating the controversy.

See Fed. R. Civ. P. 23(b). Most securities fraud cases are certified under Rule 23(b)(3), which permits certification only when (1) common questions of law or fact predominate over questions affecting only individual class members, and (2) a class action is the most effective method for adjudicating the case. See Fed. R. Civ. P. 23(b)(3). "The Rule 23(b)(3) predominance inquiry tests whether proposed classes are sufficiently cohesive to warrant adjudication by representation." Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 623 (1997). Under Rule 23(b)(3), a plaintiff must show that those issues in the proposed action subject to generalized proof outweigh the issues subject to individualized proof. See, e.g., In re Salomon Analyst Metromedia Litig., 544 F.3d 474, 480 (2d Cir. 2008); Cordes & Co. Fin. Servs., Inc. v. A.G. Edwards & Sons, Inc., 502 F.3d 91, 108-09 (2d Cir. 2007). To support such a finding, courts will look to "(A) the class members' interests in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already begun by or against class members; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; and (D) the likely difficulties in managing a class action." Fed. R. Civ. P. 23(b)(3).

The Affiliated Ute Presumption of Reliance

The Second Circuit

In In re Moody's Corp. Sec. Litig., 274 F.R.D. 480 (S.D.N.Y. 2011), investor plaintiffs brought a putative class action against a credit rating agency (Moody's) under Section 10(b) of the Exchange Act and Rule 10b-5. Specifically, plaintiffs alleged that Moody's, which was compensated via the "issuer pays" model under which a rating agency is paid for its services only if a particular company chooses to publish its ratings, engaged in "ratings shopping" and issued artificially inflated ratings. Id. at 485-86. The district court denied the lead plaintiff's motion for class certification.

The lead plaintiff contended that the class was entitled to the presumption of reliance by omission under Affiliated Ute. Id. at 493-94 (citing Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128 (1972)). However, the district court recognized that the presumption "does not apply when omissions merely exacerbate the misleading nature of the alleged conduct." Id. at 494 (citing In re Merrill Lynch Auction Rate Sec. Litig., 704 F. Supp. 2d 378, 397 (S.D.N.Y. 2010)) (internal quotation marks omitted). The district court pointed out that, in considering the defendants' motion to dismiss, it had focused on misrepresentations rather than omissions (despite the lead plaintiff's contention that Moody's inadequate assessments constituted an omission for the purposes of class certification). Id. The district court further noted that the Second Circuit had previously rejected application of the Affiliated Ute presumption where misleading statements merely "left investors with an overall 'false impression.'" Id. at 494 (quoting Starr ex rel. Estate of Sampson v. Georgeson S'holder, Inc., 412 F.3d 103, 109 (2d Cir. 2005)). As a result, the district court determined that reliance could not be assumed, holding that predominance had not been demonstrated and that class certification was improper. Id.

In In re Dynex Capital, Inc. Sec. Litig., 2011 WL 781215 (S.D.N.Y. Mar. 7, 2011), lead plaintiff brought a complaint alleging violations under Section 10(b) of the Exchange Act, contending that the defendant corporation and individual defendants sold bonds to investors without revealing that the bond collateral was impaired. The lead plaintiff moved pursuant to Fed. R. Civ. P. 23(b)(3) for the certification of a class consisting of "[a]ll purchasers of [defendant] Corporation's Collateralized Bonds Series 12 and Series 13 Bonds during the period between February 7, 2000 and May 13, 2004 who were damaged thereby." Id. at *1.

In considering the reliance prong of a Section 10(b) claim, the district court recognized that reliance by investors on alleged material omissions may be presumed. Id. at *7 (citing Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128, 153 (1972)). In the case at hand, since the omissions alleged by the lead plaintiff "'played an independent, or at least interdependent'" role in defendants' allegedly fraudulent behavior, the district court found that Affiliated Ute applied and reliance was presumed, resulting in the court granting lead plaintiff's motion for class certification. Id. at 7-9 (quoting In re Parmalat Sec. Litig., 2008 WL 3895539, at *8 (S.D.N.Y. Aug. 21, 2008)).

In Berks Cnty. Emps.' Ret. Fund v. First Am. Corp., 734 F. Supp. 2d 533 (S.D.N.Y. 2010), the plaintiff, a pension fund, alleged that First American Corporation ("First American"), its subsidiary eAppraiseIT, and five of their directors and officers fraudulently inflated the residential appraisal values that eAppraiseIT provided to Washington Mutual, Inc. ("WaMu") in violation of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The plaintiff claimed, inter alia, that the defendants issued false and misleading statements about the quality and legality of their business and reported materially overstated financial information. Id. at 535-36.

The plaintiff moved to certify a class of all persons who acquired First American common stock between April 26, 2006 and November 6, 2007. The district court denied the plaintiff's motion, holding that the plaintiff failed to demonstrate materiality, and as a result, the plaintiff could not avail itself of a presumption of reliance under either the fraud-on-the-market or Affiliated Ute doctrines. Id. at 541. Without a presumption of reliance, the plaintiff could not demonstrate that common questions of fact predominated over individual questions of reliance pursuant to Rule 23(b)(3). Id.

The plaintiff contended that it had adequately pleaded materiality, a required element of both the fraud-on-the-market and Affiliated Ute doctrines. In support of its materiality claims, the plaintiff offered an event study by Dr. R. Alan Miller to demonstrate that the "'price movements of First American stock were attributable to [defendants'] alleged misstatements or corrective disclosures.'" Id. at 538 (citation omitted) (alteration in original). Dr. Miller opined that, on May 22, 2007, when Bloomberg announced that eAppraiseIT had been subpoenaed in connection with an investigation by the New York Attorney General ("NYAG") into real estate industry appraisal practices, First American stock did not experience "a large price decline" because eAppraiseIT had publicly portrayed the news in a positive light. Id. at 540. Dr. Miller also submitted that, although the NYAG sued First American on November 1, 2007 and public disclosure of the lawsuit was made that day, the market did not react until six days later when Fannie Mae announced that it was "concerned about the allegations." Id. at 541. The district court found this reasoning unconvincing given that Fannie Mae's announcement disclosed no new information regarding the defendants. The district court rejected Dr. Miller's study as a basis for finding materiality. Id.

The Eleventh Circuit

In Bacon v. Stiefel Labs., Inc., 275 F.R.D. 681 (S.D. Fla. 2011), the district court denied the plaintiffs' motion for class certification because the plaintiffs could not satisfy the Rule 23(b)(3) requirements of predominance and superiority. The plaintiffs, participants in an ERISA plan and shareholders of the defendant, a closely-held corporation, alleged violations under ERISA and securities fraud. Id. at 685. The plaintiffs alleged a fraudulent scheme by the corporation's board members to conceal the value of the plaintiffs' shares in order to recapture those shares and benefit improperly from the plaintiffs' premature sales. Id.

The district court did not consider whether the plaintiffs satisfied all the requirements under Rule 23(a) because it found the plaintiffs' inability to satisfy Rule 23(b) to be dispositive. Id. at 693-94. Rule 23(b) required the plaintiffs to demonstrate: (1) predominance of the questions of law or fact common to the members of the class over any questions affecting only individual members; and (2) superiority of a class action for the fair and efficient adjudication of the controversy. Id. at 694-95.

Regarding the question of predominance, the district court held that proof of reliance as to the plaintiffs' Rule 10b-5 claim was a question implicating the individual members' decisions to sell back their shares, and which would not be appropriate for class action treatment. Id. at 699. The plaintiffs sought a classwide presumption of reliance, which is permissible in three circumstances: (1) where the defendants omitted information that they had an affirmative duty to disclose, pursuant to Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128 (1972); (2) in fraud-on-the-market cases; and (3) where the defendants engaged in a common scheme or plan to defraud by taking "'the same unlawful acts in the same method against the entire class.'" Bacon, 275 F.R.D. at 696-97 (quoting Kennedy v. Tallant, 710 F.2d 711, 717 (11th Cir. 1983)). The plaintiffs sought a presumption under the first and third circumstances. Id. at 696.

The district court held that the first presumption did not apply because Affiliated Ute concerned cases primarily involving omissions, whereas the plaintiffs' claims involved mixed allegations of both omissions and misrepresentations. Id. at 696, 698. The plaintiffs were also not entitled to the presumption identified in the third instance because, rather than seeking damages for a common scheme or plan, the plaintiffs sought recovery for damages based upon individual decisions to sell shares back to the corporation. Id. at 698. The district court held that "[i]nvesting decisions, particularly in a volatile market as existed at the end of 2008 and during difficult corporate conditions as may have existed" within the defendant corporation "are personal and cannot be presumed." Id.

Regarding the question of superiority, the district court found that class action treatment would not be superior to individualized inquiry for three reasons: (1) each individual plaintiff needed to detail any relevant omissions and misrepresentations that were pertinent to the individual decision to sell the shares back to the corporation; (2) some would-be class members had an interest in controlling their personal litigation because some had already filed substantially similar claims; and (3) the claims involved substantial monetary damages. Id. at 699.

The D.C. Circuit

In In re Interbank Funding Corp. Sec. Litig., 629 F.3d 213 (D.C. Cir. 2010), the lead plaintiff in a class action appealed the district court's dismissal of the lead plaintiff's suit. The lead plaintiff purchased securities from Interbank Funding Corporation ("Interbank") alleging that she relied on materially false misrepresentations and omissions by Interbank's auditor, Radin Glass & Co. ("Radin"). Id. at 214-15. Specifically, the plaintiff alleged reliance on Radin's public attestations that Interbank's financial statements were in conformance with Generally Accepted Accounting Principles ("GAAP"), despite the fact that the statements failed to disclose, inter alia, related-party transfers. Id. at 216. The plaintiff also alleged Radin omitted to disclose that Interbank's investments were a Ponzi scheme. Id. The district court dismissed the plaintiff's claim because she had not adequately pleaded reliance, and on appeal the plaintiff argued she was entitled to a presumption of reliance under Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128, 153 (1972). Id. at 217.

The D.C. Circuit affirmed the district court's decision, noting that Affiliated Ute only applies in cases of reliance on an omission (where plaintiffs would otherwise be required to prove reliance on a negative). Id. at 219. Although the circuits vary in their application of Affiliated Ute, the D.C. Circuit noted that all circuits uniformly declined to apply the presumption for a claim alleging affirmative misstatements. Plaintiff's reliance on Radin's affirmative statements regarding Interbank's compliance with GAAP did not warrant the Affiliated Ute presumption because they were not omissions. Id. at 219-20. The D.C. Circuit disagreed with plaintiff's characterization of Interbank's operations as a Ponzi scheme and held that Radin's failure to describe it as such was not an omission. Id. at 220-21.

The Fraud-on-the-Market Presumption of Reliance

The fraud-on-the-market theory is perhaps the purest instance of the intersection of law and economics. In Basic Inc. v. Levinson, 485 U.S. 224, 246-50 (1988), the Supreme Court accepted use of the fraud-on-the-market theory, allowing plaintiffs to employ a rebuttable presumption of reliance where they can show that defendants made public misrepresentations, that the misrepresentations were material, and that the securities traded in an efficient market.[72] The presumption was deemed a pragmatic response to the

[72] Whether each of these elements must be proven at class certification remains in question. See infra at 179 (discussing circuit split as to whether plaintiffs must prove materiality at the class certification stage to invoke the presumption and noting recent grant of certiorari by the Supreme Court on this issue, Amgen Inc. v. Conn. Ret. Plans & Trust Funds, 132 S. Ct. 2742 (2012)).

impossible evidentiary burden reliance poses in the modern financial era, where innumerable purchasers and sellers of securities make trade decisions for an innumerable number of reasons through a variety of mediums. Rather than force proof of the impossible, the Basic Court recognized that the utility of this presumption, reasoning that "where materially misleading statements have been disseminated into an impersonal, well-developed market for securities, the reliance of individual plaintiffs on the integrity of the market price may be presumed." Id. at 247. Although not specifically endorsing the efficient capital market hypothesis, the Supreme Court recognized that markets react instantaneously to public information disseminated in a well-developed and efficient market, such that regardless of why or how one purchases or sells securities, buyers and sellers are relying on information embedded in the security's market price. Id. at 247 n.24.

The Supreme Court

In Erica P. John Fund v. Halliburton, 131 S. Ct. 2179 (2011), Erica P. John Fund ("EPJ Fund") alleged that Halliburton made various misrepresentations designed to inflate its stock price in violation of Section 10(b) of the Exchange Act and Rule 10b-5. The alleged false statements concerned the scope of potential liability in asbestos litigation, expected revenue from construction contracts, and the benefits of a merger. Id. at 2183. The district court denied class certification, stating that EPJ Fund had failed to prove loss causation. Id. at 2183-84. The Fifth Circuit affirmed, stating that it was bound to follow the precedent set in Oscar. Id. at 2183 (citing Oscar Private Equity Invs. v. Allegiance Telecom, Inc., 487 F.3d 261, 269 (5th Cir. 2007)).

The Supreme Court reversed the Fifth Circuit, holding that plaintiffs do not have to prove loss causation at the class certification stage to invoke the Basic presumption. Id. at 2183. In a unanimous decision, Chief Justice Roberts held that the elements of reliance and loss causation in a 10b-5 action are independent. Id. at 2185-86. Relying on Basic, Chief Justice Roberts noted that the fraud-on-the-market's presumption of reliance focuses on a material misrepresentation which permeates an efficient market, affecting all purchasers and sellers. Id. "Loss causation, by contrast, requires a plaintiff to show that a misrepresentation that affected the integrity of the market price also caused a subsequent economic loss." Id. at 2186.

The Second Circuit

In In re Salomon Analyst Metromedia Litig., 544 F.3d 474 (2d Cir. 2008), the plaintiffs alleged that Citicorp USA, Inc. ("Citicorp"), Salomon Smith Barney, Inc. ("SSB"), their parent company, Citigroup, Inc. ("Citigroup"), and SSB research analyst Jack Grubman engaged in a scheme to defraud investors in Metromedia Fiber Network, Inc. ("Metromedia"), violating Section 10(b) of the Exchange Act and Rule 10b-5. Specifically, plaintiffs alleged that Grubman wrote research reports on Metromedia stating that the company was "poised for explosive growth" yet failed to disclose that Citicorp signed a commitment letter to provide a $350 million credit facility to Metromedia. Id. at 477. On June 26, 2006 the district court granted plaintiffs' motion for class certification. Pursuant to Rule 23(f), defendants appealed the district court's grant of class certification.

On appeal, the Second Circuit reviewed two specific issues relating to Rule 23(b)(3)'s predominance requirement, which "tests whether a proposed class is 'sufficiently cohesive to warrant adjudication by representation'": (1) whether Basic Inc. v. Levinson's fraud-on-the-market presumption applies to suits in which the alleged material misrepresentations were made by a research analyst issuing a report on a particular issuer (as opposed to misrepresentations by the issuer itself); and (2) if the fraud-on-the-market presumption does apply, whether the plaintiff has the affirmative burden of showing the alleged misrepresentation "moved" or "impacted" the company's stock price in a material fashion. Id. at 480 (citation omitted).

As to the first issue, the Second Circuit noted that Basic's fraud-on-the-market presumption applies to "all publicly available information, and, hence, any public material misrepresentations," not just misrepresentations made by an issuer. Id. at 481 (quoting Basic Inc. v. Levinson, 485 U.S. 224, 246 (1988)). On the second issue, concerning plaintiff's alleged need to prove the materiality of an alleged misrepresentation by associated measurable stock price movement, the Second Circuit stated that such a requirement misread Basic and that such a burden would defeat the purpose of having a presumption of reliance in the first place. Id. at 483.

The Second Circuit, however, noted that the defendants were entitled under Basic to submit evidence of "no price impact" on rebuttal, stating that "'[a]ny showing that severs the link between the alleged misrepresentation and . . . the price . . . will be sufficient to rebut the presumption of reliance.'" Id. at 484 (emphasis omitted). The Second Circuit reiterated that, "even with some limits on discovery and the extent of the hearing, the district judge must receive enough evidence, by affidavits, documents, or testimony, to be satisfied that each Rule 23 requirement has been met." Id. at 486. The Second Circuit further opined that "[t]he law guards against a flood of frivolous or vexatious lawsuits against third party speakers because (1) plaintiffs must show the materiality of the misrepresentation, [and] (2) defendants are allowed to rebut the presumption, prior to class certification, by showing, for example, the absence of a price impact . . . ." Id. at 484.

In In re Moody's Corp. Sec. Litig., 274 F.R.D. 480 (S.D.N.Y. 2011), investor plaintiffs brought a putative class action against a credit rating agency, Moody's Corporation ("Moody's"), under Section 10(b) of the Exchange Act and Rule 10b-5. Specifically, plaintiffs alleged that Moody's—which was compensated via the "issuer pays" model under which a rating agency is paid for its services only if a particular company chooses to publish its ratings—engaged in "ratings shopping" and issued artificially inflated ratings. Id. at 485-86. The lead plaintiffs moved for class certification.

The district court noted that reliance is an important component of a 10b-5-related Fed. R. Civ. P. 23(b) predominance analysis. Id. at 488. The lead plaintiffs contended that the class was entitled to a presumption of reliance based on the fraud-on-the-market theory. Id. With respect to this argument, the district court held that the proposed class was initially entitled to the presumption because the alleged misrepresentations were material and the shares traded on an efficient market. Id. at 490. However, the district court also noted that a defendant could successfully rebut a presumption of reliance by "showing that the misrepresentations did not lead to a distortion in price." Id. (citing Basic Inc. v.

Levinson, 485 U.S. 224, 248 (1988)). After weighing the "event study" submitted by the defendant's expert witness demonstrating that the alleged misrepresentation did not result in a significant statistical change in Moody's share price, the district court held that the presumption had been rebutted because Moody's had "severed the link between the misrepresentation and the price by showing that the allegedly false information the market was absorbing was not causing the stock price to artificially inflate." Id. at 492-93. As a result, the district court denied class certification. Id. at 493.

In In re Dynex Capital, Inc. Sec. Litig., 2011 WL 781215, at *1 (S.D.N.Y. Mar. 7, 2011), the lead plaintiff alleged violations under Section 10(b) of the Exchange Act, contending that defendant corporation and individual defendants sold bonds to investors without revealing that the bond collateral was impaired. The lead plaintiff moved pursuant to Rule 23(b)(3) for certification of a class consisting of "[a]ll purchasers of [defendant] Corporation's Collateralized Bonds Series 12 and Series 13 Bonds during the period between February 7, 2000 and May 13, 2004 who were damaged thereby." Id. at *1.

In order for reliance to be presumed and predominance to be established under the fraud-on-the-market theory, the district court noted, the certificates in question must have traded in an efficient market. Id. at *4. To determine whether the market for Dynex's securities was efficient, the Second Circuit applied the five distinct factors outlined in Cammer v. Bloom, 711 F. Supp. 1264 (D.N.J. 1989), appeal dismissed, 993 F.2d 875 (3d Cir. 1993). See Dynex, 2011 WL 781215, at *4. The district court recognized that the Cammer factors "[may] be adjusted in the context of bond markets," and that the lead plaintiff had adequately demonstrated that the bonds were traded actively. Id. Furthermore, the district court noted that "thirteen[] large, sophisticated and prestigious financial institutions acted as market makers," and held that the lead plaintiff had adequately demonstrated an immediate effect on the price of the bonds following the February, 2004 Moody's downgrade. Id. at *5-6. As such, the district court determined that the plaintiffs had fulfilled their burden of demonstrating a fraud-on-the-market presumption of reliance. Id.

The Third Circuit

In In re DVI Sec. Litig., 639 F.3d 623 (3d Cir. 2011), investors brought a class action against multiple parties, alleging violations of Section 10(b) of the Exchange Act and Rule 10b-5. Investors claimed that the defendants "engaged in a scheme designed to artificially inflate the price of DVI securities," after DVI filed for bankruptcy protection when alleged misrepresentations were disclosed. Id. at 628. There were two defendants involved in the appeal to the Third Circuit: Deloitte & Touche LLP ("Deloitte") and Clifford Chance LLP ("Clifford Chance"). Id. The plaintiffs alleged that Deloitte committed securities fraud by wrongfully issuing "clean" audit reports, "hiding DVI's improper accounting practices, and declining to force the company to disclose its fraudulent acts." Id. The district court granted class certification with respect to Deloitte, and Deloitte appealed. Id. at 629. The plaintiffs also alleged that defendant Clifford Chance committed securities fraud by "drafting fraudulent financial reports." Id. The district court refused to certify the claims against Clifford Chance as a class action, and the plaintiffs appealed. Id.

