SIMPSON THACHER

# SECURITIES LAW ALERT

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This month's Alert addresses a Second Circuit opinion holding that statements regarding goodwill and loan loss reserves represent opinions, not facts. We also discuss recent case law on the question of whether the "ultimate authority" requirement set forth in the Supreme Court's decision in *Janus Capital Group, Inc. v. First Derivative Traders* applies to Rule 10b-5 claims against corporate insiders. In addition, we cover two of the earliest rulings on motions to dismiss "Say on Pay" shareholder derivative actions.

This Alert also discusses a decision from the Southern District of Texas dismissing the BP derivative action on forum non conveniens grounds, as well as three rulings from the Southern District of New York: one holding that *American Pipe* tolling applies to Section 13's statute of repose; another rejecting the "listing theory" of liability for "foreign cubed" claims in the UBS securities fraud action; and finally, a third criticizing plaintiffs' counsel in the Smith Barney litigation for naming as lead plaintiff an entity that did not purchase the securities at issue.

## The Second Circuit Holds That Statements Regarding Goodwill and Loan Loss Reserves Represent Opinions, Not Facts

On August 23, 2011, the Second Circuit affirmed the dismissal of an action alleging that "certain statements concerning goodwill and loan loss reserves in a registration statement of … Regions Financial Corporation give rise to liability under [S]ections 11 and 12 of the Securities Act of 1933." *Fait v. Regions Fin. Corp.*, 2011 WL 3667784, at *1 (2d Cir. Aug. 23, 2011) (Parker, J.). The Second Circuit held that dismissal was warranted because the statements regarding goodwill and loan loss reserves were "opinions, which were not alleged to have falsely represented the speakers' beliefs at the time they were made." *Id.*

### Background

Regions Financial Corporation is a regional bank holding company. In November 2006, Regions acquired AmSouth Bancorporation, another bank holding company. In February 2008, Regions filed its 2007 Form 10-K, in which it reported $11.5 billion in goodwill (of which $6.6 billion was attributed to the AmSouth acquisition) as well as $555 million in loan loss reserves. The 10-K stated that Regions had substantially increased its loan loss reserves from the previous year to account for "'the results of the newly merged Regions for the full year,'" among other

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factors. *Id*.

For the first three quarters of 2008, Regions "continued to report goodwill of $11.5 billion and moderate increases to its allowance for credit losses." *Id*. However, in its fourth quarter results for 2008 (released in January 2009), Regions reported "a $5.6 billion net loss, 'largely driven by a $6 billion non-cash charge for impairment of goodwill,' and doubled its loan loss provision to $1.15 billion as compared to a year earlier." *Id*.

Purchasers of Regions' Trust Preferred Securities subsequently brought suit alleging that the offering documents, which incorporated by reference Regions' 2007 Form 10-K and certain other filings, "contained 'negligently false and misleading' statements concerning goodwill and loan loss reserves." *Id*. at *2. Specifically, the plaintiffs contended that "Regions [had] overstated goodwill and falsely stated that it was not impaired, and 'vastly underestimated' Regions' loan loss reserves and failed to disclose that they were inadequate." *Id*.

In May 2010, the Southern District of New York granted the defendants' motion to dismiss "on the ground that the challenged statements regarding goodwill and the adequacy of loan loss reserves were matters of opinion, which were not actionable because the complaint failed to allege that those opinions were not truly held at the time they were made." *Id*.

## The Second Circuit Affirms the Dismissal of the Plaintiff's Goodwill-Related Claims

"Although [S]ections 11 and 12 refer to misrepresentations and omissions of material *fact*," the Second Circuit explained that "matters of belief and opinion are not beyond the purview of these provisions." *Id*. at *3. "However, when a plaintiff asserts a claim under [S]ection 11 or 12 based upon a belief or opinion alleged to have been communicated by a defendant, liability lies only to the extent that the

statement was both objectively false and disbelieved by the defendant at the time it was expressed." *Id*.

The Second Circuit found that the Southern District of New York had "correctly recognized" that the "plaintiff's allegations regarding goodwill [did] not involve misstatements or omissions of material fact, but rather a misstatement regarding Regions' opinion." *Id*. at *4. "Estimates of goodwill depend on management's determination of the 'fair value' of the assets acquired and liabilities assumed, which are not matters of objective fact." *Id*. Here, the plaintiff "does not point to any objective standard such as market price that he claims Regions should have but failed to use in determining the value of AmSouth's assets." *Id*. "Absent such a standard, an estimate of the fair value of those assets will vary depending on the particular methodology and assumptions used." *Id*. "In other words, the statements regarding goodwill at issue here are subjective ones rather than 'objective factual matters.'" *Id*.