The parties disputed the reliance element of the plaintiffs' claims. Id. at 631. The Third Circuit began by noting the Supreme Court's decision in Basic, which recognized that, absent a presumption of reliance, the Rule 23(b) predominance requirement would never be met, as it would require proof of individual reliance from each potential class member. Id. at 631. The Third Circuit explained that Basic's presumption of class-wide reliance is based on the idea that, "in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business. . . . Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements. . . ." Id. (citing Basic, 485 U.S. at 242). To invoke this presumption, plaintiffs must show that they traded in an efficient market and that the alleged misrepresentation became public. Id. The Third Circuit considered factors such as the listing of a security on a major exchange, type of security, industry, price, and cause-and-effect relationship between disclosure and a security's price when determining whether or not the market was efficient. Id. at 634. The Third Circuit found that the market was efficient and held that plaintiffs could invoke the fraud-on-the-market presumption. Id. at 636.

The Third Circuit further held that defendants could successfully rebut the presumption of reliance by showing a lack of price impact because it "renders the misstatement immaterial as a matter of law." Id. at 638. The court reiterated that the burden is on the defendant at the class certification stage to introduce evidence that "an allegedly corrective disclosure did not move the market—[i.e.] that there was no market impact and therefore no loss causation" which could rebut the presumption of reliance and defeat predominance. Id. at 639. Here, the Third Circuit found that the defendant had not met this burden because the defendant offered no evidence in support of its rebuttal and did not offer any evidence that the plaintiffs relied on "anything other than publicly available information." Id. at 642.

The Seventh Circuit

In Schleicher v. Wendt, 618 F.3d 679 (7th Cir. 2010), investors brought a class action against a company that entered bankruptcy, alleging "unduly rosy statements that led investors to pay too much for the[ir] shares." Id. at 682. The district court certified the class, and defendants appealed to the Seventh Circuit. Id. On appeal, the defendants challenged the plaintiff's use of the fraud-on-the-market theory. Id. at 683. The Seventh Circuit restated the theory:

> There are three versions of the efficient capital market hypothesis: weak, semi-strong, and strong. The weak version is that prices incorporate information in a way that prevents the historical pattern of prices from being used to predict changes in price . . . . The semi-strong version adds that the value of new information is itself reflected in prices quickly after release, so that only the *first* recipient of this information (or someone with inside information) makes a profit; everyone else might as well ignore the

> information and rely on the prices. The strong version adds a claim that the price set in this way is *right*, in the sense that it accurately reflects the firm's value.

Id. at 684-85 (citations omitted) (alterations in original). While the Seventh Circuit acknowledged that the strong form had been refuted by economists, it also noted that the weak and semi-strong forms were "widely accepted," and that the fraud-on-the-market theory rests on the semi-strong form. Id. at 685.

Defendants challenged the applicability of the fraud-on-the-market presumption on numerous grounds. First, defendants argued that the presumption could not apply to plaintiffs' proposed class, which contained long sellers (who lose money when stock prices decrease) as well as short sellers (who make money when stock prices decrease). Id. at 684. The Seventh Circuit held that "[b]oth the long and the short are affected by news that influences the price they pay or receive," and the fact that both types of sellers are incorporated "does not imply that the class . . . is defective." Id. The Seventh Circuit explained that "[s]hort sellers play a role in aligning prices with information under any version of the efficient capital market hypothesis. That the resulting price may be inaccurate does not detract from the fact that false statements affect it, and cause loss, whether or not any given investor reads and relies on the false statement." Id. at 685. Notably, the Seventh Circuit also suggested that the gains made by short positions might be subtracted from the losses taken by long positions when determining damages. Id. at 684.

The defendants also challenged applicability of the Basic presumption because the alleged misstatements were designed to slow the fall of the stock price, as opposed to artificially inflate it. Id. at 683. The defendants argued that if an alleged misstatement slowed the decline of a stock price, plaintiffs are using a "materialization-of-risk theory" that is incompatible with the fraud-on-the-market theory. Id. Materialization-of-risk theory, according to the Seventh Circuit, is not a legal doctrine and has no significance to determining whether the fraud-on-the-market theory is appropriate: "[w]hether the numbers are black or red, the fraud lies in an intentionally false or misleading statement, and the loss is realized when the truth turns out to be worse that the statement implied." Id. at 684. The Seventh Circuit expressed frustration with defendants' attempts to "jettison" fraud-on-the-market theory and upheld the district court's certification of the class. Id. at 683-84, 688.

Finally, the Seventh Circuit held that plaintiffs "need not establish that the false statements or misleading omissions are material" at the class certification stage. Id. at 687. The court distinguished its earlier ruling in Szabo v. Bridgeport Machs., Inc., 249 F.3d 672 (7th Cir. 2001), clarifying that it is only permissible to "peek" at the merits of the case to make decisions that are "essential under Rule 23." Schleicher, 618 F.3d at 685. Determining whether common claims predominate is essential to Rule 23, the Seventh Circuit observed, but the defendants' request that it examine the materiality of the alleged misstatements and omissions was not. Id. Examining materiality would mean "class certification is proper only when the class is sure to prevail on the merits," but "[u]nder the current rule, certification is largely independent of the merits"—indeed, "a certified class can go down in flames on the merits." Id.

In In re Northfield Labs., Inc. Sec. Litig., 267 F.R.D. 536 (N.D. Ill. 2010), plaintiffs moved to certify a class based on alleged misstatements regarding a clinical trial of the company's primary product, a blood substitute compatible with all blood types and intended to treat life threatening blood loss. Id. at 540. In evaluating the availability of the Basic presumption, the district court first made clear that plaintiffs who rely on the fraud-on-the-market theory "must acknowledge that *all* public information is reflected in the price," meaning that the plaintiffs cannot argue that false oral statements are reflected in the price, but cautionary disclosures are not. Id. at 545. Second, the district court addressed the proper analysis for determining an efficient market. Id. While the Seventh Circuit had not specifically addressed this issue, the district court acknowledged that many others had relied on the factors set out in Cammer v. Bloom, 711 F. Supp. 1264 (D. N.J. 1989), appeal dismissed, 993 F.2d 875 (3d Cir. 1993). Northfield, 267 F.R.D. at 545. The Northfield court found the following Cammer factors persuasive: analyst coverage, trading volume, and most importantly, "empirical evidence that new information is quickly reflected in the price of a share of the stock." Id. at 546.

Evaluating the expert evidence proffered by both sides, the district court clarified that it could "consider the validity of the methodology, whether the technique has been subjected to peer review and whether the expert properly applied her methodology." Id. at 547. The district court found the methodology of plaintiffs' expert, Dr. Hakala, regarding trading volume "suspect" because he made only one calculation as to average trading volume for an entire five year period. Id. Instead, the district court substituted its own calculations to determine that the market was not efficient for the entire proposed class period, noting that for years average daily trading volume was less than three percent of the shares outstanding. Id. To show that the market quickly incorporated new information, the plaintiffs offered an event study, i.e., "a regression analysis designed to examine the effect of an event—news about a company—on a dependent variable—the company's share price." Id. at 548. The district court found the method used by the plaintiff's expert to be "unreliable" because he excluded 117 event dates from the study "making it appear as though the release of news had a greater impact on share price than it actually had." Id. Without the event study, the plaintiffs failed to show that the defendant's shares traded in an efficient market, and were not entitled to a presumption of reliance. Id. at 549. Without this presumption, the plaintiffs' individual issues predominated over class issues, and class certification was denied. Id.

The Ninth Circuit

In Conn. Ret. Plans & Trust Funds v. Amgen, Inc., 660 F.3d 1170 (9th Cir. 2011), plaintiffs brought an action under Rule 10b-5 and sought to certify a class, alleging that Amgen and several of its directors and officers misstated and failed to disclose safety information about two Amgen pharmaceutical products. Id. at 1172. These alleged misstatements and omissions inflated the price of Amgen's stock, causing losses later when corrective disclosures were made. Id. at 1173. At the district court level, the defendants asserted a truth-on-the-market defense to rebut the fraud-on-the-market presumption, claiming that the truth credibly entered the market via FDA announcements and analyst reports about Amgen's business which publicized the truth about the safety issues of Amgen's drugs, and that the alleged misrepresentations therefore could not have affected the stock price. Id. at 1174. The district court refused to consider the defendant's truth-on-the-market defense, noting that any rebuttal of the fraud-on-the-market presumption was an issue for trial, not class certification. Id.

In determining whether plaintiffs must prove materiality to gain the benefit of the fraud-on-the-market presumption,[73] the Ninth Circuit observed and explored a circuit split on the issue originating from divergent interpretations of a footnote in Basic.[74] On the one hand, the Ninth Circuit noted the Third and Seventh Circuit holdings that materiality is not a precondition to class certification because the materiality of a misstatement affects all investors alike (rendering proof of materiality at the class certification stage inappropriate). See Amgen, 660 F.3d at 1175-76 (citing In re DVI, Inc. Sec. Litig., 639 F.3d 623, 631 (3d Cir. 2011); Schleicher v. Wendt, 618 F.3d 679, 865 (7th Cir. 2010)). But the Ninth Circuit also cited Second and Fifth Circuit decisions taking the opposite position, i.e., that materiality must be proven at the class certification stage. Id. at 1176 (citing In re Salomon Analyst Metromedia Litig., 544 F.3d 474, 481 (2d Cir. 2008) and Oscar Private Equity Invs. v. Allegiance Telecom, Inc., 487 F.3d 261, 264 (5th Cir. 2007), abrogated on other grounds by Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179 (2011). Ultimately, the Ninth Circuit agreed with the Seventh Circuit's reasoning in Schleicher that the Basic footnote only envisioned materiality as an essential element of the fraud-on-the-market presumption *on the merits*, and did not adopt materiality as a precondition to class certification. Id.

Therefore, the Ninth Circuit held that the plaintiffs need not prove materiality to avail themselves of the fraud-on-the-market provision at class certification, and that only the presence of an efficient market for the stock and the public nature of the alleged misrepresentation must be proven at class certification. Id. at 1177. The Ninth Circuit also affirmed the district court's refusal to consider the defendant's truth-on-the-market defense at the class certification stage, holding that rebuttal of the fraud-on-the-market provision was a merits issue to be reached "at trial or by summary judgment motion if the facts are uncontested." Id. at 1177.

The Fraud-Created-the-Market Theory

The Third Circuit

In Malack v. BDO Seidman, LLP, 617 F.3d 743 (3d Cir. 2010), the Third Circuit considered the validity of the "fraud-created-the-market" theory—an issue of first impression in that court. Id. at 745. There, an investor who purchased notes later rendered worthless during the financial crisis sought compensation from the defendant, an

---

[73] On June 11, 2012, the Supreme Court granted Amgen's petition for a writ of certiorari to address a split of authority among circuit courts on this issue. See Amgen Inc. v. Conn. Ret. Plans & Trust Funds, 132 S. Ct. 2742 (2012).

[74] See Basic, 485 U.S. at 248 n.27 (observing the Sixth Circuit holding that "in order to invoke the presumption, a plaintiff must allege and prove . . . that the misrepresentations were material.").

accounting firm that gave the relevant issuer "clean" audit opinions. Id. The plaintiff alleged that without the audit opinions, the issuer "would not have been able to register the notes with the SEC," and investors would not have purchased them. Id. The plaintiff asserted violations of Section 10(b) of the Exchange Act and Rule 10b-5 and appealed to the Third Circuit after the district court's denial of class certification. Id. at 746.

The Third Circuit recognized a split among the courts of appeals as to the viability of a presumption of reliance via a "fraud-created-the-market" theory. Id. at 747 (comparing, e.g., Shores v. Sklar, 647 F.2d 462, 464 (5th Cir. 1981) (setting forth the fraud-created-the-market theory), overruled on other grounds sub nom. Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164 (1994), with Eckstein v. Balcor Film Investors, 8 F.3d 1121, 1130-31 (7th Cir. 1993) (rejecting the theory)). The fraud-created-the-market theory posits that "[t]he securities laws allow an investor to rely on the integrity of the market to the extent that the securities it offers to him for purchase are entitled to be in the market-place." Id. at 747 (quoting Shores, 647 F.2d at 471). Under this theory, a presumption of reliance is established if the plaintiff proves that the defendant conspires to market securities that were not entitled to be on the market. Id. at 747-48.

The Third Circuit reasoned that, when creating presumptions, it must consider fairness, public policy, common sense, and most importantly, the probability that existence of one fact renders the existence of another presumed fact true. Id. at 749 (citing Basic, 485 U.S. at 245-46). The Third Circuit found that these considerations favored rejecting the novel theory that a security's appearance on the market indicates its genuineness. Id. The court noted that "the entities most commonly involved in bringing a security to market do not imbue the security with any guarantee against fraud." Id. The Third Circuit also observed that the SEC does not conduct "merit regulation," but rather is concerned with adequate disclosure. Id. at 750. Furthermore, the Third Circuit dismissed the notion that "probability" supports the fraud-created-the-market theory, as this rationale would eviscerate the need to prove reliance in any securities fraud case. Id. at 752.

The Ninth Circuit

In George v. Cal. Infrastructure & Econ. Dev. Bank, 2010 WL 2383520 (E.D. Cal. June 10, 2010) the plaintiffs alleged that defendants California Infrastructure and Economic Development Bank ("I-Bank") and its bond counsel, Orrick, Herrington & Sutcliffe LLP ("Orrick") violated Section 10(b) of the Exchange Act and Rule 10b-5 by making allegedly misleading statements and omissions in a prospectus used to market I-Bank bonds, the proceeds of which were loaned to COPIA, a California non-profit corporation. Id. at *2. I-Bank had issued similar bonds and also loaned the proceeds to COPIA in 1999 and 2007, but despite these infusions of capital, COPIA filed for bankruptcy in 2008. Id. at *3. The plaintiffs alleged that as a result of Orrick's failure to issue a necessary opinion, holders of the 1999 and 2007 bonds became entirely unsecured creditors and the 1999 bonds became defeased as a result of a settlement incorporated into the bankruptcy plan. Id.

The plaintiffs argued that the district court should have applied a fraud-created-the-market presumption to its claim, allowing it to satisfy the reliance requirement. Id. at *7.

This presumption had previously been recognized by the Fifth Circuit. Id. (citing Shores v. Sklar, 647 F.2d 462 (5th Cir. 1981) (en banc), overruled on other grounds sub nom. Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164 (1994)). Under this theory, "'actors who introduced an otherwise unmarketable security into the market by means of fraud are deemed guilty of manipulation, and a plaintiff can plead that he relied on the integrity of the market rather than on individual fraudulent disclosures . . . .'" Id. (quoting Regents of Univ. of Cal. v. Credit Suisse First Bos. (USA), Inc., 482 F.3d 372, 391 (5th Cir. 2007)). The theory "presumes the securities market is legitimate, and that buyers rely on its legitimacy." Id. Ultimately, the district court granted the defendants' motion to dismiss on different grounds, holding that the plaintiffs did not sufficiently allege that the bonds were legally or economically unmarketable and therefore were unable to show that the fraud-created-the-market presumption could be applied even if recognized. Id. at *8.

Looking Beyond the Pleadings

In reviewing whether a plaintiff has satisfied the requirements of Fed. R. Civ. P. 23, a district court is generally not limited to the allegations in the complaint. A district court is permitted to "make whatever legal and factual inquiries are necessary" to resolve class certification issues. See In re New Motor Vehicles Canadian Exp. Antitrust Litig., 522 F.3d 6, 24 (1st Cir. 2008) (citing Szabo v. Bridgeport Machs., Inc., 249 F.3d 672, 675-76 (7th Cir. 2001)); see also In re New Motor Vehicles Canadian Exp. Antitrust Litig., 522 F.3d 6, 25 (1st Cir. 2008) (noting that district courts are "'entitled to look beyond the pleadings'" in adjudicating class certification motions) (citation omitted); In re Initial Pub. Offerings Sec. Litig., 471 F.3d 24, 41 (2d Cir. 2006), reh'g denied, 483 F.3d 70 (2d Cir. 2007) (holding that "the obligation to make such determinations is not lessened by overlap between a Rule 23 requirement and a merits issue, even a merits issue that is identical with a Rule 23 requirement.").

The fact that a Rule 23 requirement might overlap with an issue on the merits does not lessen the court's obligation to make a ruling as to whether the requirement is met. However, such a circumstance might appropriately limit the scope of the court's inquiry at the class certification stage.

The Second Circuit

In In re Initial Pub. Offerings Sec. Litig., 471 F.3d 24 (2d Cir. 2006), reh'g denied, 483 F.3d 70 (2d Cir. 2007), the Second Circuit, considering a motion for class certification, held that "the district judge must receive enough evidence, by affidavits, documents, or testimony, to be satisfied that each Rule 23 requirement has been met." Id. at 41. The Second Circuit further found that the district court had improperly applied a lenient "some showing" standard to conclude that the plaintiffs had sufficiently shown the existence of an efficient market to invoke the Basic presumption of reliance. Id. at 42. Without the Basic presumption, individual questions of reliance would predominate over common questions and class certification would be inappropriate. Id. at 43, 45.

In light of previous confusion regarding the appropriate standard of proof, the Second Circuit set forth the following rules:

> (1) a district judge may certify a class only after making determinations that each of the Rule 23 requirements has been met; (2) such determinations can be made only if the judge resolves factual disputes relevant to each Rule 23 requirement and finds that whatever underlying facts are relevant to a particular Rule 23 requirement have been established and is persuaded to rule, based on the relevant facts and the applicable legal standard, that the requirement is met; (3) the obligation to make such determinations is not lessened by overlap between a Rule 23 requirement and a merits issue, even a merits issue that is identical with a Rule 23 requirement; (4) in making such determinations, a district judge should not assess any aspect of the merits unrelated to a Rule 23 requirement; and (5) a district judge has ample discretion to circumscribe both the extent of discovery concerning Rule 23 requirements and the extent of a hearing to determine whether such requirements are met in order to assure that a class certification motion does not become a pretext for a partial trial of the merits.

Id. at 41.

6

Other Procedural Issues

Statute of Limitations

The Supreme Court

In Merck & Co. v. Reynolds, 130 S. Ct. 1784, 1790 (2010), plaintiff investors brought a 10b-5 action against Merck & Co., alleging that it had "knowingly misrepresented the risks of heart attacks accompanying the use of Merck's pain-killing drug, Vioxx (leading to economic losses when the risks later became apparent)." The applicable statute of limitations states that a cause of action may be brought no later than the earlier of two years after discovery of the facts constituting the violation or five years after the violation itself. 28 U.S.C. § 1658(b). Merck argued that the plaintiffs knew or should have known of facts constituting the violation more than two years prior to filing their complaint. Merck, 130 S. Ct. at 1792. The district court agreed and dismissed the complaint, and the Third Circuit reversed. Id. at 1792-93.

Merck argued before the Supreme Court that the statute of limitations began to run when the plaintiffs were on "inquiry notice," which it defined as the point when a plaintiff possesses information "sufficiently suggestive of wrongdoing that he should conduct a further inquiry." Id. at 1797 (internal quotation marks omitted). Merck contended that a number of public disclosures concerning the risks associated with Vioxx put the plaintiffs on inquiry notice more than two years before they filed suit, making their claim untimely. Id.

In a unanimous opinion, the Supreme Court rejected Merck's proposed inquiry notice standard, holding that the limitations period for a 10b-5 claim "begins to run once the plaintiff did discover *or a reasonably diligent plaintiff would have 'discover[ed]* the facts constituting the violation'—whichever comes first." Id. at 1798 (emphasis added). Among the facts a reasonably diligent plaintiff must discover to trigger the statute of limitations, the Court continued, are facts showing scienter—"an important and necessary element" of the claim. Id.

Applying these standards, the Court reasoned that an FDA warning letter and products-liability complaints filed against Merck did not contain enough specific information concerning the defendants' states of mind to trigger the limitations period. Id. at 1798-99. Because the plaintiffs alleged no facts suggesting scienter on the part of Merck more than two years prior to filing of the complaint, the Court affirmed the Third Circuit's judgment. Id. at 1799.

The First Circuit

In FirstBank P.R., Inc. v. La Vida Merger Sub, Inc., 638 F.3d 37 (1st Cir.), cert. denied, 132 S. Ct. 248 (2011), a warrant-holder brought a securities fraud action alleging that the defendant corporation and its acquiring entity violated Section 10(b) of the Exchange Act and Rule 10b-5 by engaging in a fraudulent scheme to deprive the plaintiff of the right to acquire 15% of the corporation's common voting stock. Id. at 38. The district court held that the suit was time-barred by the Sarbanes-Oxley Act's two-year statute of limitations, and the plaintiff appealed. Id.

The First Circuit affirmed that the suit was time-barred, noting that a claim under Section 10(b) and Rule 10b-5 must be brought no later than the earlier of: "(1) 2 years after the discovery of the facts constituting the violation; or (2) 5 years after such violation." Id. at 40 (citing Merck, 130 S. Ct. at 1789). The First Circuit found that the statute of limitations in this case began to run when the plaintiff discovered that the corporation and acquirer had executed a merger agreement and had not given the plaintiff notice of this transaction. Id. at 39. The First Circuit concluded that this necessarily happened before October 5, 2007 because, on that date, the plaintiff moved to compel the defendants to produce a complete version of their merger agreement. Id. Because the First Circuit found that the plaintiff had actual notice of the alleged fraud more than two years before suit was filed, it held the suit properly time-barred. Id. at 40.

The Second Circuit

In City of Pontiac Gen. Emps.' Ret. Sys. v. MBIA, Inc., 637 F.3d 169 (2d Cir. 2011), a purported class of shareholders brought an action against defendant MBIA, an insurer to issuers of bonds, alleging violations of Section 10(b) of the Exchange Act and Rule 10b-5. In 1998, one of MBIA's policyholders defaulted on a bond-issue, leaving MBIA with $170 million in debt. Id. at 172. Three European reinsurance companies agreed to reinsure MBIA on the defaulted bonds in exchange for an upfront fee and the purchase of additional reinsurance services. Id. MBIA initially booked this transaction as income, but in 2005, it restated its financials to treat the 1998 transaction as a loan. Id. MBIA moved to dismiss the initial complaint as time-barred by the two-year statute of limitations ("SOL") and five-year statute of repose ("SOR") under the Sarbanes-Oxley Act of 2002 ("SOX"). In granting defendant's motion to dismiss, the district court ruled that discussions among the press of MBIA's allegedly fraudulent transaction put the proposed class on inquiry notice by December 2002. Id. at 172-73.

Prior to oral argument on the plaintiffs' appeal of this decision, the Supreme Court held that "the limitations period commences not when a reasonable investor would have begun investigating, but when such a reasonable investor conducting such a timely investigation would have uncovered the facts constituting a violation." Id. at 174 (citing

Merck, 130 S. Ct. at 1798). While the Merck Court specifically declined to articulate exactly which facts are required in order for an alleged fraud to be deemed "discovered" for SOL purposes, the Court did determine that the SOL may not begin to run without a reasonably diligent plaintiff's discovery of the facts constituting scienter. Id. at 174 (citing Merck, 130 S. Ct. at 1796). Interpreting Merck, the Second Circuit concluded that "the reasonably diligent plaintiff has not 'discovered' one of the facts constituting a securities fraud violation until he can plead that fact with sufficient detail and particularity to survive a 12(b)(6) motion to dismiss." Id. at 175. As such, the Second Circuit remanded the case, prompting the district court to determine the starting point of the SOL by determining at what point the plaintiffs had enough information about MBIA's scienter to plead it with the particularity required to overcome a motion to dismiss. Id.

The Seventh Circuit

In McCann v. Hy-Vee, Inc., 663 F.3d 926 (7th Cir. 2011), the plaintiff alleged that she was defrauded in 2002 during divorce negotiations, during which Hy-Vee's CFO falsely told her that her husband's shares could not be sold until he died or left the company. Id. at 928. In 2007, the plaintiff agreed to sell the Hy-Vee shares she acquired in the divorce back to her husband, believing them to have no current value. Id. After finding out that her ex-husband immediately sold the shares back to Hy-Vee at a profit, the plaintiff brought suit against the company for violations of Section 10(b) of the Exchange Act, but the district court dismissed her claims as untimely. Id. at 929.

The Seventh Circuit held that the time limit for filing a claim under Section 10(b) pursuant to 28 U.S.C. § 1658(b)(2) begins to run from the date of the fraud, not the date of the injury. Id. at 929. For a claim under Section 10(b), a plaintiff must bring an action "not later than the earlier of—(1) 2 years after the discovery of the facts constituting the violation; or (2) 5 years after such violation." Id. The plaintiff argued that the "violation" occurs at the time of injury, as opposed to at the time of fraud. Id. at 930. The Seventh Circuit rejected this proposition, explaining that it would create a "heads I win, tails you lose" opportunity for plaintiffs in securities suits. Id. at 931. If § 1658(b) were a statute of limitations, a plaintiff who had been defrauded could "wait indefinitely to determine whether his purchase had been a mistake (because of the fraud) or a windfall (because despite the fraud the price of the security had risen beyond expectations)." Id. The Seventh Circuit acknowledged that statutes of repose are "strong medicine" because plaintiffs' claims can be foreclosed through no fault of their own. Id. at 930. However, the court found that "[S]ection 1658(b)(2) (subsection (1) as well, but we're not ruling on the application of (1) in this case) is best regarded as a statute of repose." Id. at 932.

In Antelis v. Freeman, 799 F. Supp. 2d 854 (N.D. Ill. 2011), plaintiff Antelis brought a 10b-5 action against his business partner and long-time friend for alleged misstatements relating to an investment they both made in a third party's real estate ponzi scheme. Id. at 858. The defendant moved to dismiss the claims as time-barred. Id. at 860. The district court recognized that statutes of limitations are normally not addressed on a motion to dismiss because plaintiffs in securities fraud actions are not required to plead that the suit is timely, however timeliness can be decided "where a plaintiff has affirmatively pleaded facts indicating his suit is time barred." Id. at 860. The district court interpreted the Supreme Court's decision in Merck to mean that the statute of limitations begins to run "when such a reasonable investor would have *actually uncovered* the facts constituting the fraud," not "when a reasonable investor would have *begun* investigating." Id. at 861 (citing Merck, 130 S. Ct. at 1798). Based on the pleadings, the district court concluded that Antelis had no reason to suspect a fraud until the real estate scheme went bankrupt, and declined to dismiss the suit as untimely. Id. at 862.

In Stone v. Chi. Inv. Grp., LLC, 2011 WL 6841817 (N.D. Ill. Dec. 29, 2011), investors claimed violations of Rule 10b-5 against a broker who allegedly promised a fifteen percent return on notes, but then repeatedly delayed payment. Id. at *1. The district court applied the Supreme Court's decision in Merck to find the plaintiffs' claims timely. Id. at *3-4. The district court acknowledged that Merck rejected inquiry notice analysis, and explained that the clock on 10b-5 violations began to run "when a reasonably diligent plaintiff would have discovered the facts constituting the violation, including scienter." Id. at *2. The district court also recognized that the plaintiffs knew in 2007 that the broker's note would not pay fifteen percent, but reasoned that, under Merck, this "does not show that they had discovered facts sufficient to establish a securities violation." Id. at *4. An investment loss or facts tending to show a materially false or misleading statement, the district court continued, are not sufficient on their own to meet the standard set forth in Merck. Id. Based on the allegations in the complaint, the district court held that the plaintiffs' claims were timely because no "reasonably diligent investor would have discovered the facts underlying the alleged violation" more than two years before filing the suit. See id.

The Ninth Circuit

In Allstate Ins. Co. v. Countrywide Fin. Corp., 824 F. Supp. 2d. 1164 (C.D. Cal. 2011), purchasers of residential mortgage-backed securities ("RMBS") brought a variety of state and federal securities claims against the sellers, issuers, and the issuer's directors and officers based on Countrywide's abandonment of its underwriting standards. Id. at 1168, 1179. Different versions of this case have been decided in state and federal courts around the country, so it was previously established that "a reasonable purchaser of Countrywide-originated RMBS, exercising reasonable diligence 'should have discovered facts sufficient to state every element of its claim at least prior to February 14, 2009.'" Id. at 1179 (quoting Stichting Pensioenfonds ABP v. Countrywide Fin. Corp., 802 F. Supp. 2d 1125, 1139 (C.D. Cal. 2011)). Allstate filed its claim in the instant action on December 27, 2010, and the defendants moved to dismiss the claim as time-barred. Id. The district court noted that under Merck, a Section 10(b) claim must be filed "within two years of the date Plaintiff either knew, or through exercise of reasonable diligence should have known 'the facts constituting the violation.'" Id. Recognizing that the Supreme Court's standard in Merck "require[s] that a plaintiff either knew (or through exercise of reasonable diligence [should] have known) enough facts to surmount a motion to dismiss," the district court found that the plaintiffs' claims were time-barred. Id. The plaintiffs argued that their complaint was based on a loan-level analysis that was not available until 2010. Id.

The district court found that for such an analysis to "delay the triggering of the statute of limitations, its loan level analysis would have to have (i) generated new facts which had not been previously known, (ii) been essential to surviving a motion to dismiss, and (iii) not been possible until at least December 27, 2008." Id. at 1180. The court explained that analyzing already known facts or generating new opinions based on previously-known facts is not sufficient to delay the statute of limitations. Id. The district court also noted that the plaintiffs' analysis was based on information available in the original offering prospectuses, and therefore Allstate could have analyzed that information anytime it wished. Id. Thus, the district court granted the defendants' motion to dismiss with prejudice. Id. at 1181.

In Stichting Pensioenfonds ABP v. Countrywide Fin. Corp., 802 F. Supp. 2d 1125 (C.D. Cal. 2011), the plaintiff, an investor in residential mortgage-backed securities ("RMBS") structured and sold by defendants including Countrywide Financial Corporation ("Countrywide"), brought claims against Countrywide for violations of Sections 11, 12(a), and 15 of the Securities Act (the "Original Complaint"). Id. at 1129. The plaintiff filed an amended complaint approximately five months later, adding claims for violations of Section 10(b) of the Exchange Act (the "Amended Complaint"). Id. Whereas the Original Complaint expressly disclaimed all allegations of fraud and scienter, the Amended Complaint added pages of new allegations regarding the same. Id. at 1133. The defendants moved to dismiss these new claims as time-barred, arguing that they did not relate back to the Original Complaint. Id.

After holding that the plaintiff had procedurally waived its relation back argument by failing to respond to similar arguments raised in the defendants' brief, the district court offered an alternative basis on the merits. Id. at 1132-33. The district court began its analysis by noting that the "question of whether an amended complaint that—for the first time—introduces scienter-based allegations relates back to an earlier complaint which disclaimed scienter is a novel one." Id. at 1133. The district court found that because the defendants contested relation back and because they could not have been on notice of the plaintiff's scienter allegations, the relation back doctrine did not apply. Id. at 1133-34. The district court recognized that "[s]everal courts have held that a [Section] 11 claim relates back to an earlier-filed [Section] 10(b) claim," (id. at 1133) and distinguished those cases by noting that to plead a Section 10(b) claim, one must plead a material misrepresentation that puts the defendant on notice of facts surrounding the later-filed Section 11 claim, but to plead a Section 11 claim, a plaintiff "need not have pled scienter, reliance, or loss causation in its earlier complaint." Id. at 1133. Because relation back did not apply, the district court found that the statute of limitations had run and granted the plaintiff's motion to dismiss. Id. at 1134.

The Tenth Circuit

In Roaring Fork Capital SBIC, L.P. v. ATC Healthcare, Inc., 2011 WL 1258504 (D. Colo. Mar. 29, 2011), the plaintiff, an investor in the defendant company, brought a 10b-5 claim against the company and its outside auditor. Id. at *2. The defendants moved to dismiss, arguing that the two-year statute of limitations barred the claim. Id. Citing the recently-decided Supreme Court opinion in Merck, the district court noted that although the Supreme Court rejected an argument that the statute of limitations period begins upon inquiry notice, it did recognize that "such notice may be useful to the extent [it] identif[ies] a time when the facts would have prompted a reasonably diligent plaintiff to begin investigating." Id. at *8 (quoting Merck, 130 S. Ct. at 1798) (internal quotation marks omitted). Pointing to the plaintiff's allegations of "obvious and glaring deficiencies" in the defendant company's recordkeeping and accounting, the district court found that a disclosure by the defendant company that it had "'discovered certain items which may not have been properly recorded in prior financial statements'" triggered the plaintiff's duty to investigate further. Id. at *1, *10. Estimating that an investigation would have required approximately sixty days, the district court found that the statute of limitations began sixty days after the company's disclosure was made, which was more than two years before the plaintiff had filed its claim, and accordingly granted the defendants' motions to dismiss. Id. at *10-11.

Expert Testimony and Daubert Motions

The Supreme Court

Although the Supreme Court's decision in Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 2541 (2011), is best known for its language on commonality, its dicta on Daubert at the class certification stage could have significant impact. In Wal-Mart, the three named plaintiffs represented 1.5 million class members, each current or former female employees of Wal-Mart, asserting sexual discrimination in violation of Title VII of the 1964 Civil Rights Act. Id. at 2547. Specifically, the plaintiffs alleged that local managers' discretion over pay and promotions was exercised disproportionately in favor of men, leading to an unlawful disparate impact on female employees. Id. at 2548. In support of their motion for class certification, the plaintiffs relied on statistical evidence demonstrating pay and promotion disparities and the testimony of a sociologist, Dr. William Bielby, who conducted a "social framework analysis," concluding that the company was "vulnerable" to gender discrimination." Id. at 2549. The district court and Ninth Circuit each approved certification of the class. Id. at 2549-50.

Justice Scalia's opinion in Wal-Mart also touched upon whether class certification expert witnesses should be subjected to Daubert scrutiny—a frequently-litigated issue. See generally Daubert v. Merrell Dow Pharm., Inc., 509 U.S. 579 (1993). In Wal-Mart, the district court determined that courts need not "apply the full Daubert 'gatekeeper' standard" to expert testimony at class certification, holding instead that "a lower Daubert standard should be employed . . . ." Dukes v. Wal-Mart, Inc., 222 F.R.D. 189, 191 (N.D. Cal. 2004) (citations omitted). The Ninth Circuit, sitting en banc, affirmed this determination. Dukes v. Wal-Mart Stores, Inc., 603 F.3d 571, 602-03 (9th Cir. 2010) (en banc). The Supreme Court characterized the district court's decision as finding that "Daubert did not apply to expert testimony at the certification stage . . . ." Wal-Mart, 131 S. Ct. at 2553-54. After stating that "[w]e doubt that is so," the Supreme Court went on to explain that "even if properly considered, [the expert] testimony does nothing to advance [plaintiffs'] case" because it failed to address the dispositive question at issue. Id. at 2554.

Thus, while the Court's expressed "doubt" is dicta, it nonetheless signals a preference for full Daubert scrutiny at the class certification stage.

The Fourth Circuit

In City of Ann Arbor Emps.' Ret. Sys. v. Sonoco Prods. Co., 827 F. Supp. 2d 559 (D.S.C. 2011), the plaintiffs brought a 10b-5 class action against Sonoco alleging failure to disclose price concessions given to key customers and the loss of a major account. Id. at 562. On a motion for summary judgment, both sides moved to exclude expert testimony submitted to support claims regarding loss causation and damages. Id. at 569. The district court considered the motions in light of Federal Rule of Evidence 702 and the Supreme Court's decision in Daubert v. Merrell Dow Pharm., Inc., 509 U.S. 579 (1993). City of Ann Arbor, 827 F. Supp. 2d at 569. Under Fourth Circuit precedent, the district court considered two questions: (1) "'whether the reasoning or methodology underlying the expert's proffered opinion is reliable—that is, whether it is supported by adequate validation to render it trustworthy;'" and (2) "whether the opinion is relevant to the facts at issue . . . . The focus of the second prong has, thus, been described as 'fit.'" Id. at 570 (quoting Bourne v. E.I. DuPont de Nemours & Co., 85 F. App'x 964, 967 (4th Cir. 2004)). The district court found the plaintiffs' expert's event study to be sufficiently reliable because the report accounted for other factors that may have caused the drop in the stock price. Id. at 571 (acknowledging that the Fourth Circuit does not require plaintiffs to prove that the defendant's conduct was the sole cause of the drop in price, only a "substantial cause"). The district court found that the defendants' expert Dr. Noe was qualified to provide testimony. Id. at 571-72. Dr. Noe took the position that "the price reductions and lost customer were accounted for in Sonoco's earnings guidance" that was published before the class period, so that information was not new to the market when later released. Id. Based on this argument, no "event" of dissemination occurred, and therefore no event study was necessary. Id. at 572. The district court found that it was not "fatal" to Dr. Noe's testimony that he did not conduct an event study, and denied both sides' motions to exclude. Id. at *10-11.

The Ninth Circuit

In In re MannKind Sec. Actions, 835 F. Supp. 2d 797 (C.D. Cal. 2011), investors brought a class action alleging violations of Sections 10(b) and 20(a) of the Exchange Act stemming from alleged misstatements indicating that the FDA had pre-approved MannKind Corp.'s drug testing protocol for a new product. Id. at 800. Later, the FDA sent a Complete Response Letter ("CRL") to the company refusing to approve the product, which the company allegedly failed to disclose to investors. Id. at 801. The company continued testing the products and making positive statements to the public, but eventually received a second CRL that was later disclosed to the public, after which the stock dropped in price. Id. at 802-04. The defendants moved to strike the plaintiffs' expert report, which was attached to the complaint as an exhibit. Id. at 820-21. The report was entered to show (1) that it would be against FDA practice to reach an agreement for a drug protocol and then later reject the protocol, and (2) that the studies were inadequate. Id. at 821. The district court explained that the Ninth Circuit permits affidavits and declarations as exhibits only when the exhibit "'*form[s] the basis of the complaint*.'" Id. at 821 (quoting United States v. Ritchie, 342 F.3d 903, 908 (9th Cir. 2003)). The district court also stated that "'averments in an expert affidavit carry no additional probative weight merely because they appear within an affidavit rather than numbered paragraphs of the complaint'" so a "better approach might be to include the expert's non-conclusory assertions within specific paragraphs in the complaint." Id. at 820 (quoting DeMarco v. DepoTech Corp., 149 F. Supp. 2d 1212, 1221-22 (S.D. Cal. 2001)). In DeMarco, the court found that the expert affidavit did not form the basis of the complaint and granted the motion to strike, but allowed the paragraphs appearing in the complaint to stand. Id. at 821. The district court noted that the expert report was "not essential" to its denial of the motion to dismiss; instead, the report "serve[d] merely to buttress Plaintiffs' contentions concerning the lack of an agreement of understanding with the FDA" and the inadequacy of their trials. Id. at 822-23. Based on those findings, the district court denied the motion to strike. Id.

Standing

The First Circuit

In In re Evergreen Ultra Short Opportunities Fund Sec. Litig., 275 F.R.D. 382 (D. Mass. 2011), shareholders in a mutual fund brought a class action against companies that marketed, managed, and advised the fund, as well as directors and officers of those companies, alleging that they violated federal securities law by registering, marketing, and selling the fund as safe and stable when it was actually comprised of illiquid, risky, and volatile securities. Id. at 385. Several claims survived a motion to dismiss, and the plaintiffs moved for class certification. The defendants argued, inter alia, that the "plaintiffs do not have standing and the proposed class is over-broad in that no lead plaintiff purchased any shares in the Fund before January 2007, nearly 15 months after the beginning of the proposed class period." Id. at 387.

The district court held that the lead plaintiffs had standing, despite not having purchased shares at the beginning of the class period. Id. The district court reasoned that the lead plaintiffs were not precluded from bringing suit because their claims arose "out of the same allegedly misleading course of conduct as the claims of class members who made earlier purchases." Id. When the offering materials used by the defendants are alleged to be "'part of a common, fraudulent scheme,'" the court explained, the plaintiffs have standing even when they did not purchase stock at the start of the class period. Id. (citation omitted).