While the plaintiff alleged that the "defendants should have reached different conclusions about the amount of and the need to test for goodwill," the Second Circuit found that the plaintiff had not "plausibly allege[d] that [the] defendants did not believe the statements regarding goodwill at the time they made them." *Id*. at *6. The Second Circuit held that "such an omission is fatal to [the] plaintiff's [S]ection 11 and 12 claims." *Id*.

### The Second Circuit Also Affirms the Dismissal of Claims Regarding Loan Loss Reserves

The Second Circuit ruled that the plaintiff's allegations regarding loan loss reserves "suffer from the same deficiencies as those regarding goodwill." *Id.* "As the [Southern District of New York] recognized, determining the adequacy of loan loss reserves is not a matter of objective fact." *Id.* Rather, "loan loss reserves reflect management's opinion or judgment about what, if any, portion of amounts due on the loans ultimately might not be collectible." *Id.* "Such a determination is inherently subjective, and like goodwill, estimates will vary depending on a variety of predictable and unpredictable circumstances." *Id.*

Here, the plaintiff "does not point to an objective standard for setting loan loss reserves." *Id.* at *7. "Thus, in order for the alleged statements regarding the adequacy of loan loss reserves to give rise to liability under [S]ections 11 and 12," the Second Circuit explained that "[the] plaintiff must allege that [the] defendant's opinions were both false and not honestly believed when they were made." *Id.* "Because the complaint does not plausibly allege subjective falsity," the Second Circuit held that the plaintiff "fails to state a claim" as to the loan loss reserves. *Id.*

## Two District Courts Consider Whether the *Janus* Court's "Ultimate Authority" Requirement Applies to Rule 10b-5 Claims Against Corporate Insiders

In *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011), the Supreme Court 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." *Id.* at 2302. (To read our discussion of the *Janus* decision in the June edition of the Alert, please click here.) One of the questions to arise in the district courts out of the *Janus* ruling is whether this "ultimate authority" requirement applies to Rule 10b-5 claims against corporate insiders who make statements on behalf of the company.

Two recent decisions have considered this issue. While the District of New Jersey held that the "ultimate authority" requirement does not apply to claims against corporate insiders, the Northern District of Ohio took the opposite view. We discuss these decisions below.

### The District of New Jersey Holds That the "Ultimate Authority" Requirement Does Not Apply to Claims Against Corporate Insiders

On August 8, 2011, the District of New Jersey held that *Janus* "certainly cannot be read to restrict liability for Rule 10b-5 claims against corporate officers to instances in which a plaintiff can plead, and ultimately prove, that those officers—as opposed to the corporation itself—had 'ultimate authority' over the statement." *In re Merck & Co., Inc. Sec., Derivative, & ERISA Litig.*, 2011 WL 3444199, at *25 (D.N.J. Aug. 8, 2011) (Chesler, J.).

Merck executive Edward M. Scolnick had moved to dismiss securities fraud claims brought in connection with statements he allegedly made regarding Vioxx, a prescription arthritis medication that Merck eventually withdrew from the market "due to safety concerns." *Id.* at *1. Scolnick contended that he could not face liability under Section 10(b) and Rule 10b-5 "even as to those statements attributed to [him] … because the [c]omplaint does not allege that he had 'ultimate authority over'" those statements as required by the Supreme Court's holding in *Janus*. *Id.* at *24. Scolnick further argued that "attribution … by itself …

is not enough to give rise to a Rule 10b-5 claim against a person or entity." *Id.* at *25.

The District of New Jersey found that Scolnick had "take[n] the *Janus* holding out of context." *Id. Janus* concerned allegations that "the investment adviser *Janus* Capital Management had been significantly involved in preparing misleading statements contained in prospectuses filed with the SEC by mutual fund Janus Investment Fund." *Id.* Here, however, Scolnick allegedly "made the statements [at issue] pursuant to his responsibility and authority to act as an agent of Merck, not as in *Janus*, on behalf of some separate and independent entity." *Id.* The court explained that "Scolnick's role in the statements attributed to him is in no way analogous to Janus Capital Management's relationship to the statements issued by Janus Investment Fund." *Id.*

The *Merck* court held that "*Janus* does not alter the well-established rule that 'a corporation can act only through its employees and agents.'" *Id.* To rule otherwise "would absolve corporate officers of primary liability for all Rule 10b-5 claims," the court explained, "because ultimately, [corporate officers'] statements are within the control of the corporation which employs them." *Id.* The court therefore permitted the Section 10(b)/Rule 10b-5 claim to proceed against Scolnick "insofar as it is predicated on misrepresentations … that were made by and attributed to him." *Id.* at *26.