The Second Circuit

In In re Bank of America Corp. Sec., Deriv., & ERISA Litig., 2011 WL 3211472 (S.D.N.Y. July 29, 2011), the district court granted in part and denied in part the defendants' motion to dismiss the plaintiffs' claims brought pursuant to Section 10(b) of the Exchange Act and Rule 10b-5. The plaintiffs, investors, alleged that the defendants, Bank of America Corporation ("BofA"), its former Chief Executive Officer ("CEO") Kenneth D. Lewis, and its former Chief Financial Officer ("CFO") Joe L. Price, made material misstatements and omissions related to BofA's acquisition of Merrill Lynch & Co. ("Merrill"). Id. at *1.

The district court held that, following In re AIG Advisor Grp., 2007 WL 1213395, at *3-6 (E.D.N.Y. Apr. 25, 2007), aff'd on other grounds, 309 F. App'x 495 (2d Cir. 2009) and "the bulk of the authority in this District," the class plaintiffs did not have Article III standing to bring claims on behalf of purchasers or sellers of securities that the class plaintiffs did not themselves purchase or sell during the class period. Id. at *13. Thus, the district court dismissed the lead plaintiffs' claims brought on behalf of holders of BofA preferred shares, debt securities, and call options that were not purchased by any of the lead plaintiffs during the class period. Id. at *13-14. However, the district court denied the motion to dismiss as to holders of "CUSIP 060505DP6" bonds, because one of the class representatives purchased the bond series during the class period. Id. at *14. The district court also denied the motion to dismiss as to holders of January 2011 call options because one of the class representatives purchased call options and sold them for a loss. Id.

In In re Wachovia Equity Sec. Litig., 753 F. Supp. 2d 326 (S.D.N.Y. 2011), the district court dismissed the plaintiffs' claims under Sections 11, 12(a)(2) and 15 of the Securities Act, Sections 10(b) and 20(a) of the Exchange Act, and Rule 10b-5. The case involved four complaints and seven motions to dismiss that arose from the "financial disintegration" experienced by the defendant Wachovia Corporation ("Wachovia") between its 2006 purchase of Golden West Financial Corporation and its 2008 merger with Wells Fargo & Company. Id. at 341. The plaintiffs alleged that Wachovia made multiple misrepresentations to conceal its risky practices, which when revealed in early 2008, led to a drastic decrease in the value of Wachovia's share price. Id. at 343.

Numerous investment banks that served as underwriters in connection with offerings of Wachovia securities moved to dismiss on the basis that the plaintiffs lacked standing to sue with respect to sixteen of the challenged offerings under both Article III and the Securities Act. Id. at 345. The pleadings contained no allegations that the named plaintiffs purchased securities in or traceable to these sixteen offerings. Id. at 368. "Because a plaintiff cannot claim a personal injury in connection with a security he did not purchase," the district court recited, "he 'lacks standing to sue on claims arising from . . . offerings which he did not purchase.'" Id. (quoting N.J. Carpenters Health Fund v. DLJ Mortg. Capital, Inc., 2010 WL 1473288, at *3 (S.D.N.Y. Mar. 29, 2010)). The district court explained that class certification does not obviate the need for the named plaintiffs to plead personal injury for standing purposes. Id. at 369. Thus, the court held that the named plaintiffs had no standing to assert claims in relation to "'funds in which they did not personally invest.'" Id. (quoting Hoffman v. UBS-AG, 591 F. Supp. 2d 522, 532 (S.D.N.Y. 2008)). Likewise, the district court held that the text of Sections 11 and 12(a)(2) also limited standing to plaintiffs who purchased or acquired the securities in question. Id. at 369. Thus, the district court dismissed the claims arising from the sixteen challenged offerings for lack of standing. Id. at 370.

In Royal Bank of Scotland Grp. PLC Sec. Litig., 765 F. Supp. 2d 327 (S.D.N.Y. 2011), purchasers of both ordinary and preferred shares initiated a consolidated class action against a foreign bank ("RBS"), international underwriters, and various individuals alleging violations of Section 10(b) of the Exchange Act and Rule 10b-5. The plaintiffs alleged that, as a result of certain behavior undertaken by RBS management and underwriters, they suffered losses in shareholder value due to write-downs that occurred because of RBS' subprime portfolio. Id. at 330. The district court granted the defendants' partial motion to dismiss. The plaintiffs argued that their purchase of ordinary shares on foreign exchanges allowed them standing to bring claims based on ADRs trading on the New York Stock Exchange, since ADRs are directly tied to the underlying ordinary shares and may be exchanged for such shares at any time. The district court disagreed, holding that these ADR claims must be dismissed since "'[c]ourts in the Second Circuit and elsewhere have . . . concluded that a plaintiff must have purchased in the particular offering in order to have standing to challenge related material misstatements and omissions.'" Id. at 337-38 (quoting N.J. Carpenters Vacation Fund v. Royal Bank of Scotland Grp., PLC, 720 F. Supp. 2d 254, 265-66 (S.D.N.Y. 2010)). As such, the district court determined that the plaintiffs did not have standing to bring domestic ADR claims. Id. at 338.

In Ashland Inc. v. Morgan Stanley & Co., 700 F. Supp. 2d 453 (S.D.N.Y. 2010), aff'd, 652 F.3d 333 (2d Cir. 2011), purchasers of Student Loan Auction Rate Securities ("SLARS") alleged violations of Section 10(b) of the Exchange Act and Rule 10b-5, contending that, as a result of defendant's material misstatements and omissions, the plaintiffs were induced to both purchase SLARS and to refrain from selling these securities at a time when the defendant knew that the market for SLARS was collapsing. Id. at 457. Although both Ashland and AshThree were plaintiffs in the action, the securities in question were purchased solely by AshThree, an entity created under the laws of Delaware of which Ashland was the only member. Id. at 458. The defendant moved to dismiss.

The defendant asserted that Ashland did not have standing to assert a securities fraud claim since it did not itself purchase any SLARS. Id. at 466. The district court reiterated that, according to the Second Circuit in Birnbaum, "the plaintiff class in a Rule 10b-5 action [is] limited to actual purchasers and sellers." Id. (quoting Birnbaum v. Newport Steel Corp., 193 F.2d 461, 463-64 (2d Cir. 1952)). Despite the holding of Blue Chip, which articulates three classes of plaintiffs barred from bringing suit under 10b-5, where a company creates an "alter ego" entity to act as an intermediary for investment purposes, the parent company has standing pursuant to investments made by its intermediary. Id. at 466-67 (citing Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737-38 (1975)). Since AshThree was merely a subdivision of Ashland used solely for the facilitation of investments, the district court held that Ashland had standing to allege violations of Section 10(b) for all claims that concerned the "purchase or sale" of a security. Thus, with the exception of the plaintiffs' claims alleging that the defendant induced it to *hold* its SLARS positions—an allegation deemed by Blue Chip not to be actionable—the district court determined that Ashland had standing with respect to those investments made by AshThree. Id.

The Tenth Circuit

In Bixler v. Foster, 596 F.3d 751 (10th Cir. 2010), the Tenth Circuit affirmed the district court's ruling that the PSLRA precluded RICO claims based on securities fraud. The plaintiffs, minority shareholders in Mineral Energy and Technology Corporation ("METCO"), alleged that the directors and majority shareholders of METCO negotiated a trade of mining rights to another corporation, Uranium King, Ltd. ("UKL"), in exchange for cash and stock in UKL that was never received. Id. The plaintiffs alleged that this rendered METCO worthless and that the directors and majority shareholders were highly compensated. Id. The plaintiffs brought a RICO claim against the directors and majority shareholders of METCO and UKL, alleging that they had conspired to deprive the plaintiffs of the value of their shares. Id. The district court ruled that the plaintiffs did not have standing to bring a RICO claim on METCO's behalf and that the PSLRA precluded RICO claims based on securities fraud. Id. On appeal, the Tenth Circuit held that because the alleged fraud was purported to have been committed in connection with the purchase or sale of securities, a RICO claim was explicitly precluded by the PSLRA. Id. at 759-60.

Damages

The Seventh Circuit

In Jaffe Pension Plan v. Household Int'l, Inc., 756 F. Supp. 2d 928 (N.D. Ill. 2010), a jury previously found the defendants guilty of violating Sections 10(b) and 20(a) of the Exchange Act, and the class action proceeded to a second stage where the defendants attempted to rebut the fraud-on-the-market presumption and the parties litigated the issue of damages. Id. at 930. The district court addressed a threshold issue in a 10b-5 action: whether "out-of-pocket damages are limited to actual damages such that plaintiffs' losses must be netted against any of their profits attributable to the same fraud." Id. at 935. Recognizing that the Seventh Circuit has not yet ruled on this issue, the district court followed the Second, Fifth, Ninth, and Tenth Circuits, holding that "plaintiff's losses [must] be netted against their profits attributable to the same fraud." Id.

Second, the district court addressed the appropriate method of matching purchases and sales for shareholders that made multiple purchases. Id. at 936. The defendants argued for application of "last-in first-out" ("LIFO") accounting, where "sales of the defendant's stock during the class period are matched against the last shares purchased." Id. The plaintiffs argued for "first-in first-out" ("FIFO") treatment, where "plaintiff's sales are matched first against the earliest purchases of stock, often matching sales during a class period with stock purchased prior to the class period." Id. at 936-37. The district court held that "given the tax laws and recent developments in the accounting world," FIFO was the appropriate method for matching purchases and sales. Id. at 938. However, recognizing that FIFO can result in high damages and plaintiff windfalls, the district court determined that the "fair and reasonable method for calculating damages" was to pair FIFO with "netting plaintiffs' losses against any profits." Id.

Stay of Discovery

The Third Circuit

In In re Heckmann Corp. Sec. Litig., 2010 WL 5887794 (D. Del. Feb. 28, 2010), plaintiff brought a class action alleging violations of Section 10(b) of the Exchange Act and Rule 10b-5, among other violations. The plaintiff claimed that the defendant made materially false and misleading statements in connection with a shareholder-approved merger. Id. at *1. In this action, the plaintiff requested the court's permission for partial modification of the PSLRA discovery stay, so that he could serve document preservation subpoenas on non-party entities, as non-parties are not required to preserve documents under the PSLRA. Id. The plaintiff also requested a modification of the stay to serve a single interrogatory on the defendant, to ascertain the correct names and address of the targets of the preservation subpoenas. Id.

The district court denied the plaintiff's request for a modification of the stay. Id. at *6. The district court found that the plaintiff had "not adequately shown that the interrogatory and preservation subpoenas [were] needed and that preservation letters [were] insufficient." Id. at *5. The district court noted that it could not determine "whether the risk of destruction of relevant evidence is imminent based on allegations of possible destruction." Id. The district court found that plaintiff's arguments, based on speculation of document destruction by third parties, did not show that lifting the stay was necessary. Id.

The Fourth Circuit

In In re Massey Energy Co. Sec. Litig., 2011 WL 4528509 (S.D.W. Va. Sept. 28, 2011), the plaintiffs moved for partial relief from the PSLRA discovery stay in a class action suit alleging misrepresentations leading up to a mine explosion. Id. at *1. Reviewing the congressional record and precedent, the district court concluded that "Congress clearly anticipated that in securities litigation, a stay of discovery will remain in effect while motions to dismiss are pending unless an exceptional circumstance requires particularized discovery to preserve evidence or prevent undue prejudice." Id. at *4. The court explained that the first inquiry in a motion to lift the stay on discovery is whether the plaintiff's request is sufficiently particularized, which requires the plaintiff to identify the target of the discovery and the types of information requested. Id. The district court found the plaintiffs' request for mine safety information that had already been provided for a government investigation sufficiently particularized. Id. at *5. Furthermore, the district court noted precedent for lifting the stay when plaintiffs can demonstrate that the evidence or documents are in immediate or probable peril of destruction. Id. Since Massey Energy was recently purchased by a company that was not a party to the lawsuit, the court found that the transition could result in the inadvertent destruction of documents and, therefore, the stay should be lifted. Id. at *6. In addition, the court found that the plaintiffs demonstrated undue prejudice because concurrent civil, criminal, and administrative actions may result in settlements or fines against the defendant. Id.

In Latham v. Stein, 2010 WL 3294722 (D.S.C. Aug. 20, 2010), investors brought a 10b-5 class action against a medical device company and its officers and board members. Id. at *1. The company and five individual defendants moved to dismiss, which was granted in part and denied in part. Id. About a month later, a defendant who was served with a separate complaint moved to dismiss. Id. The first set of defendants argued that the PSLRA stay of discovery applies while *any* motion to dismiss is pending. Id. at *2. The district court disagreed, stating that the PSLRA discovery stay clearly contemplates that "'discovery should be permitted in securities class actions *only after the court has sustained the legal sufficiency of the complaint.*'" Id. (quoting SG Cowen Sec. Corp. v. U.S. Dist. Court for N. Dist. of Cal., 189 F.3d 909, 912-13 (9th Cir. 1999)). The district court determined that the purpose of the stay was satisfied with regard to the first set of defendants because the court already found the plaintiff's claims to be legally sufficient as to them—the fact that another defendant had a motion to dismiss pending did not matter for the purposes of the PSLRA stay of discovery. Id. at *3.

The Ninth Circuit

In Moomjy v. HQ Sustainable Mar. Indus., Inc., 2011 WL 4048792 (W.D. Wash. Sept. 12, 2011), after the plaintiffs filed a securities class action in federal court, certain members of the class brought a derivative action in state court. Id. at *1. The defendants moved for a stay of state court discovery, relying on a PSLRA provision allowing federal courts to "'stay discovery proceedings in any private action in a State court, as necessary in aid of its jurisdiction, or to protect or to effectuate its judgments.'" Id. (quoting 15 U.S.C. § 78u-4(b)(3)(D)). The district court noted the purpose of this provision is to prevent plaintiffs from circumventing the PSLRA stay of discovery by filing a related state court action that would allow them access to information beneficial to their federal court case. Id.

The district court listed three factors that courts generally consider in staying a state court proceeding: "(1) the risk of federal plaintiffs obtaining the state plaintiff's discovery, (2) the extent of factual and legal overlap between the state and federal actions, and (3) the burden of state-court discovery on defendants." Id. at *2. With regard to the first factor, the court focused on whether the discovery was likely to reach the federal court plaintiffs before the motion to dismiss was adjudicated in federal court. Id. The district court found this risk "substantial" because the state court plaintiffs were members of the federal class. Id. The district court rejected the plaintiffs' offer to agree to a protective order as insufficient. Id. The plaintiffs argued that the second factor weighed in their favor because the state court claim was a derivative action. Id. The court did not find this reasoning persuasive because the "factual allegations in the complaints are substantially identical." Id. The district court observed that the relevant inquiry as to the second factor is whether state discovery "'will adversely affect a court's ability to decide a federal securities action, not whether the state claims mirror the federal claims.'" Id. (quoting In re Gilead Scis. Sec. Litig., 2004 WL 3712008, at *4 (N.D. Cal. Nov. 22, 2004)). Finally, as to the third factor, the district court concluded that the state plaintiffs' discovery requests were "extensive" and would lead to the production of evidence relevant to the

PSLRA litigation in federal court. Id. at *3. Based on this three factor analysis, the district court granted the defendants' motion to stay discovery in the state court case. Id.

The Tenth Circuit

In In re Thornburg Mortg., Inc. Sec. Litig., 2010 WL 2977620 (D.N.M. July 1, 2010), the district court denied the plaintiffs' motion for a partial lift of the PSLRA stay because the court found there to be no concerns regarding spoliation of evidence and because the plaintiffs failed to adequately show they would be "unduly prejudiced by the disclosure of certain documents to non-party entities." Id. at *1.

The plaintiffs, investors in the defendant company, filed a class action complaint against Thornburg Mortgage, Inc. ("TMI") and its underwriters, alleging claims under Rule 10b-5. Id. During the pendency of the lawsuit, TMI filed for Chapter 11 Bankruptcy. Id. In an earlier opinion, the district court dismissed all claims against TMI's underwriters and the plaintiffs filed a motion for leave to amend its complaint. Id. The plaintiffs moved to lift the PSLRA stay, arguing that (1) it was necessary to preserve evidence because two of the individual defendants, executives of TMI, absconded with potentially relevant evidence; and (2) that the plaintiffs were unduly prejudiced because some documents had been given to the SEC, the NYSE, and a bankruptcy creditors committee pursuant to the regulators' investigation of TMI and the bankruptcy proceeding. Id. at *2. During a hearing, TMI's bankruptcy trustee informed the court that he had secured all the evidence removed by the individual defendants, that he had no intention of destroying any of the documents, and that he would be willing to enter into an evidence-preservation order similar to the order already in effect in the bankruptcy proceeding. Id. at *3. During the hearing, when the court asked the plaintiffs how obtaining the documents would assist them, the plaintiffs' counsel responded that it would "allow [the plaintiffs] to evaluate the [d]efendants' culpability with regard to the action, and decide whether the [plaintiffs] want to just settle out for [insurance] policy limits at this time." Id. at *7 (internal alterations omitted).

The district court determined that the steps taken by TMI's bankruptcy trustee alleviated any spoliation concerns. Id. In addressing the plaintiffs' prejudice arguments, the district court noted that "although the . . . plaintiffs [were] at an informational disadvantage with respect to the NYSE and the SEC, there [was] no indication that these entities are competing for pieces of the same financial pie." Id. at *8. Although it recognized that the bankruptcy creditors committee shared a financial interest in securing funds from TMI, the district court found this insufficient to lift the discovery stay because, inter alia, the plaintiffs' case against TMI could not proceed while the bankruptcy was pending due to the automatic stay of all debtor litigation in bankruptcy proceedings. Id. at *8 n.9. In denying the plaintiffs' motion, the district court stated that the plaintiffs sought discovery "for the more routine purposes of discovery, i.e., to obtain additional evidence of the [d]efendants' wrongdoing to better assess the strength of their claims" and concluded that "this normal, routine situation" was not "imposing 'undue prejudice' to the . . . [p]laintiffs, given that it is a prejudice or a risk that is in every case." Id. at *9.

Imposition of Rule 11 Sanctions

Congress, in furtherance of its goal to end abusive and meritless securities fraud strike suits, included provisions in the PSLRA that strengthened the sanctions authorized under Federal Rule of Civil Procedure 11. See 15 U.S.C. § 77z-1(c)(1); 15 U.S.C. § 78u-4(c)(1). The PSLRA provides for mandatory fee shifting when a court determines that an action was meritless. In addition, it requires courts to decide, at the conclusion of every securities fraud case, whether all parties and all attorneys have complied with Rule 11(b), which requires an attorney to certify that any document presented to the court is not serving an improper purpose, that the claims, defenses or other legal contentions contained therein are warranted, that the allegations have support and that any denial of fact is warranted. See, e.g., Weintraub v. Glen Rauch Sec., Inc., 419 F. Supp. 2d 507, 512 (S.D.N.Y. 2005), appeal dismissed, 180 F. App'x 233 (2d Cir. 2006) (imposing sanctions after dismissing the plaintiffs' complaint and stating that "[i]n a securities fraud case, once the court has determined that Rule 11 has been violated, the PSLRA requires that the court impose 'sanctions in accordance with Rule 11.' Where the violation of Rule 11 is 'substantial,' the PSLRA creates a [rebuttable] presumption that the appropriate sanction is an award to the opposing party of the full amount of its reasonable fees and expenses."); Amalgamated Bank v. Coca-Cola Co., 2006 WL 2818973, at *17 (N.D. Ga. Sept. 29, 2006), aff'd sub nom. Selbst v. Coca-Cola Co., 262 F. App'x 177 (11th Cir. 2008) (stating that "[t]he PSLRA expressly requires courts to make Rule 11 findings upon the final adjudication of a federal securities fraud action" and, after dismissing the plaintiffs' claims, directing them to file a brief addressing this issue).

The Second Circuit

In In re Star Gas Sec. Litig., 745 F. Supp. 2d 26 (D. Conn. 2010), the purported class action plaintiffs sued Star Gas Partners, L.P. ("Star Gas"), Star Gas LLC, and three individual defendants, asserting violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 as well as Securities Act claims. The plaintiffs claimed, inter alia, that the defendants "misled investors as to the health and stability of Star Gas's Business Process Redesign Improvement Program ("BIP")[,] Star Gas's customer attrition rates[,] the extent to which [d]efendants masked customer attrition with new acquisitions[,] and Star Gas's failure to adequately hedge against a sharp rise in heating oil prices." Id. at 29. The district court dismissed all of the plaintiffs' claims on the defendants' motion to dismiss. Id. at 32. After the Second Circuit affirmed dismissal of the claims, the district court granted the defendants' motion pursuant to the PSLRA for a mandatory Rule 11 inquiry and mandatory fee shifting. Id.

The defendants asserted that the plaintiffs' lead counsel violated Rule 11(b)(2) by filing frivolous legal claims and violated Rule 11(b)(3) by bringing allegations that lacked evidentiary support. The district court agreed, finding, for instance, that the claim that the defendants misrepresented the health and stability of the BIP had "'no chance of success'" because lead counsel relied on a cooperating witness who stated that Star Gas' customer service problems arose *after* the defendants issued statements "highlighting customer service strengths." Id. at 35. The district court thus held that statements "could not possibly have been materially untrue so as to give rise to liability under the 1933 Act or 1934 Act." Id. at 34. Additionally, the district court concluded that the lead counsel had mischaracterized the testimony of confidential witnesses regarding Star Gas' customer attrition rates, both in the complaint and throughout oral arguments. Id. at 36. The district court found that the plaintiffs violated Rule 11(b)(3) in pleading that Star Gas misrepresented its net customer attrition rates because "there remain[ed] no relationship between what the [p]laintiffs' 'credible witnesses' said and the fraud claims [p]laintiffs advanced." Id. Even though the district court found certain of the plaintiffs' hedging allegations non-frivolous, those allegations "were not of such weight and quality as to render the suit as a whole 'nonabusive,'" because the frivolous allegations "'infect[ed] the entire pleading.'" Id. at 38-39 (quoting Fed. R. Civ. P. 11 Advisory Committee Note (1993)). The district court thus found the lead counsel's Rule 11 violations "substantial" under the Second Circuit standard. Id.

In In re Austl. & N.Z. Banking Grp. Ltd. Sec. Litig., 712 F. Supp. 2d 255, 259 (S.D.N.Y. 2010), investors in American Depositary Receipts ("ADRs") of a foreign entity initiated an action against the defendant corporation and its officers pursuant to Section 10(b) of the Exchange Act and Rule 10b-5, alleging misrepresentations with respect to projected future performance and previous financial results. However, upon filing an amended complaint, the plaintiffs abandoned their previous allegations, premising their new claims on an altogether different theory of liability. Id. at 260. The defendants' motion to dismiss was granted in December of 2009, a ruling which was based on the determination that none of the allegedly misleading allegations were sufficient to fulfill the requirements of a Section 10(b) claim. Id. at 261. The defendant corporation moved for sanctions pursuant to the PSLRA and Rule 11.

The district court recognized that the PSLRA required district courts to include in the record information regarding each party and its representative's compliance with the requirements of Rule 11(b). Id. at 262 (citing Rombach v. Chang, 355 F.3d 164, 178 (2d Cir. 2004)). The district court explained that, should it be determined that a party or attorney has violated any aspect of 11(b), the PSLRA requires that "'the court *shall* impose sanctions on such party or attorney . . . .'" Id. (quoting 15 U.S.C. § Section 78u-4(c)(2)). The district court also noted that the PSLRA "'obviates the need to find bad faith prior to the imposition of sanctions.'" Id. at 263 (citation omitted). The district court determined that the plaintiffs' inclusion of paragraph 25 in the original complaint—the only paragraph in the complaint alleging scienter—was "objectively unreasonable." Id. at 264. The district court explained that this was "not an isolated misstatement concerning a collateral or trivial fact, but rather, a material allegation central to the viability of the entire pleading." Id. In so concluding, the district court rejected the plaintiffs' argument that the error was made in good faith, finding no precedent in the Second Circuit for the notion that "good faith, without more, represents a complete defense to Rule 11 liability." Id. at 265 (citing Kiobel v. Millson, 592 F.3d 78, 83 (2d Cir. 2010)). As such, sanctions were imposed against plaintiffs' attorneys pursuant to Rule 11(b)(3) and the PSLRA. Id. at 271.

The Eleventh Circuit

In Thompson v. RelationServe Media, Inc., 610 F.3d 628 (11th Cir. 2010), the Eleventh Circuit affirmed the district court's dismissal of the plaintiffs' putative class action claims brought under Sections 10(b) and 20(a) of the Exchange Act against an internet marketing firm and eleven of its directors and employees. L. Allen Jacoby led a putative class of all purchasers who bought stock in RelationServe Media, Inc. ("RelationServe") on the open market prior to the company's public disclosure of a pending lawsuit alleging that RelationServe sold securities through unregistered brokers. Id. at 630, 632. Before RelationServe became a publicly-traded company, it hired an independent consulting agency to sell shares through a private offering to investors. Id. at 631. Jacoby claimed that RelationServe did not disclose that a broker was involved in the company's earlier securities sale, allegedly to hide the fact that RelationServe sold securities through unregistered brokers and to mislead the public regarding the company's worth. Id. at 634.

The Eleventh Circuit affirmed the district court's dismissal of plaintiffs' claims under Sections 10(b) and 20(a) of the Exchange Act, but remanded because the district court failed to sufficiently analyze its denial of Rule 11(b) sanctions under the PSLRA. Id. at 638. The Eleventh Circuit directed that the PSLRA required imposition of sanctions for frivolous litigation, and thus removed the district court's discretion in (1) choosing whether to conduct a Rule 11(b) inquiry and (2) determining whether to impose sanctions following a finding of a Rule 11(b) violation. Id. at 636. Further, the Eleventh Circuit instructed the district court to provide specific findings supporting its ruling and to discuss compliance by each party and their attorney(s) with each requirement of Rule 11(b) as to any complaint, responsive pleading, or dispositive motion. Id. at 637-38. The Eleventh Circuit remanded because the district court was better situated to develop the record and apply the fact-dependent legal standard mandated by Rule 11(b). Id. at 638-39.

In Zisholtz v. SunTrust Banks, Inc., 2010 WL 1963167 (N.D. Ga. May 14, 2010), the district court denied the defendants' motion for sanctions after dismissing the plaintiffs' securities fraud class action. The plaintiffs, investors, alleged that the defendants, SunTrust Banks, Inc. ("SunTrust Banks") and SunTrust Robinson Humphrey, Inc. ("SunTrust Robinson"), a wholly owned subsidiary, made false and misleading statements about auction rate securities and thereby defrauded the plaintiffs. Id. at *1.

The defendants alleged that the plaintiffs had no evidentiary basis for asserting that they purchased their securities from SunTrust Robinson, as opposed to SunTrust Investment Services, Inc. ("SunTrust Investment"), a different subsidiary of SunTrust Banks. Id. The district court held that Rule 11 sanctions were not warranted because, although the plaintiffs' evidentiary support was "weak," they only needed "some evidence" to support their factual allegations. Id. at *3. Despite the fact that the plaintiffs' monthly statements came from SunTrust Investment, the district court held that the plaintiffs had sufficient evidence to believe SunTrust Robinson was the subsidiary responsible because SunTrust Robinson was named in two regulatory investigations of auction rate securities. Id. at *4.

The defendants also alleged that no evidentiary basis existed for the plaintiffs' assertion that they were harmed by the collapse of the market for auction rate securities because, by the time the plaintiffs filed a class action, they had already redeemed these securities for par value. Id. at *5. The district court held that the plaintiffs were harmed because they believed that their investments had short term liquidity, and "[e]ven if they could eventually sell at par, they suffered harm because of the long period of illiquidity." Id. Further, the plaintiffs had not made false allegations that they still owned the securities or that they had not been redeemed at par value. Id. at *6.

Motions to Compel Disclosure of Confidential Witnesses During Discovery

The Second Circuit

In Plumbers & Pipefitters Local Union No. 630 Pension-Annuity Trust Fund v. Arbitron, Inc., 278 F.R.D. 335 (S.D.N.Y. 2011), plaintiffs alleged that defendant corporation ("Arbitron") and associated individuals violated Section 10(b) of the Exchange Act and Rule 10b-5 by making false and misleading statements about the firm's planned release of a new technology. The district court granted the defendants' motion to compel disclosure of former Arbitron employees designated in the complaint as confidential witnesses ("CWs"). Id. at 337.

The plaintiffs defended their refusal to disclose the names of the eleven CWs in question on two separate grounds. Id. at 337-38. First, the plaintiffs asserted that they had made all initial disclosures to the defendants required under Rule 26 by providing a list of eighty-three former and current Arbitron employees likely to have discoverable information—a list which included the names of the eleven CWs. Id. Second, they asserted that the CWs' identities were protected by the attorney work product doctrine. Id. at 338.

With respect to the plaintiffs' first contention, the district court determined that the names of the 11 CWs were "relevant information that 'appears reasonably calculated to lead to the discovery of admissible evidence' and thus responsive to . . . Rule 26(b)(1)." Id. With respect to the plaintiffs' second contention, the district court considered it highly unlikely that the identification of the CWs would reveal plaintiffs' counsel's "mental impressions, opinions, or trial strategy." Id. at 340. As such, the district court granted defendants' motion to compel disclosure of the CWs' names.

In In re SLM Corp. Sec. Litig., 2011 WL 611854 (S.D.N.Y. Feb. 15, 2011) ("SLM II"), the plaintiffs brought a putative class action lawsuit against SLM Corporation and two of its officers, Albert Lord ("Lord") and Charles Andrews ("Andrews"), alleging that the defendants made misleading statements about Sallie Mae's earnings, underwriting guidelines, and loan forbearance practices in violation of Sections 10(b) and 20(a) of the Exchange Act. See In re SLM Corp. Sec. Litig., 740 F. Supp. 2d 542, 547 (S.D.N.Y. 2010) ("SLM I"). After the plaintiffs disclosed the identities of 73 former SLM employees with relevant knowledge (including but not specifically naming sixteen CWs relied upon in the plaintiffs' complaint), the defendants sought particularized disclosure of the CW identities. SLM II, 2011 WL 611854, at *1.

The district court began by noting that, "[a]bsent a showing of need and undue hardship, [d]efendants may not force [p]laintiffs to disclose the identities of witnesses interviewed during the[ir] investigation . . . ." Id. Applying this rule, the district court held that the defendants "cannot demonstrate undue hardship in conducting an investigation of the 73 former employees listed in Plaintiffs' initial disclosures." Id. The court compared the case before it to In re Veeco Instruments, Inc. Sec. Litig., 2007 WL 274800 (S.D.N.Y. Jan. 29, 2007) (finding investigation of fifty-five potential witnesses not unduly burdensome), while distinguishing In re Marsh & McLennan Cos. Sec. Litig., 2008 WL 2941215, at *4-5 (S.D.N.Y. July 30, 2008) (holding that an investigation of 362 potential witnesses was unmanageable and ordering disclosure of seventeen CWs relied upon by the plaintiffs). The district court stressed that, as the CWs' former employer, SLM was "in the best position to know who among the 73 former employees may have the most relevant testimony." SLM II, 2011 WL 611854, at *1.

In In re Marsh & McLennan Cos. Sec. Litig., 2008 WL 2941215, at *1 (S.D.N.Y. July 30, 2008), Lead Plaintiffs sued on behalf of all persons and entities who purchased or otherwise acquired securities issued by Marsh & McLennan Companies, relying in part on statements from seventeen confidential witnesses ("CWs"). The defendants moved to compel disclosure of "all documents concerning the confidential sources . . . including but not limited to, documents sufficient to identify each and every [CW]." Id.

The district court affirmed an order of the special master requiring plaintiffs to identify the CWs, holding that any privilege that would attach to their identities would be "much more attenuated" than the privilege with respect to documents like interview notes. Id. at *3. The district court further rejected defendants' arguments that public policy prohibited disclosure, reasoning that (1) it would be unduly burdensome for the defendants to use their share of depositions to discover the CW identities and (2) potential retaliation against the CWs was insufficient to prevent disclosure. Id. at *4-5. However, the district court noted that this situation was "fundamentally different from those where the defendant could ascertain confidential witnesses' identities through a relatively small number of depositions." Id. at * 4.

The Eleventh Circuit

In Hubbard v. Bankatlantic Bancorp, Inc., 2009 WL 3856458, at *1 (S.D. Fla. Nov. 17, 2009), plaintiffs brought a class action under Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5, relying in part on allegations from six confidential witnesses ("CWs") to establish scienter. Subsequently, the defendants moved to dismiss arguing, inter alia, that the CW allegations were insufficient. Id. After the district court denied this motion, the defendants moved to compel disclosure of the CWs' identities, arguing that the identities (1) were not protected as work product, (2) did not constitute attorney-client communications, and (3) were not protected by privacy concerns or the public interest. Id. The plaintiffs responded that (1) they did not intend to use the CWs as trial witnesses and so did not have to reveal their identities, (2) the identities of the confidential witnesses were protected attorney work product, (3) the defendants had no substantial need for the CWs' identities, (4) protecting the identities of the non-testifying CWs served public policy and the policy of the PSLRA, and (5) work product protection should be enhanced where CWs fear retaliation from a former employer. Id. at *2. The district court granted the defendants' motion. Id.

While the district court agreed that the plaintiffs did not have to provide the names of all persons with knowledge of the relevant facts in their initial disclosures pursuant to Rule 26, the court ultimately held that this limitation did not apply to the defendants' motion to compel because the defendants were "requesting the names of the confidential witnesses in a discovery request, not as part of [p]laintiffs' initial disclosure . . . ." Id. at *3.

The district court also rejected the plaintiffs' argument that the CW identities were protected under the attorney work product doctrine, emphasizing that the plaintiffs had "already disclosed their existence and some of the information obtained from them" in the complaint. Id. at *3. Disclosure would therefore "not reveal any more of the mental impressions, conclusions, opinions and legal theories of [p]laintiffs' attorneys than [they] have already chosen to reveal . . . ." Id. The district court further reasoned that "it would be unfair to permit [p]laintiffs to rely so heavily in their [c]omplaint on the confidential witnesses, yet allow [p]laintiffs to keep their identities from [d]efendants during discovery, unless and until Plaintiffs decide to use the confidential witnesses [as] trial witnesses, perhaps at the very end of the discovery period." Id. at *4. The district court found that the defendants had established a "substantial need" for this information, pointing to the absence of *any* initial disclosures from the plaintiffs listing potential trial witnesses. Id. at *4.

Finally, the district court rebuked the plaintiffs' assertions that fear of retaliation created a right of privacy that justified protection of the CW identities, emphasizing that the plaintiffs had not sought any protective order to address these concerns. Id. at *5.

About Weil, Gotshal & Manges LLP

Founded in 1931, Weil, Gotshal & Manges LLP is a leading international law firm, headquartered in New York and comprising 21 offices worldwide. Recognized by clients, the media and professional commentators as best-in-class, our approximately 1,200 lawyers are known for the clarity, timeliness and effectiveness of their counsel across practices and, as a result, have become our clients' call of first resort for solutions to their toughest legal challenges. Indeed, our one-firm approach ensures that we work seamlessly to handle the most complex Litigation, Corporate, Regulatory, and Restructuring issues for clients that rank among today's most sophisticated corporations and financial services organizations. This breadth of experience and legal skill continues to distinguish Weil from many of its peer firms, and coupled with our global presence, has solidified the firm's position among the global elite.

Our award-winning Securities Litigation group, formed in 1984 as the Business and Securities Litigation Department, illustrates Weil's client service paradigm and market leadership. The firm's involvement in some of the earliest epoch-defining corporate transactions of the 1980s prompted a group of attorneys within the firm to establish a practice dedicated to solving the complex legal challenges of clients engaged in contests for corporate control, including proxy fights, tender offers, and consent solicitations. As these contests became a fixture on the business landscape, Weil's practice quickly grew to encompass a broad range of complementary legal skills, notably corporate governance and securities law and government investigations, and particularly concerning issues arising under federal and state securities laws and Delaware corporate law. Today, the group comprises more than 60 lawyers who collectively possess knowledge, both experiential and intellectual, few law firms in the world can match. Our team includes top former regulators, jurists and prosecutors, as well as prestigious scholars, giving us an edge in efficiently resolving critical securities and corporate governance matters, regardless of the scope of the issue.

The group's capabilities are more easily appreciated when viewed within the context of its work in the field. Many of the landmark cases establishing legal precedent in corporate law have been litigated by attorneys in Weil's Securities Litigation group, including:

- the leading case on fiduciary obligations in granting "lock-up" options;
- the leading decisions on the demand requirement in derivative litigation;
- the leading case on unconstitutionality of "control share" statutes affecting tender offers by foreign corporations;
- the leading case on "entire fairness" doctrine;
- the leading decisions regarding tracking stock;
- the case establishing the "Blasius" standard for a breach of fiduciary duty claim relating to manipulating the corporate machinery;

- a key case on fiduciary duties in “closely-held” corporations; and
- many, many more key decisions affecting securities law, both nationally and in important state courts.

Today, the group continues to add to its cutting-edge practice by leveraging its decades-long involvement in corporate governance theory and regulation. We have built one of the top practices in the US addressing corporate governance and corporate control matters on behalf of boards, committees, senior management and shareholders, including those relating to the Sarbanes-Oxley Act and the Dodd-Frank Act. The group’s attorneys also have garnered national attention for their multi-jurisdictional case management capabilities – and successes – including a broad range of class and “mass” actions and multi-district proceedings that serve as an index to most of the major legal events to have affected the business community in recent memory. From the Enron bankruptcy, to stock option backdating, to market timing and late trading, to the vast amount of litigation and regulatory and criminal investigations that have arisen out of the recent financial crisis, Weil’s Securities Litigation group has maintained a position at the vanguard of the global practice.

Robert F. Carangelo

Partner, New York
robert.carangelo@weil.com
767 Fifth Avenue
New York, NY 10153-0119
Tel +1 212 310 8499
Fax +1 212 310 8007

Robert Carangelo is a partner in Weil's Litigation Department and a member of the Securities Litigation practice. He focuses on complex commercial, securities, accounting and corporate matters at the trial and appellate levels, criminal and regulatory investigations by the SEC, DOJ, FINRA, FCIC, New York Attorney General's Office, and other federal, state and foreign regulators, and counseling boards of directors and board committees on disclosure issues, fiduciary duties and corporate governance, and internal and governmental investigations. Mr. Carangelo has extensive experience defending class actions, including securities fraud litigations in both state and federal courts.

As part of Mr. Carangelo's nationwide litigation and counseling practice, he has represented industry-leading corporations and financial institutions such as American International Group, Inc. (AIG), Arthur Andersen LLP, Comverse Technology, Merrill Lynch, the New York Stock Exchange, Verizon Communications Inc., United Health Group, General Motors Corporation's Audit Committee, and the Special Committee of the Board of Directors of Krispy Kreme Doughnuts, Inc. His notable matters include the ongoing representation of AIG in myriad investigations and class and derivative litigation arising out of the financial crisis, and the successful defense of accountant malpractice claims asserted against Arthur Andersen by a Trustee in Bankruptcy on summary judgment (including a four-day, live witness hearing), upheld by the Second Circuit.

Mr. Carangelo has litigated and supervised numerous pro bono matters. He is the chair of the firm's Hiring Committee, and is also the Chairman of the Board of Health for the Town of Greenwich.

Mr. Carangelo received his B.A. from Fairfield University and received his J.D., *cum laude*, from New York Law School, where he was managing editor of the *New York Law School Law Review* and a member of the Moot Court Executive Board.

Key Representations

- *AIG* – Co-lead Counsel for AIG in all regulatory and litigation matters arising from current subprime crisis.
- *Krispy Kreme Doughnuts, Inc.* – Co-lead counsel for special committee of outside directors investigating allegations of wrongdoing and responding to derivative litigations. Final report issued on August 9, 2005.