## The Northern District of Ohio Takes the Opposite View, Holding That the *Janus* Court's "Ultimate Authority" Requirement Applies to Claims Against Corporate Insiders

Less than a month after the District of New Jersey's decision in *Merck*, the Northern District of Ohio determined that the *Janus* Court's "ultimate authority" requirement for Rule 10b-5 claims "cannot be ignored simply because the defendants are corporate insiders." *Hawaii Ironworkers Annuity Trust Fund v. Cole*, 2011 WL 3862206, at *4 (N.D. Ohio Sept. 1, 2011) (Carr, J.) ("*Hawaii Ironworkers II*").

At issue in *Hawaii Ironworkers* were claims that corporate insiders had "improperly manipulated" financial results for Dana Corporation's CVS and Heavy Vehicle Group business units in order "'to inflate Dana's … earnings.'" *Id.* at *5. The defendants did not directly communicate the allegedly fraudulent financial results to investors; rather, this financial information was incorporated into Dana's public filings.

The Northern District of Ohio denied the defendants' motion to dismiss the complaint, finding that "those who spoke directly to the investing public merely conveyed to the public the defendants' conduct that was at the heart of the fraud." *Hawaii Ironworkers Annuity Trust Fund v. Cole*, 2011 WL 1257756, at *8 (N.D. Ohio March 31, 2011) (Carr, J.). Relying upon the *Janus* decision, however, the defendants successfully moved for reconsideration of the court's ruling.

In opposition to the defendants' motion for reconsideration, the plaintiffs argued that "*Janus* should not alter [the court's] prior holding in this case for the simple reason that here [the] defendants are corporate insiders" and "'*Janus* does not analyze whether corporate executives can be liable.'" *Hawaii Ironworkers II*, 2011 WL 3862206, at *3. The Northern District of Ohio rejected this contention, explaining that "nothing in the Court's decision in *Janus* limits the key holding … to legally separate entities." *Id.* "Therefore," the court determined that "the proper inquiry for the case at hand is whether the defendants

had ultimate authority over the [allegedly] false statements in question." *Id*. at *4.

The complaint alleged that the defendants were under a "mandatory directive" to report a 6% profit margin increase. *Id*. at *4-5. "'Faced with these pressures, [the] defendants [allegedly] crafted numerous ways to fraudulently manipulate … revenues and accounts payable to meet the 6% target and make it appear as if the [c]ompany's restructuring and cost reduction efforts were paying off.'" *Id*. at *4. Based on these allegations, the court concluded that "[t]he complaint does not state a claim for primary liability under *Janus*, because the defendants did not have ultimate authority over the content of the statement[s]" that were made to the investing public. *Id*. at *5.

### The Northern District of Ohio Disagrees with the District of New Jersey's Rationale in *Merck*

The Northern District of Ohio expressly "disagree[d] with the [District of New Jersey]'s stated rationale" in *Merck*. *Id*. at *4 n.3. Nonetheless, the Northern District of Ohio found that "the outcome in *Merck* [was] undoubtedly correct" because "the [corporate officer] was the speaker, the corporation was the speechwriter, and 'it is the speaker who takes credit—or blame—for what is ultimately said'" under *Janus*. *Id*. The court explained that in *Merck*, "a very high-ranking officer … spoke to the public—by signing [Securities & Exchange Commission] forms and being quoted in articles and reports—and then attempted to disavow liability for those statements as being under the ultimate authority of the corporation." *Id*. The Northern District of Ohio agreed with the *Merck* court's denial of the corporate officer's motion to dismiss, and explained that under *Janus*, "attribution within a statement or implicit from surrounding circumstances is strong evidence that a statement was made by—and only by—the party to whom it is attributed." *Id*.

## Two Courts Take Opposite Views in Ruling on Dismissal Motions in "Say on Pay" Shareholder Derivative Actions

Under the Dodd-Frank Wall Street Reform and Consumer Protection Act, publicly traded companies must provide their shareholders with an advisory "Say on Pay" vote on executive compensation at least once every three years. *See* 15 U.S.C.A. § 78n-1(a)(1) (West 2011). The statute expressly provides that "Say on Pay" votes may not be construed as "overruling a decision" by the company or its board of directors, "creat[ing] or imply[ing] any changes to [their] fiduciary duties," or imposing "any additional fiduciary duties." 15 U.S.C.A. § 78n-1(c) (West 2011). Notwithstanding the advisory nature of "Say on Pay" votes, plaintiffs have begun filing derivative suits on the heels of negative votes. (Please click here to read our first report on this trend in the July edition of the Alert.)