- *Glassman v. Arthur Andersen* – Co-lead counsel representing Arthur Andersen in defense of purported class action on behalf of purchasers of The Bennett Funding Group securities issued pursuant to alleged Ponzi scheme. Defeated motion for certification of class of purchasers of hundreds of millions of dollars of defaulted notes and securities. Obtained favorable settlement after motion for class certification was denied without leave to replead.
- *Breeden v. Arthur Andersen* – Co-lead counsel representing Arthur Andersen in defense of $150 million accountant malpractice claims by Trustee in Bankruptcy of The Bennett Funding Group. Arthur Andersen's motion for summary judgment based on standing *in pari delicto* granted after live witness hearing, and affirmed by Second Circuit on appeal.
- *Laurence v. Entravision Communications Company, L.L.C.* – Co-lead counsel representing Entravision in arbitration action in which plaintiff sought $60 million under an agreement to locate certain television stations for Entravision. Mr. Carangelo was co-lead counsel at the seven-day arbitration trial during which he conducted direct and cross-examinations of plaintiff's witnesses, including the cross-examination of plaintiff's expert regarding broad band actions. The arbitrator awarded plaintiff less than $1 million.
- *1300 Federal L.L.C. v. Verizon Communications Inc.* – Co-lead counsel for Verizon Communications in commercial dispute involving $40 million lease guaranty. After filing motion to dismiss, the case was settled on terms favorable to Verizon.
- *Bayerische Hypo-Und Vereinsbank AG v. Arthur Andersen* (S.D.N.Y.) – Lead counsel representing Arthur Andersen in action brought by a German bank to recover investment losses suffered on securitizations sponsored by Commercial Financial Services, Inc. Mr. Carangelo briefed and argued the motion to dismiss in the Southern District of New York. The case was transferred to the Northern District of Oklahoma without Judge Sprizzo ruling on Arthur Andersen's motion.

Paul A. Ferrillo

Counsel, New York
paul.ferrillo@weil.com
767 Fifth Avenue
New York, NY 10153-0119
Tel +1 212 310 8372
Fax +1 212 310 8007

Paul Ferrillo is counsel in Weil's Litigation Department, where he focuses on complex securities and business litigation. He has substantial experience in the representation of public companies and their directors and officers in shareholder class and derivative actions, as well as in internal investigations. In particular, Mr. Ferrillo has coordinated numerous internal investigations on behalf of audit committees and special committees, and handled the defense of several significant securities class actions alleging accounting irregularities and/or financial fraud.

Mr. Ferrillo has represented companies in a wide range of industries, including financial services, energy, oil and gas, and real estate. Among his recent notable matters, Mr. Ferrillo is part of the Weil team representing American International Group in securities class action litigation relating to the financial crisis, and was part of the team representing Kinder Morgan Inc. in the successful defense of shareholder litigation brought in connection with the company's acquisition of El Paso Corp.

Mr. Ferrillo also has extensive experience in the area of directors' and officers' liability insurance issues by virtue of his prior employment with National Union Fire Insurance Company of Pittsburgh, Pa. (the largest writer of D&O insurance in the US), where he held numerous senior-level positions in its claims and underwriting areas. He frequently counsels public companies and their boards of directors on a vast array of issues relating to the nature, extent, types and availability of all D&O and Management Liability Insurance-related products. Drawing on this distinctive experience, Mr. Ferrillo provides specialized counseling to clients concerning the actual interplay of their D&O coverage in the class action litigation process.

He is a frequent contributor of articles concerning securities and accounting fraud issues to the *New York Law Journal* and other national publications, and is a frequent speaker on securities law, corporate governance and directors' and officers' liability insurance issues for the ALI-ABA, the New York State Bar Association, the American Conference Institute, and the Directors Roundtable.

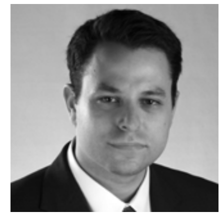
Mr. Ferrillo received his J.D. in 1989 from St. John's University School of Law, and received his B.S. in Accounting in 1986 from St. John's University.

Key Representations

- HiT Entertainment Limited – Representing HiT Entertainment, the company behind popular pre-school brands including Thomas & Friends™ and Bob the Builder™, in its $680 million acquisition by Mattel, Inc. from an entity majority-owned by funds managed by Apax Partners, LLP and its affiliates.
- Avista Capital Partners – Represented Avista Capital Partners in its acquisition of Anthony International, the world's largest manufacturer of specialty glass, commercial glass refrigerator and freezer doors, case lighting, and display and merchandising systems, from Aurora Capital Group.
- Thomas H. Lee Partners, L.P. – Counsel to Thomas H. Lee Partners in its $171 million minority investment in Sterling Financial Corporation, bank holding company for Sterling Savings Bank, the largest commercial bank headquartered in Washington State, as part of a series of agreements to raise a total of $730 million in new capital from institutional, private equity and other accredited investors.
- Worldcom/MCI – Co-lead counsel for Worldcom with respect to directors and officers liability insurance related disputes during its successful reorganization.
- *In re AK Steel Securities Litigation* – Participated in successful effort to defeat class certification in nationwide securities class action; obtained favorable settlement based upon decision.
- Krispy Kreme Donuts, Inc. – Co-lead counsel in special committee investigation relating to revenue recognition issues.
- OM Group, Inc. – Co-lead counsel in audit committee investigation relating to revenue recognition issues.
- *In Re M.H. Meyerson Securities Litigation* – Motion to dismiss granted; favorable settlement obtained after repleading.
- *CTC Litigation Trust v. Fabbricatore, et al.* – Current representation of independent directors in breach of fiduciary duty litigation.
- *Connolly v. Universal American Financial Corporation, et al.* – Current representation of private equity funds in breach of fiduciary duty litigation.
- *In Re Acclaim Entertainment Securities Litigation* – Current representation of former CFO in nationwide securities class action and in claim by Bankruptcy Trustee against former executives; favorable settlement obtained after motion to dismiss.
- *In re Acterna Corporation Securities Litigation* – Current representation of directors and officers in nationwide securities class action; motion to dismiss granted.
- Representation of numerous companies relating to stock option related issues, litigations and investigations.
- Representation of Audit Committees/Special Committees – Currently representing both audit committees and special committees in numerous internal investigations.

David J. Schwartz

Associate, New York
david.schwartz@weil.com
767 Fifth Avenue
New York, NY 10153-0119
Tel +1 212 310 8096
Fax +1 212 310 8007



David Schwartz's core practice areas consist of complex commercial and subprime litigation, including securities class actions, contract disputes, and representing major financial institutions in connection with DOJ and SEC investigations.

Mr. Schwartz has worked extensively on *In re American International Group, Inc. 2008 Securities Litigation*, representing defendant, American International Group, Inc. (AIG). Mr. Schwartz was part of the team that obtained the successful resolution – with no charges filed – of the SEC and DOJ's criminal investigations relating to AIG's super senior credit default swap portfolio. Recently, Mr. Schwartz represented non-parties Perella Weinberg Partners and Goldman Sachs & Co. in connection with the *Wells Fargo & Co. v. Citigroup Inc. Litigation*.

Mr. Schwartz has enjoyed working on numerous pro bono matters, including representations of the Innocence Project, The Legal Aid Society, and Housing Court Answers, Inc. in connection with *amicus* briefs submitted to the New York State Court of Appeals.

Prior to joining Weil, Gotshal & Manges, Mr. Schwartz worked for several years at Fried, Frank, Harris, Shriver & Jacobson LLP as a Corporate Resources Analyst. Mr. Schwartz graduated from the University of Chicago with honors, with a B.A. in economics and received his law degree from Fordham University School of Law. Mr. Schwartz is admitted to practice in New York State and the Southern District of New York.

Matthew D. Altemeier

Associate, New York
matthew.altemeier@weil.com
767 Fifth Avenue
New York, NY 10153-0119
Tel +1 212 310 8087
Fax +1 212 310 8007

Matt Altemeier's practice focuses on securities fraud class actions, with additional experience in complex commercial matters, contract disputes, and government investigations. Mr. Altemeier has represented clients in a variety of litigation settings, including pleadings, motions to dismiss, discovery disputes, depositions, motions for class certification, and mediation.

While most deeply involved in *In re American International Group, Inc. 2008 Securities Litigation* representing defendant American International Group, Inc., Mr. Altemeier has also represented Thomas H. Lee Partners, L.P., hedge fund clients, and individuals in the context of government investigations. In addition, Mr. Altemeier represented the Blau Weiss Gottschee Soccer Club—a community-based club headquartered in Queens, New York with an emphasis on inner-city youth development—in a pro bono capacity.

Before joining Weil, Gotshal & Manges, Mr. Altemeier interned at the United States District Court for the District of Delaware as an unpaid law clerk for Magistrate Judge Mary Pat Thynge, drafting opinions and orders in cases addressing patents, discrimination under Title VII, contract disputes, social security disability, and discovery issues.

Mr. Altemeier graduated from Princeton University with an A.B. in Politics and Certificates of Proficiency in Political Economy and American Studies. Mr. Altemeier received his law degree with honors from the University of Texas School of Law, and is admitted to practice in the State of New York.

Table of Authorities

Cases: **Page(s):**

In re 2007 Novastar Fin. Inc., Sec. Litig., 579 F.3d 878 (8th Cir. 2009).. 11

380544 Canada, Inc. v. Aspen Tech., Inc., 544 F. Supp. 2d 199 (S.D.N.Y. 2008) 66

Absolute Activist Value Master Fund Ltd. v. Ficeto, 677 F.3d 60 (2d Cir. 2012) .... vii, 2, 3, 4

ACA Fin. Guar. Corp. v. Advest, Inc., 512 F.3d 46 (1st Cir. 2008)... 11

In re Accredo Health, Inc. Sec. Litig., 2006 WL 1716910 (W.D. Tenn. Apr. 19, 2006) 166

Acito v. IMCERA Grp., Inc., 47 F.3d 47 (2d Cir. 1995).. 25

Adams v. Kinder Morgan, Inc., 340 F.3d 1083 (10th Cir. 2003) 84

In re Advanta Corp. Sec. Litig., 180 F.3d 525 (3d Cir. 1999) 29, 30

In re Aetna, Inc. Sec. Litig., 617 F.3d 272 (3d Cir. 2010) 110, 111

Affco Invs. 2001 L.L.C. v. Proskauer Rose, L.L.P., 625 F.3d 185 (5th Cir. 2010)............................ 143

Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128 (1972).............. 102, 169, 170, 171, 172

In re AIG Advisor Grp., 2007 WL 1213395 (E.D.N.Y. Apr. 25, 2007),
aff'd, 309 F. App'x 495 (2d Cir. 2009) 191

In re Alcatel Sec. Litig., 382 F. Supp. 2d 513 (S.D.N.Y. 2005) 18

Allstate Ins. Co. v. Countrywide Fin. Corp., 824 F. Supp. 2d 1164 (C.D. Cal. 2011) 186, 187

Allstate Life Ins. Co. v. Robert W. Baird & Co., 756 F. Supp. 2d 1113 (D. Ariz. 2010).... 115, 118, 119

In re Alstom SA Sec. Litig., 741 F. Supp. 2d 469 (S.D.N.Y. 2010)... 2, 8

Amalgamated Bank v. Coca-Cola Co., 2006 WL 2818973 (N.D. Ga. Sept. 29, 2006),
aff'd sub nom. Selbst v. Coca-Cola Co., 262 F. App'x 177 (11th Cir. 2008)................................ 197

In re Ambac Fin. Grp., Inc. Sec. Litig., 693 F. Supp. 2d 241 (S.D.N.Y. 2010)........................ 48, 50, 51

Ambert v. Caribe Equity Grp., Inc., 2011 WL 4626012 (D.P.R. Sept. 30, 2011) 12, 13

Amchem Prods., Inc. v. Windsor, 521 U.S. 591 (1997) 169

Amgen Inc. v. Conn. Ret. Plans & Trust Funds, 132 S. Ct. 2742 (2012) 172, 179

AnchorBank, FSB v. Hofer, 649 F.3d 610 (7th Cir. 2011) 127

Andrews v. Bechtel Power Corp., 780 F.2d 124, 130 (1st Cir. 1985) 167

Andropolis v. Red Robin Gourmet Burgers, Inc., 505 F. Supp. 2d 662 (D. Colo. 2007) 99, 100

Antelis v. Freeman, 799 F. Supp. 2d 854 (N.D. Ill. 2011) 185, 186

Anwar v. Fairfield Greenwich Ltd., 728 F. Supp. 2d 372 (S.D.N.Y. 2010) 68

In re Apollo Grp., Inc. Sec. Litig., 2011 WL 5101787 (D. Ariz. Oct. 27, 2011) 129

In re Apple Computer Sec. Litig., 886 F.2d 1109 (9th Cir. 1989) 106

Ashland Inc. v. Morgan Stanley & Co., 700 F. Supp. 2d 453 (S.D.N.Y. 2010),
aff'd, 652 F.3d 333 (2d Cir. 2011) 192

Ashland, Inc. v. Oppenheimer & Co., 648 F.3d 461 (6th Cir. 2011) 2, 22, 23

In re Atlas Air Worldwide Holdings, Inc. Sec. Litig.,
324 F. Supp. 2d 474 (S.D.N.Y. 2004) 72

In re Atlas Mining Co. Sec. Litig., 2008 WL 821756 (D. Idaho Mar. 25, 2008) 157

In re Austl. & N.Z. Banking Grp. Ltd. Sec. Litig., 712 F. Supp. 2d 255 (S.D.N.Y. 2010) 198

Bacon v. Stiefel Labs., Inc., 275 F.R.D. 681 (S.D. Fla. 2011) 171, 172

Bang v. Acura Pharm., 2011 WL 91099 (N.D. Ill. Jan. 11, 2011) 159

In re Bank of Am. Corp. Sec., Deriv. & ERISA Litig.,
2011 WL 3211472 (S.D.N.Y. July 29, 2011) 41, 42, 46, 47, 190, 191

In re BankAtlantic Bancorp, Inc. Sec. Litig.,
2010 WL 6397500 (S.D. Fla. Aug. 18, 2010) 53, 54, 106, 107, 132, 133

In re Bare Escentuals, Inc. Sec. Litig., 745 F. Supp. 2d 1052 (N.D. Cal. 2010) 114, 115

Barnard v. Verizon Commc'ns, Inc., 2011 WL 5517326 (3d Cir. Nov. 14, 2011),
cert. denied, 132 S. Ct. 2107 (2012) 15, 16

Basic Inc. v. Levinson, 485 U.S. 224 (1988) .... xii, 88, 172, 173, 174,
.... 175, 176, 179

In re Bear Stearns Cos. Sec., Deriv. & ERISA Litig.,
763 F. Supp. 2d 423 (S.D.N.Y. 2011) 47, 48

Belizan v. Hershon, 434 F.3d 579 (D.C. Cir. 2006) 12

Bell Atl. Corp. v. Twombly, 550 U.S. 544 (2007) 11

Berks Ctny. Emps.' Ret. Fund v. First Am. Corp., 734 F. Supp. 2d 533 (S.D.N.Y. 2010) 170, 171

Berson v. Applied Signal Tech., Inc., 527 F.3d 982 (9th Cir. 2008) 98

Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir. 1952) 192

Bixler v. Foster, 596 F.3d 751 (10th Cir. 2010) 193

Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) 192

Bourne v. E.I. DuPont de Nemours & Co., 85 F. App'x 964 (4th Cir. 2004) 189

In re BP Prudhoe Bay Royalty Trust Sec. Litig.,
2007 WL 3171435 (W.D. Wash. Oct. 26, 2007) 149

In re Bradley Pharm., Inc. Sec. Litig., 421 F. Supp. 2d 822 (D.N.J. 2006) 125

Brody v. Transitional Hosps. Corp., 280 F.3d 997 (9th Cir. 2002) 98

Brown v. E.F. Hutton Grp., Inc., 991 F.2d 1020 (2d Cir. 1993) 45

Bryant v. Avado Brands, Inc., 187 F.3d 1271 (11th Cir. 1999) 28, 29

In re Burlington Coat Factory Sec. Litig., 114 F.3d 1410 (3d Cir. 1997) 12

Caiola v. Citibank, N.A., 295 F.3d 312 (2d Cir. 2002) 5

Cal. Pub. Emps.' Ret. Sys. v. Chubb Corp., 394 F.3d 126 (3d Cir. 2004) 81

Cammer v. Bloom, 711 F. Supp. 1264 (D.N.J. 1989),
appeal dismissed, 993 F.2d 875 (3d Cir. 1993) 175, 178

Camofi Master LDC v. Riptide Worldwide, Inc.,
2011 WL 1197659 (S.D.N.Y. Mar. 25, 2011) 66, 67

Cardon v. TestOut! Corp., 244 F. App'x 908 (10th Cir. 2007) 2

In re Carter-Wallace, Inc. Sec. Litig., 220 F.3d 36 (2d Cir. 2000) 26

Cascade Fund, LLP v. Absolute Capital Mgmt. Holdings Ltd.,
2011 WL 1211511 (D. Colo. Mar. 31, 2011) 2, 9, 10

Cent. Laborers' Pension Fund v. Integrated Elec. Servs. Inc.,
497 F.3d 546 (5th Cir. 2007) 2

Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.,
511 U.S. 164 (1994) .... v, 136, 137, 146

Chemtech Int'l, Inc. v. Chem. Injection Techs., Inc., 247 F. App'x 403 (3d Cir. 2007) 12

Chill v. Gen. Elec. Co., 101 F.3d 263 (2d Cir. 1996) 36, 50

Cho v. UCBH Holdings, Inc., 2011 WL 3809903 (N.D. Cal. May 17, 2011) 44

In re Citigroup Inc. Sec. Litig., 753 F. Supp. 2d 206 (S.D.N.Y. 2010) 15, 48, 49, 50, 67, 68

City of Dearborn Heights Act 345 Police & Fire Ret. Sys. v. Waters Corp.,
632 F.3d 751 (1st Cir. 2011) 30, 31, 36

City of Ann Arbor Emps.' Ret. Sys. v. Sonoco Prods. Co.,
827 F. Supp. 2d 559 (D.S.C. 2011) 112, 189

City of Livonia Emps.' Ret. Sys. v. Boeing Co.,
2010 WL 2169491 (N.D. Ill. May 26, 2010) 82

City of Monroe Emps. Ret. Sys. v. Bridgestone Corp., 399 F.3d 651 (6th Cir. 2005) 62, 63,
.... 87, 96, 97

City of Monroe Emps.' Ret. Sys. v. Hartford Fin. Servs. Grp., Inc.,
2011 WL 4357368 (S.D.N.Y. Sept. 19, 2011) 45, 46

City of Phila. v. Fleming Cos., 264 F.3d 1245 (10th Cir. 2001) 30, 53

City of Pontiac Gen. Emps.' Ret. Sys. v. MBIA, Inc., 637 F.3d 169 (2d Cir. 2011) 184, 185

City of Pontiac Gen. Emps. Ret. Sys. v. Schweitzer-Mauduit Int'l, Inc.,
806 F. Supp. 2d 1267 (N.D. Ga. 2011) 18, 39, 40, 55, 84

City of Roseville Emps.' Ret. Sys. v. EnergySolutions, Inc.,
2011 WL 4527328 (S.D.N.Y. Sept. 30, 2011) 139

City of Roseville Emps.' Ret. Sys. v. Horizon Lines, Inc.,
442 F. App'x 672 (3d Cir. 2011) 60, 62

In re Coinstar Inc. Sec. Litig., 2011 WL 4712206 (W.D. Wash. Oct. 6, 2011) 149

Comcast Corp. v. Behrend, 2012 WL 113090 (U.S. June 25, 2012) xi

Conn. Ret. Plans & Trust Funds v. Amgen Inc., 660 F.3d 1170 (9th Cir. 2011), cert. granted, 132 S. Ct. 2742 (2012) .... ix, xi, xii, 178, 179

In re Connetics Corp. Sec. Litig., 542 F. Supp. 2d 996 (N.D. Cal. 2008) 129

In re Constellation Energy Grp., Inc. Sec. Litig., 738 F. Supp. 2d 614 (D. Md. 2010) 66, 72, 73, 95

In re Coventry Healthcare, Inc. Sec. Litig., 2011 WL 1230998 (D. Md. Mar. 30, 2011) 38

In re Coventry Healthcare, Inc. Sec. Litig., 2011 WL 3880431 (D. Md. Aug. 30, 2011) 81

Cordes & Co. Fin. Servs., Inc. v. A.G. Edwards & Sons, Inc., 502 F.3d 91 (2d Cir. 2007) 169

Cornwell v. Credit Suisse Grp., 729 F. Supp. 2d 620 (S.D.N.Y.), mot. to certify denied, 270 F.R.D. 145 (S.D.N.Y. 2010) 7, 8