Two of the earliest decisions—one from the Southern District of Ohio and the other from a Georgia state court—reflect sharply differing judicial views on the viability of these suits. While a Georgia state court dismissed in its entirety a "Say on Pay" suit brought derivatively on behalf of Beazer Homes USA, the Southern District of Ohio declined to dismiss a similar action brought derivatively on behalf of Cincinnati Bell.

### A Georgia State Court Dismisses the Beazer Homes "Say on Pay" Suit in its Entirety

On September 15, 2011, a Georgia state court ruled that a negative "Say on Pay" vote was not sufficient to "rebut[ ] the business judgment rule's presumption that the Beazer Board [had] appropriately acted in good faith, on an informed basis, and in the honest belief that their decisions concerning the 2010 executive

compensation were in the best interests of Beazer's shareholders." *See Teamsters Local 237 Additional Security Benefit Fund v. McCarthy*, No. 2011-cv-197841, slip op. at 19 (Ga. Super. Ct. Sept. 16, 2011) (Westmoreland, J.).

## Background

In Beazer Homes' December 2010 proxy statement, the Board of Directors recommended that shareholders vote in favor of approving the company's 2010 compensation "pursuant to newly applicable 'say on pay' provisions of the [Dodd-Frank Act]." *Id.* at 2. "[A] majority of voting Beazer shares voted against advisory approval of the challenged compensation." *Id.* at 3.

Several Beazer shareholders subsequently brought a derivative action asserting that the director defendants had "breached their duties of loyalty, candor, and good faith by (i) approving 2010 executive pay that [the] [p]laintiffs challenge[d] as 'excessive' and (ii) recommending that the Beazer shareholders vote in favor of approving the challenged compensation." *Id.* at 2. The plaintiffs contended that "the results of the say on pay vote … rebutted the presumption that the Beazer directors' decisions regarding the challenged compensation reflected valid business judgments deserving of deference." *Id.* at 3.

Because Beazer is a Delaware corporation, the court applied Delaware law in assessing the plaintiffs' claims.

## The *Beazer* Court Finds That the Plaintiff Failed to Rebut the Business Judgment Presumption

The court found that the complaint "lacks particularized factual allegations raising any doubt that the challenged compensation decisions were made in good faith and in [the] directors' honest belief that the decisions were in Beazer's best interests." *Id.* at 10. The plaintiffs did not "allege that the challenged compensation was … [in]consistent with [the] executives' performance against [ ] predetermined financial and non-financial goals and targets," nor did they assert that "the Beazer Board did not in good faith believe that those performance goals and targets were … appropriate metrics on which to base executives' compensation." *Id.*

The court explicitly rejected the plaintiffs' contention that "the adverse vote by a majority of Beazer shares voting in the 'say on pay' vote held at the [c]ompany's 2011 Annual Stockholders meeting in April 2010 constitutes evidence that rebuts the [business judgment] presumption" with respect to the company's 2010 executive compensation. *Id.* Finding this claim to be "wholly unpersuasive both factually and legally," the court explained that "Delaware law … places authority to set executive compensation with corporate directors, not shareholders." *Id.* at 10, 12. Moreover, the "[t]he Dodd-Frank Act expressly and unambiguously states that shareholder say on pay votes are advisory," and clearly "preserve[s] the pre-existing fiduciary duty framework concerning directors' executive compensation decisions." *Id* at 12. Accordingly, the court ruled that "an adverse say on pay vote" does not "*alone* suffice[ ] to rebut the presumption of business judgment protection applicable to directors' compensation decisions." *Id.*

The court also held that the plaintiffs' allegations

based on the Beazer Board's failure to "'rescind[ ]' the challenged 2010 executive compensation" following the "Say on Pay" vote did not "rebut the business judgment rule." *Id.* at 12-13. Neither Delaware law nor the provisions of the Dodd-Frank Act "require[ ] that the challenged pay be rescinded" because of the "Say on Pay" vote. *Id.* at 13. Moreover, the court noted that plaintiffs had "not alleged any basis on which the Beazer Board could have rescinded the challenged pay, which Beazer's executives [had] earned based on their performance in satisfying the incentive compensation targets and guidelines established by Beazer's Compensation Committee at the outset of fiscal 2010." *Id.*