Cosmas v. Hassett, 886 F.2d 8 (2d Cir. 1989) 72

In re Countrywide Fin. Corp. Sec. Litig., 588 F. Supp. 2d 1132 (C.D. Cal. 2008) 147

Coyne v. Gen. Elec. Co., 2010 WL 2836730 (D. Conn. July 15, 2010), aff'd sub nom. Inter-Local Pension Fund GCC/IBT v. Gen. Elec. Co., 445 F. App'x 368 (2d Cir. 2011) 32

In re Cutera Sec. Litig., 610 F.3d 1103 (9th Cir. 2010) 88, 98, 108, 113

In re Cybershop.com Sec. Litig., 189 F. Supp. 2d 214 (D.N.J. 2002) 12

In re Cytyc Corp. Sec. Litig., 2005 WL 3801468 (D. Mass. Mar. 2, 2005) 114

Daubert v. Merrell Dow Pharm., Inc., 509 U.S. 579 (1993) .... xi, 188, 189

Defer LP v. Raymond James Fin., Inc., 2010 WL 3452387 (S.D.N.Y. Sept. 2, 2010) 57, 91, 92

Dellastatious v. Williams, 242 F.3d 191 (4th Cir. 2001) 153

DeMarco v. DepoTech Corp., 149 F. Supp. 2d 1212 (S.D. Cal. 2001) 190

Desai v. Deutsche Bank Sec. Ltd., 573 F.3d 931 (9th Cir. 2009) 2

Dickinson v. Zurko, 527 U.S. 150 (1999) 149

Dodge v. Cambrex Corp., 2007 WL 608365 (D.N.J. Feb. 23, 2007) 164, 165

Dolphin & Bradbury, Inc. v. SEC, 512 F.3d 634 (D.C. Cir. 2008) 149, 150

Donohoe v. Consol. Operating & Prod. Corp., 30 F.3d 907 (7th Cir. 1994) 153

Dow Corning Corp. v. BB & T Corp., 2010 WL 4860354 (D.N.J. Nov. 23, 2010)........................ 42, 43

Dronsejko v. Thornton, 632 F.3d 658 (10th Cir. 2011) 52, 53

DSAM Global Value Fund v. Altris Software, Inc., 288 F.3d 385 (9th Cir. 2002)............................... 28

Dukes v. Wal-Mart, Inc., 222 F.R.D. 189 (N.D. Cal. 2004)... xi, 188

Dukes v. Wal-Mart Stores, Inc., 603 F.3d 571 (9th Cir. 2010),
rev'd, 131 S. Ct. 2541 (2011) .... xi, 188

Dura Pharm., Inc. v. Broudo, 544 U.S. 336 (2005) .... v, 119, 120, 128, 164

Durgin v. Mon, 415 F. App'x 161 (11th Cir. 2011) 58, 59

In re DVI, Inc. Sec. Litig., 639 F.3d 623 (3d Cir. 2011).. xii, 2, 141, 142, 175,
.... 176, 179

In re Dynex Capital, Inc. Sec. Litig., 2011 WL 781215 (S.D.N.Y. Mar. 7, 2011)...................... 170, 175

ECA, Local 134 IBEW Joint Pension Trust of Chi. v. JP Morgan Chase Co.,
553 F.3d 187 (2d Cir. 2009) 26, 33, 46

Eckstein v. Balcor Film Investors, 8 F.3d 1121 (7th Cir. 1993)... 180

Edison Fund v. Cogent Inv. Strategies Fund, Ltd., 551 F. Supp. 2d 210 (S.D.N.Y. 2008)................. 151

Edward J. Goodman Life Income Trust v. Jabil Circuit, Inc.,
594 F.3d 783 (11th Cir. 2010) 28, 77, 78, 115, 116

Elam v. Neidorff, 544 F.3d 921 (8th Cir. 2008) 11

Elliott Assocs. v. Porsche Auto. Holding SE, 759 F. Supp. 2d 469 (S.D.N.Y. 2010)......................... 8, 9

Emergent Capital Inv. Mgmt., LLC v. Stonepath Grp., Inc., 343 F.3d 189 (2d Cir. 2003)................. 121

Empl'rs Teamsters Local Nos. 175 and 505 Pension Trust Fund v. The Clorox Co.,
353 F.3d 1125 (9th Cir. 2004) 114

Engstrom v. Elan Corp., 2011 WL 4946434 (S.D.N.Y. Oct. 18, 2011) 41

In re Enron Corp. Sec., Deriv. & ERISA Litig., 235 F. Supp. 2d 549 (S.D. Tex. 2002)..................... 147

Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179 (2011) ....v, viii, ix, 2, 173

Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) 19, 31

In re Evergreen Ultra Short Opportunities Fund Sec. Litig., 275 F.R.D. 382 (D. Mass. 2011) 190

Ezra Charitable Trust v. Tyco Int'l, Ltd., 466 F.3d 1 (1st Cir. 2006) 147

Fait v. Regions Fin. Corp., 655 F.3d 105 (2d Cir. 2011) 103

In re Fannie Mae 2008 Sec. Litig., 742 F. Supp. 2d 382 (S.D.N.Y. 2010) 50, 117, 118

In re Fed. Nat'l Mortg. Ass'n Sec., Deriv., & ERISA Litig., 503 F. Supp. 2d 25 (D.D.C. 2007) 155

Feder v. Elec. Data Sys. Corp., 429 F.3d 125 (5th Cir. 2005) 158

Fin. Acquisition Partners LP v. Blackwell, 440 F.3d 278 (5th Cir. 2006) 71

FindWhat Investor Grp. v. FindWhat.com, 658 F.3d 1282 (11th Cir. 2011) .... 2, 28, 29, 87, 100, ... 130, 131

FirstBank P.R., Inc. v. La Vida Merger Sub, Inc., 638 F.3d 37 (1st Cir.), cert. denied, 132 S. Ct. 248 (2011) 184

First Nationwide Bank v. Gelt Funding Corp., 27 F.3d 763 (2d Cir. 1994) 52

Fla. State Bd. of Admin. v. Green Tree Fin. Corp., 270 F.3d 645 (8th Cir. 2001) 30

In re Flag Telecom Holdings, Ltd. Sec. Litig., 574 F.3d 29 (2d Cir. 2009) 120, 163, 164

Foley v. Transocean Ltd., 272 F.R.D. 126 (S.D.N.Y. 2011) 157, 158, 159

Footbridge Ltd. v. Countrywide Home Loans, Inc., 2010 WL 3790810 (S.D.N.Y. Sept. 28, 2010) 13, 14, 66

In re Ford Motor Co., Sec. Litig., 184 F. Supp. 2d 626 (E.D. Mich. 2001), aff'd, 381 F.3d 563 (6th Cir. 2004) 97

Fosbre v. Las Vegas Sands Corp., 2011 WL 3705023 (D. Nev. Aug. 24, 2011) 113, 114

Frank v. Dana Corp., 646 F.3d 954 (6th Cir. 2011) 23, 152, 153

Fulton Cnty. Emps.' Ret. Sys. v. MGIC Inv. Co., 2010 WL 5095294 (E.D. Wis. Dec. 8, 2010), aff'd, 675 F.3d 1047 (7th Cir. 2012) 76, 77

Ganino v. Citizens Utils. Co., 228 F.3d 154 (2d Cir. 2000) 25, 91

Garden City Emps.' Ret. Sys. v. Anixter Int'l, Inc.,
2011 WL 1303387 (N.D. Ill. Mar. 31, 2011) 38

Gen. Tel. Co. of the Sw. v. Falcon, 457 U.S. 147 (1982) 162

Geinko v. Padda, 2002 WL 276236 (N.D. Ill. Feb. 27, 2002) 129

George v. Cal. Infrastructure & Econ. Dev. Bank,
2010 WL 2383520 (E.D. Cal. June 10, 2010) 180, 181

In re Gilead Scis. Sec. Litig., 2004 WL 3712008 (N.D. Cal. Nov. 22, 2004) 195

Gissin v. Endres, 739 F. Supp. 2d 488 (S.D.N.Y. 2010) 27, 28, 109, 110

Glaser v. The9, Ltd., 772 F. Supp. 2d 573 (S.D.N.Y. 2011) 79, 80

Glazer Capital Mgmt., LP v. Magistri, 549 F.3d 736 (9th Cir. 2008) 28, 59, 71

Gompper v. VISX, Inc., 298 F.3d 893 (9th Cir. 2002) 28

Greebel v. FTP Software, Inc., 194 F.3d 185 (1st Cir. 1999) 30

Greenhouse v. MCG Capital Corp., 392 F.3d 650 (4th Cir. 2004) 94, 95

Greer v. Advanced Equities, Inc., 683 F. Supp. 2d 761 (N.D. Ill. 2010) 34

Groussman v. Motorola, Inc., 2011 WL 5554030 (N.D. Ill. Nov. 15, 2011) 162, 163

Hanon v. Dataproducts Corp., 976 F.2d 497 (9th Cir. 1992) 106

Halperin v. eBanker USA.com, Inc., 295 F.3d 352 (2d Cir. 2002) 117, 118

Harris v. Ivax Corp., 182 F.3d 799 (11th Cir. 1999) 114

Haw. Ironworkers Annuity Trust Fund v. Cole,
2011 WL 1257756 (N.D. Ohio Mar. 31, 2011),
mot. to certify denied, 2011 WL 1982714 (N.D. Ohio May 20, 2011) 126, 127

Haw. Ironworkers Annuity Trust Fund v. Cole,
2011 WL 3862206 (N.D. Ohio Sept. 1, 2011) 144, 145

In re HealthSouth Corp. Sec. Litig., 261 F.R.D. 616 (N.D. Ala. 2009) 161

In re Heckmann Corp. Sec. Litig., 2010 WL 5887794 (D. Del. Feb. 28, 2010) 194

Helwig v. Vencor, Inc., 251 F.3d 540 (6th Cir. 2001) 23, 30, 31, 114

In re Herley Indus. Inc. Sec. Litig., 2010 WL 176869 (E.D. Pa. Jan. 15, 2010) 160

Higginbotham v. Baxter Int'l, Inc., 495 F.3d 753 (7th Cir. 2007).. 82

Hill v. Gozani, 651 F.3d 151 (1st Cir. 2011) 88, 89

Hodges v. Akeena Solar, Inc., 274 F.R.D. 259 (N.D. Cal. 2011).. 161

Hoff v. Popular, Inc., 727 F. Supp. 2d 77 (D.P.R. 2010)... 74, 75

Hoffman v. UBS-AG, 591 F. Supp. 2d 522 (S.D.N.Y. 2008) 191

In re HomeBanc Corp. Sec. Litig., 706 F. Supp. 2d 1336 (N.D. Ga. 2010) 85, 101, 133, 134

Hubbard v. Bankatlantic Bancorp, Inc., 2009 WL 3856458 (S.D. Fla. Nov. 17, 2009)............. 201, 202

Hunt v. Alliance N. Am. Gov't Income Trust, Inc., 159 F.3d 723 (2d Cir. 1998) 14

Ill. State Bd. of Inv. v. Authentidate Holding Corp., 369 F. App'x 260 (2d Cir. 2010)...................... 117

In re IMAX Sec. Litig., 272 F.R.D. 138 (S.D.N.Y. 2010)... 163, 164

In re Immucor, Inc. Sec. Litig., 2011 WL 2619092 (N.D. Ga. June 30, 2011) 131, 132

In re Impax Labs., Inc. Sec. Litig., 2008 WL 1766943 (N.D. Cal. Apr. 17, 2008) 160

In re Initial Pub. Offering Sec. Litig., 214 F.R.D. 117 (S.D.N.Y. 2002)... 160

In re Initial Pub. Offerings Sec. Litig., 471 F.3d 24 (2d Cir. 2006),
reh'g denied, 483 F.3d 70 (2d Cir. 2007) 181, 182

Inst'l Investors Grp. v. Avaya, Inc., 564 F.3d 242 (3d Cir. 2009)..................................... 16, 17, 22, 28,
.... 30, 62, 81, 108, 109
.... 111, 112

In re Interbank Funding Corp. Sec. Litig., 629 F.3d 213 (D.C. Cir. 2010).. 172

Inter-Local Pension Fund GCC/IBT v. Gen. Elec. Co., 445 F. App'x 368 (2d Cir. 2011) 32

Jaffe Pension Plan v. Household Int'l, Inc., 756 F. Supp. 2d 928 (N.D. Ill. 2010) 193

Janus Capital Grp., Inc. v. First Deriv. Traders, 131 S. Ct. 2296 (2011)......................... v, ix, x, 66, 135,
.... 136, 139, 142, 145, 149

Kalnit v. Eichler, 264 F.3d 131 (2d Cir. 2001) 26

Katyle v. Penn Nat'l Gaming, Inc., 637 F.3d 462 (4th Cir.), cert. denied, 132 S. Ct. 115 (2011) 2, 125, 126

Kennedy v. Tallant, 710 F.2d 711 (11th Cir. 1983) 171

Kiobel v. Millson, 592 F.3d 78 (2d Cir. 2010) 198

La. Sch. Emps.' Ret. Sys. v. Ernst & Young, LLP, 622 F.3d 471 (6th Cir. 2010) 143, 144

Laperriere v. Vesta Ins. Grp., Inc., 526 F.3d 715 (11th Cir. 2008) 152, 153, 154, 155

Latham v. Stein, 2010 WL 3294722 (D.S.C. Aug. 20, 2010) 195

Lax v. First Merchs. Acceptance Corp., 1997 WL 461036 (N.D. Ill. Aug. 11, 1997) 158

In re Lehman Bros. Sec. & ERISA Litig., 799 F. Supp. 2d 258 (S.D.N.Y. 2011) 75, 76, 123, 124, 140, 141

Lentell v. Merrill Lynch & Co., 396 F.3d 161 (2d Cir. 2005) 121, 122, 124, 133, 134

In re Lincoln Educ. Servs. Corp. Sec. Litig., 2011 WL 3912832 (D.N.J. Sept. 6, 2011) 111, 112

Litwin v. Blackstone Grp., L.P., 634 F.3d 706 (2d Cir.), cert. denied, 132 S. Ct. 242 (2011) 87, 89, 90

Livid Holdings Ltd. v. Salomon Smith Barney, Inc., 416 F.3d 940 (9th Cir. 2005) 98, 99

Local 295/Local 851 IBT Emp'r Grp. Pension Trust & Welfare Fund v. Fifth Third Bancorp., 731 F. Supp. 2d 689 (S.D. Ohio 2010) 31, 32, 69

Local 703, I.B. of T. Grocery & Food Emps. Welfare Fund v. Regions Fin. Corp., 2011 U.S. Dist. LEXIS 60761 (N.D. Ala. June 7, 2011) 29

Local 731 I.B. of T. Excavators & Pavers Pension Trust Fund v. Swanson, 2011 WL 2444675 (D. Del. June 14, 2011) 81

Local No. 38 Int'l Bhd. Of Elec. Workers Pension Fund v. Am. Express Co., 724 F. Supp. 2d 447 (S.D.N.Y. 2010), aff'd, 430 F. App'x 63 (2d Cir. 2012) 42, 80

Lustgraaf v. Behrens, 619 F.3d 867 (8th Cir. 2010) 11, 153, 154

Makor Issues & Rights, Ltd. v. Tellabs, Inc., 437 F.3d 588 (7th Cir. 2006), rev'd in part, 551 U.S. 308 (2007) 71

Makor Issues & Rights, Ltd. v. Tellabs Inc., 513 F.3d 702 (7th Cir. 2008) 20, 63, 64, 65, 81, 82

Malack v. BDO Seidman, LLP, 617 F.3d 743 (3d Cir. 2010) 179, 180

In re MannKind Sec. Actions, 2011 WL 6327089 (C.D. Cal. Dec. 16, 2011) 38, 39, 43, 44, 189, 190

In re Manulife Fin. Corp. Sec. Litig., 276 F.R.D. 87 (S.D.N.Y. 2011) 124

In re Marsh & McLennan Cos. Sec. Litig., 501 F. Supp. 2d 452 (S.D.N.Y. 2006)............................... 34

In re Marsh & McLennan Cos. Sec. Litig., 2008 WL 2941215 (S.D.N.Y. July 30, 2008) 201

In re Massey Energy Co. Sec. Litig., 2011 WL 4528509 (S.D.W. Va. Sept. 28, 2011)...................... 194

Matrixx Initiatives, Inc. v. Siracusano, 131 S. Ct. 1309 (2011) ....v, vii, viii, 2, 19,
.... 20, 21, 23, 87, 88, 102

In re MBIA, Inc. Sec. Litig., 700 F. Supp. 2d 566 (S.D.N.Y. 2010) 104

McCabe v. Ernst & Young, LLP, 494 F.3d 418 (3d Cir. 2007)... 125

McCann v. Hy-Vee, Inc., 663 F.3d 926 (7th Cir. 2011) 185

In re Medicis Pharm. Corp. Sec. Litig., 2010 WL 3154863 (D. Ariz. Aug. 9, 2010)............................ 77

Merck & Co. v. Reynolds, 130 S. Ct. 1784 (2010)... v, vi, 183, 184, 185,
.... 186, 188

In re Merck & Co. Sec., Deriv. & "ERISA" Litig.,
2011 WL 3444199 (D.N.J. Aug. 8, 2011) 30, 57, 58, 87, 93, 94,
.... 125, 142, 143

In re Merck & Co. Sec. Litig., 432 F.3d 261 (3d Cir. 2005) 92, 93

In re Merrill Lynch Auction Rate Sec. Litig., 704 F. Supp. 2d 378 (S.D.N.Y. 2010)......................... 169

Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71 (2006)... v

Meyer v. St. Joe Co., 2011 WL 3750324 (N.D. Fla. Aug. 24, 2011) 78, 79, 131

Minneapolis Firefighters' Relief Ass'n v. MEMC Elec. Materials, Inc.,
641 F.3d 1023 (8th Cir. 2011) 97, 98

Mishkin v. Zynex Inc., 2011 WL 1158715 (D. Colo. Mar. 30, 2011).. 84

Miss. Pub. Emps.' Ret. Sys. v. Bos. Scientific Corp., 523 F.3d 75 (1st Cir. 2008)......................... 66, 74

Miss. Pub. Emps.' Ret. Sys. v. Bos. Scientific Corp., 649 F.3d 5 (1st Cir. 2011).................................. 2

Mizzaro v. Home Depot, Inc., 544 F.3d 1230 (11th Cir. 2008)............................... 17, 18, 28, 55, 58, 84

In re Moody's Corp. Sec. Litig., 274 F.R.D. 480 (S.D.N.Y. 2011) 169, 170, 174, 175

Moomjy v. HQ Sustainable Maritime Indus., Inc.,
2011 WL 4048792 (W.D. Wash. Sept. 12, 2011) 195, 196

Morrison v. Nat'l Austl. Bank Ltd., 130 S. Ct. 2869 (2010) ....v, vi, vii, 2, 3,
.... 4, 5, 6, 8, 10

In re MRV Commc'ns, Inc. Deriv. Litig., 2010 WL 5313442 (C.D. Cal. Dec. 27, 2010) 24

Murphy v. Sofamor Danek Grp., Inc., 123 F.3d 394 (6th Cir. 1997) 97

In re NAHC, Inc. Sec. Litig., 306 F.3d 1314 (3d Cir. 2002) 105

In re Nash Finch Co. Sec. Litig., 502 F. Supp. 2d 861 (D. Minn.),
mot. to certify denied, 2007 WL 2226028 (D. Minn. July 31, 2007).. 112

Nathenson v. Zonagen, Inc., 267 F.3d 400 (5th Cir. 2001) 30

N.M. State Inv. Council v. Ernst & Young, LLP, 641 F.3d 1089 (9th Cir. 2011)....................... 147, 148

In re New Motor Vehicles Canadian Exp. Antitrust Litig., 522 F.3d 6 (1st Cir. 2008) 181

Newman v. Family Mgmt. Corp., 748 F. Supp. 2d 299 (S.D.N.Y. 2010) 33

Niederklein v. PCS Edventures!.com, Inc., 2011 WL 759553 (D. Idaho Feb. 24, 2011)............ 158, 159

N.J. Carpenters Health Fund v. DLJ Mortg. Capital, Inc.,
2010 WL 1473288 (S.D.N.Y. Mar. 29, 2010).. 191

N.J. Carpenters Vacation Fund v. Royal Bank of Scot. Grp., PLC,
720 F. Supp. 2d 254, 265-66 (S.D.N.Y. 2010).. 192

In re Northfield Labs., Inc. Sec. Litig., 267 F.R.D. 536 (N.D. Ill. 2010) 167, 168, 178

Novak v. Kasaks, 216 F.3d 300 (2d Cir. 2000) 25, 26, 27, 33, 42,
.... 47, 51, 56, 147

In re Nuveen Funds/City of Alameda Sec. Litig.,
2011 WL 1842819 (N.D. Cal. May 16, 2011).. 129, 130

In re NVIDIA Corp. Sec. Litig., 2011 WL 4831192 (N.D. Cal. Oct. 12, 2011)............................. 82, 83

In re Omnicom Grp., Inc. Sec. Litig., 597 F.3d 501 (2d Cir. 2010) 120, 121, 123

In re Optimal U.S. Litig., 2011 WL 4908745 (S.D.N.Y. Oct. 14, 2011).................................... 138, 139

Operating Local 649 Annuity Trust Fund v. Smith Barney Fund Mgmt. LLC, 595 F.3d 86 (2d Cir. 2010) 91, 104

In re Oracle Corp. Sec. Litig., 627 F.3d 376 (9th Cir. 2010) 128, 130

Oscar Private Equity Invs. v. Allegiance Telecom, Inc., 487 F.3d 261 (5th Cir. 2007), abrogated in part by Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179 (2011) .... viii, xii, 173, 179

Ottmann v. Hanger Orthopedic Grp., Inc., 353 F.3d 338 (4th Cir. 2003) 30

In re Oxford Health Plans, 187 F.R.D. 133 (S.D.N.Y. 1999) 66

Pac. Inv. Mgmt. Co. v. Mayer Brown LLP, 603 F.3d 144 (2d Cir. 2010), cert. denied, 131 S. Ct. 3021 (2011) 56, 138, 141

In re Parmalat Sec. Litig., 2008 WL 3895539 (S.D.N.Y. Aug. 21, 2008) 170

P. Stolz Family P'ship L.P. v. Daum, 355 F.3d 92 (2d Cir. 2004) 117

In re PetSmart, Inc. Sec. Litig., 61 F. Supp. 2d 982 (D. Ariz. 1999) 43

Phila. Fin. Mgmt. of S.F., LLC v. DJSP Enters., Inc., 2011 WL 4591541 (S.D. Fla. Sept. 30, 2011) 35, 100, 101, 116

Philco Invs., Ltd. v. Martin, 2011 WL 500694 (N.D. Cal. Feb. 9, 2011) 105

Phillips v. Scientific-Atlanta, Inc., 374 F.3d 1015 (11th Cir. 2004) 71

Pirelli Armstrong Tire Corp. Retiree Med. Benefits Trust v. LaBranche & Co., 229 F.R.D. 395 (S.D.N.Y. 2004), mot. to amend denied sub nom. In re NYSE Specialists Litig., 2004 WL 1656599 (S.D.N.Y. July 23, 2004) 157, 158

Plotkin v. IP Axess Inc., 407 F.3d 690 (5th Cir. 2005) 95, 96

Plumbers & Pipefitters Local Union No. 630 Pension-Annuity Trust Fund v. Allscripts-Misys Healthcare Solutions, Inc., 778 F. Supp. 2d 858 (N.D. Ill. 2011) 32, 112, 113

Plumbers & Pipefitters Local Union No. 630 Pension-Annuity Trust Fund v. Arbitron Inc., 741 F. Supp. 2d 474 (S.D.N.Y. 2010) 36, 37, 87, 90, 91

Plumbers & Pipefitters Local Union No. 630 Pension-Annuity Trust Fund v. Arbitron, Inc., 278 F.R.D. 335 (S.D.N.Y. 2011) 200

Plumbers & Steamfitters Local 773 Pension Fund v. Canadian Imperial Bank of Commerce, 694 F. Supp. 2d 287 (S.D.N.Y. 2010) 26, 27, 56

Plumbers Local No. 200 Pension Fund v. Wash. Post Co.,
2011 WL 6445252 (D.D.C. Dec. 23, 2011) 65, 66, 71, 74

Plumbers' Union Local No. 12 Pension Fund v. Swiss Reinsurance Co.,
753 F. Supp. 2d 166 (S.D.N.Y. 2010) 7, 14, 15

Poptech, L.P. v. Stewardship Credit Arbitrage Fund, LLC,
792 F. Supp. 2d 328 (D. Conn. 2011) 150, 151

In re Portal Software, Inc. Sec. Litig., 2005 WL 1910923 (N.D. Cal. Aug. 10, 2005) 43

Prager v. FMS Bonds, Inc., 2010 WL 2950065 (S.D. Fla. July 26, 2010) 18, 19

Pub. Emps.' Ret. Sys. of Miss. v. Merrill Lynch & Co., 277 F.R.D. 97 (S.D.N.Y. 2011) 162

Pugh v. Tribune Co., 521 F.3d 686 (7th Cir. 2008) 38, 63, 64, 69, 145

Puskala v. Koss Corp., 799 F. Supp. 2d 941 (E.D. Wis. 2011) 52, 146, 147

In re PXRE Grp., Ltd., Sec. Litig., 600 F. Supp. 2d 510 (S.D.N.Y. 2009) 27

Quail Cruises Ship Mgmt. Ltd. v. Agencia de Viagens CVC Tur Limitada,
645 F.3d 1307 (11th Cir. 2011) 2, 10

In re Radian Sec. Litig., 2010 WL 1767195 (E.D. Pa. Apr. 30, 2010) 37, 38, 52

In re Ramp Networks, Inc. Sec. Litig., 201 F. Supp. 2d 1051 (N.D. Cal. 2002) 77

In re Read-Rite Corp., Sec. Litig., 335 F.3d 843 (9th Cir. 2003) 28

Reese v. BP Exploration (Ala.) Inc., 643 F.3d 681 (9th Cir. 2011) 11, 104, 105

Regents of Univ. of Cal. v. Credit Suisse First Bos. (USA), Inc.,
482 F.3d 372 (5th Cir. 2007) 181

In re REMEC Inc. Sec. Litig., 702 F. Supp. 2d 1202 (S.D. Cal. 2010) 106

In re Rigel Pharm., Inc. Sec. Litig., 2010 WL 8816155 (N.D. Cal. Aug. 24, 2010) 105, 106

Roaring Fork Capital SBIC, L.P. v. ATC Healthcare, Inc.,
2011 WL 1258504 (D. Colo. Mar. 29, 2011) 187, 188

Rolin v. Spartan Mullen Et Cie, S.A., 2011 WL 5920931 (S.D.N.Y. Nov. 23, 2011) 12, 66, 67

Rombach v. Chang, 355 F.3d 164 (2d Cir. 2004) 21, 92, 149, 198

Ronconi v. Larkin, 253 F.3d 423 (9th Cir. 2001) 39

Rosenbaum v. Seybold, 2011 WL 3843946 (N.D. Ind. Aug. 30, 2011) 146

Ross v. Walton, 668 F. Supp. 2d 32 (D.D.C. 2009) 132

Rubke v. Capitol Bancorp, Ltd., 551 F.3d 1156 (9th Cir. 2009) 106

Russo v. Bruce, 777 F. Supp. 2d 505 (S.D.N.Y. 2011) 21, 22

In re Royal Bank of Scot. Grp. PLC Sec. Litig., 765 F. Supp. 2d 327 (S.D.N.Y. 2011) 5, 6, 191, 192

In re Salomon Analyst Metromedia Litig., 544 F.3d 474 (2d Cir. 2008) .... xii, 169, 173, 174, 179

In re Sanofi-Aventis Sec. Litig., 774 F. Supp. 2d 549 (S.D.N.Y. 2011) 35, 36, 87, 90

San Leandro Emergency Med. Grp. Profit Sharing Plan v. Philip Morris Cos., 75 F.3d 801 (2d Cir. 1996) 33

Schleicher v. Wendt, 618 F.3d 679 (7th Cir. 2010) .... xii, 176, 177, 179

Schnall v. Annuity & Life Re (Holdings) Ltd., 2004 WL 231439 (D. Conn. Feb. 4, 2004) 70

In re Scholastic Corp. Sec. Litig., 252 F.3d 63 (2d Cir. 2001) 37

Schwartz v. Celestial Seasonings, Inc., 124 F.3d 1246 (10th Cir. 1997) 70

In re Scientific-Atlanta, Inc. Sec. Litig., 2007 WL 2683729 (N.D. Ga. Sept. 7, 2007) 166, 168

In re Seagate Tech. II Sec. Litig., 843 F. Supp. 1341 (N.D. Cal. 1994) 168

SEC v. Espuelas, 699 F. Supp. 2d 655 (S.D.N.Y. 2010) 68, 69

SEC v. Kelly, 817 F. Supp 2d 340 (S.D.N.Y. 2011) 139, 140

SEC v. PIMCO Advisors Fund Mgmt. LLC, 341 F. Supp. 2d 454 (S.D.N.Y. 2004) 140

SEC v. Tambone, 597 F.3d 436 (1st Cir. 2010) 137

In re Sec. Capital Assurance Ltd. Sec. Litig., 2011 WL 4444206 (S.D.N.Y. Sept. 23, 2011) 122, 123

In re Sec. Capital Assurance, Ltd. Sec. Litig., 729 F. Supp. 2d 569 (S.D.N.Y. 2010) 55, 56

In re Seitel, Inc. Sec. Litig., 245 F.R.D. 263 (S.D. Tex. 2007) 165, 166

In re SemGroup Energy Partners, L.P. Sec. Litig., 729 F. Supp. 2d 1276 (N.D. Okla. 2010) 70

SG Cowen Sec. Corp. v. U.S. Dist. Court for N. Dist. of Cal.,
189 F.3d 909 (9th Cir. 1999) 195

Sgalambo v. McKenzie, 739 F. Supp. 2d 453 (S.D.N.Y. 2010) 56, 57, 110

Sharenow v. Impac Mortg. Holdings, Inc., 385 F. App'x 714 (9th Cir. 2010).......... 23, 24

Shields v. Citytrust Bancorp, Inc., 25 F.3d 1124 (2d Cir. 1994) 26

Shores v. Sklar, 647 F.2d 462 (5th Cir. 1981), overruled in part sub nom.
Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.,
511 U.S. 164 (1994) 180, 181

In re Sierra Wireless, Inc. Sec. Litig., 482 F. Supp. 2d 365 (S.D.N.Y. 2007) 110

In re Silicon Graphics, Inc. Sec. Litig., 183 F.3d 970 (9th Cir. 1999).......... 28

Silverman v. Motorola, Inc., 772 F. Supp. 2d 923 (N.D. Ill. 2011) 153

Slayton v. Am. Express Co., 604 F.3d 758 (2d Cir. 2010) 108, 109

In re SLM Corp. Sec. Litig., 740 F. Supp. 2d 542 (S.D.N.Y. 2010) 33, 34, 200

In re SLM Corp. Sec. Litig., 2011 WL 611854 (S.D.N.Y. Feb. 15, 2011).......... 200, 201

In re Smith Barney Transfer Agent Litig., 2011 WL 6318988 (S.D.N.Y. Dec. 15, 2011).......... 158, 159,
.... 160

Solomon-Shrawder v. CardioNet, Inc., 2010 WL 3168366 (E.D. Pa. Aug. 10, 2010).......... 16, 17

Solow v. Citigroup, Inc., 2011 WL 5869599 (S.D.N.Y. Nov. 22, 2011) 45

In re Sonus Networks, Inc. Sec. Litig., 247 F.R.D. 244 (D. Mass. 2007).......... 166, 167

S. Cherry St., LLC v. Hennessee Grp. LLC, 573 F.3d 98 (2d Cir. 2009).......... 46

S. Ferry LP, No. 2 v. Killinger, 542 F.3d 776 (9th Cir. 2008).......... 28

Southland Sec. Corp. v. INSpire Ins. Solutions, Inc., 365 F.3d 353 (5th Cir. 2004).......... 59, 64, 153

In re St. Jude Med., Inc. Sec. Litig., 2011 WL 6755008 (D. Minn. Dec. 23, 2011).......... 73

In re Star Gas Sec. Litig., 745 F. Supp. 2d 26 (D. Conn. 2010) 197, 198

Starr ex rel. Estate of Sampson v. Georgeson S'holder, Inc., 412 F.3d 103 (2d Cir. 2005) 169

Steamfitters Local 449 Pension Fund v. Alter,
2011 WL 4528385 (E.D. Pa. Sept. 30, 2011) 51, 52, 93, 151, 152

Stichting Pensioenfonds ABP v. Countrywide Fin. Corp.,
802 F. Supp. 2d 1125 (C.D. Cal. 2011) 186, 187

In re StockerYale Sec. Litig., 453 F. Supp. 2d 345 (D.N.H. 2006) 129

Stone v. Chi. Inv. Grp., LLC, 2011 WL 6841817 (N.D. Ill. Dec. 29, 2011) 186

In re Stone & Webster, Inc. Sec. Litig., 424 F.3d 24 (1st Cir. 2005) 153

Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148 (2008) .... v, 136, 137, 138
.... 142, 143, 145

In re Sturm, Ruger & Co. Sec. Litig., 2011 WL 494753 (D. Conn. Feb. 7, 2011) 103, 104

Suez Equity Investors, L.P. v. Toronto-Dominion Bank, 250 F.3d 87 (2d Cir. 2001) 143

In re Suprema Specialties, Inc. Sec. Litig., 438 F.3d 256 (3d Cir. 2006) 151

In re Syntex Corp. Sec. Litig., 855 F. Supp. 1086 (N.D. Cal. 1994),
aff'd, 95 F.3d 922 (9th Cir. 1996) 98

Szabo v. Bridgeport Machs., Inc., 249 F.3d 672 (7th Cir. 2001) 177, 181

Szymborski v. Ormat Techs., Inc., 776 F. Supp. 2d 1191 (D. Nev. 2011) 83

In re Take-Two Interactive Sec. Litig., 551 F. Supp. 2d 247 (S.D.N.Y. 2008) 129

Teachers' Ret. Sys. of La. v. Hunter, 477 F.3d 162 (4th Cir. 2007) 38, 81, 126

Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital Inc.,
531 F.3d 190 (2d Cir. 2008) 59, 60, 61, 62

Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308 (2007) .... v, 19, 20, 21, 22, 23
.... 25, 64, 78, 109

Thompson v. RelationServe Media, Inc., 610 F.3d 628 (11th Cir. 2010) 17, 199

In re Thornburg Mortg., Inc. Sec. Litig., 2010 WL 2977620 (D.N.M. July 1, 2010) 196

In re Thornburg Mortg., Inc. Sec. Litig., 695 F. Supp. 2d 1165 (D.N.M. 2010) 39, 70, 71

In re Toyota Motor Corp. Sec. Litig., 2011 WL 2675395 (C.D. Cal. July 7, 2011) 9

In re Tronox, Inc. Sec. Litig., 2010 WL 2835545 (S.D.N.Y. June 28, 2010) 141

TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438 (1976) 87, 102

Turley v. Police Dep't of the City of N.Y., 167 F.3d 757 (2d Cir. 1999) 61

In re UBS Sec. Litig., 2011 WL 4059356 (S.D.N.Y. Sept. 13, 2011) 2, 5

In re United Am. Healthcare Corp. Sec. Litig.,
2007 WL 313491 (E.D. Mich. Jan. 30, 2007) 97

United States v. Ritchie, 342 F.3d 903 (9th Cir. 2003) 190

Valentini v. Citigroup, Inc., 837 F. Supp. 2d 304 (S.D.N.Y. 2011) 4, 5, 44, 45

In re Veeco Instruments, Inc. Sec. Litig., 2007 WL 274800 (S.D.N.Y. Jan. 29, 2007) 201

Vining v. Oppenheimer Holdings Inc., 2010 WL 3825722 (S.D.N.Y. Sept. 29, 2010) 60, 61, 62

Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083 (1991) 103

In re Vivendi Universal, S.A. Sec. Litig., 765 F. Supp. 2d 512 (S.D.N.Y. 2011) 5, 6, 7, 60, 61

In re Wachovia Equity Sec. Litig., 753 F. Supp. 2d 326 (S.D.N.Y. 2011) 47, 59, 60, 71,
.... 72, 191

Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 2541 (2011) .... v, x, xi, 161, 162, 188

Waterford Twp. Gen. Emps. Ret. Sys. v. BankUnited Fin. Corp.,
2010 WL 1332574 (S.D. Fla. Mar. 30, 2010) 24, 25, 40, 59, 79,
.... 101, 102

Waterford Twp. Gen. Emps. Ret. Sys. v. SunTrust Banks, Inc.,
2010 WL 3368922 (N.D. Ga. Aug. 19, 2010) 132

Weintraub v. Glen Rauch Sec., Inc., 419 F. Supp. 2d 507 (S.D.N.Y. 2005),
appeal dismissed, 180 F. App'x 233 (2d Cir. 2006) 197

Wilamowsky v. Take-Two Interactive Software, Inc.,
2011 WL 4542754 (S.D.N.Y. Sept. 30, 2011) 122

Winer Family Trust v. Queen, 503 F.3d 319 (3d Cir. 2007) 11, 66, 71

WPP Luxembourg Gamma Three Sarl v. Spot Runner, Inc.,
655 F.3d 1039 (9th Cir. 2011), cert. denied, 132 S. Ct. 2713 (2012) 127, 128

W.R. Huff Asset Mgmt. Co. v. Deloitte & Touche LLP, 549 F.3d 100 (2d Cir. 2008) 158

In re XenoPort, Inc. Sec. Litig., 2011 WL 6153134 (N.D. Cal. Dec. 12, 2011) 34, 35

Zavolta v. Lord, Abbett & Co., 2010 WL 686546 (D.N.J. Feb. 24, 2010) 60, 63

Zisholtz v. SunTrust Banks, Inc., 2010 WL 1963167 (N.D. Ga. May 14, 2010) 199, 200

Zucco Partners, LLC v. Digimarc Corp., 552 F.3d 981 (9th Cir. 2009) 83

Statutes & Rules:

17 C.F.R. § 240.10b-5 1

17 C.F.R. § 240.13a-14 55

15 U.S.C. § 77z-1 197

15 U.S.C. § 78j 1

15 U.S.C. § 78u-4 .... 12, 19, 72, 119, 157
.... 158, 195, 197, 198

15 U.S.C. § 78u-5 .... 107, 108

15 U.S.C. § 7241 55

28 U.S.C. § 1367 9

28 U.S.C. § 1658 .... v, 183, 185

Fed. R. Civ. P. 9(b) 11, 19

Fed. R. Civ. P. 11 198

Fed. R. Civ. P. 23 .... 157, 161, 169, 181

Other Authorities:

Cornerstone Research, Securities Class Action Filings: 2011 Review and Analysis (2011) xiii

Cornerstone Research, Securities Class Action Filings: 2011 Year in Review (2011) xii

Cornerstone Research, Securities Class Action Filings: 2012 Mid-Year Assessment (2012) xiii

Irwin H. Warren and Matthew E.K. Howatt, Transnational Securities Litigation In The U.S. Courts After Morrison v. National Australia Bank: An "F-Cubed" Regression Analysis, The Canadian Institute's 9th Annual Advanced Forum on Securities Litigation & Enforcement (October 2010) 3

Municipal Securities Disclosure, SEC Release No. 26100, 1988 WL 999989 (Sept. 22, 1988) 150

Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45, 151 (Aug. 19, 1999) 89

Weil

weil.com

BEIJING
BOSTON
BUDAPEST
DALLAS
DUBAI
FRANKFURT
HONG KONG
HOUSTON
LONDON
MIAMI
MUNICH
NEW YORK
PARIS
PRAGUE
PRINCETON
PROVIDENCE
SHANGHAI
SILICON VALLEY
WARSAW
WASHINGTON, DC
WILMINGTON

New York
767 Fifth Avenue
New York, NY 10153
+1 212 310 8000 tel
+1 212 310 8007 fax

Weil, Gotshal & Manges LLP