### The *Beazer* Court Rules That the Plaintiffs Failed to Plead Demand Futility

"Under Delaware law, shareholders who file suit without first making a demand must allege *particularized facts* in their complaint demonstrating legal excuse from the demand requirement." *Id.* at 7. "Where a claim seeks to challenge a decision undertaken by a company's board, the test articulated in *Aronson* [*v. Lewis*, 473 A.2d 805 (Del. 1984)] applies." *Id.* at 7-8. "Under the *Aronson* test, in order to properly allege excuse from the demand requirement, the complaint must allege particularized facts raising a reasonable doubt that either (i) a majority of the board was 'disinterested' … and 'independent' … ; or (ii) the challenged decision was the result of a valid exercise of business judgment." *Id.* at 8.

With respect to the plaintiffs' allegations that "the Beazer Board breached its fiduciary duties … by allegedly approving 'excessive' compensation for the [c]ompany's executives in 2010 and recommending that shareholders vote to approve the compensation," the court found that the plaintiffs had "not allege[d] any basis to doubt that a majority of Beazer directors were disinterested as to [the] challenged compensation decision," nor had they "allege[d] that a majority of Beazer directors were … incapable of making an independent evaluation of the merits of the challenged compensation." *Id.* at 8, 9.

The court also found that the plaintiffs could not satisfy the second prong of the *Aronson* test because the plaintiffs had "not rebutted the presumption of business judgment rule protection [either] as to the Beazer directors' decisions to approve and recommend that shareholders vote for the challenged compensation" or "the Beazer Board's failure to rescind the challenged pay." *Id.* at 12, 13.

### The *Beazer* Court Dismisses the Plaintiffs' Claim for Unjust Enrichment

Because the complaint did not "raise a reasonable doubt that the Beazer Board's decisions regarding the challenged compensation reflected appropriate exercises of business judgment to which this [c]ourt should defer," the court held that the "unjust enrichment claim must [also] be dismissed for failure to state a claim." *Id.* at 22-23.

## The Southern District of Ohio Declines to Dismiss the Cincinnati Bell "Say on Pay" Action

On September 20, 2011, the Southern District of Ohio held that the plaintiffs adequately alleged that the Cincinnati Bell board had breached its fiduciary duty of loyalty by approving the company's 2010 executive compensation. *See NECA-IBEW Pension Fund v. Cox*, 2011 WL 4383368 (S.D. Ohio Sept. 20, 2011) (Black, J.). The court ruled that the plaintiff's "allegations create a reasonable doubt that the challenged transaction is the result of a valid business judgment, and, accordingly, the directors possess a disqualifying interest sufficient to render pre-suit demand futile and hence unnecessary." *Id.* at *9.

## Background

In Cincinnati Bell's March 2011 proxy statement, the Board of Directors included a resolution "seeking shareholder approval of the [company's] 2010 executive compensation," and recommended that the shareholders vote in support of the resolution. *Id.* at *1. On May 3, 2011, 66% of Cincinnati Bell's voting shareholders voted against the 2010 executive compensation.

Following this negative "Say on Pay" vote, a shareholder brought suit "alleging that the Cincinnati Bell Board [had] breached its fiduciary duty of loyalty when it decided to approve large pay raises and bonuses to its top three officers in a year when … the company [had] performed dismally." *Id.* The plaintiff contended that the 2010 executive compensation "violated Cincinnati Bell's written compensation policy," which allegedly "link[s] executive compensation with the returns realized by shareholders." *Id.* at *3, n.3. Moreover, the plaintiff "assert[ed] that the negative shareholder advisory vote on executive compensation … provides 'direct and probative evidence that the 2010 executive compensation was not in the best interests of the Cincinnati Bell shareholders.'" *Id.* at *3, n.4.

Because Cincinnati Bell is an Ohio corporation, the court applied Ohio law as well as the Federal Rules of Civil Procedure in assessing the plaintiff's claims.

## The *Cincinnati Bell* Court Finds That the Business Judgment Rule Does Not Require Dismissal

While "a board of directors is protected by the 'business judgment rule' when making decisions about executive compensation," the Southern District of Ohio found that "'the business judgment rule imposes a burden of proof, not a burden of pleading.'" *Id.* at *1, 2. Here, the court determined that the plaintiff had "made adequate pleadings that 'the Cincinnati Bell Board is not entitled to business judgment protection for its 2010 executive pay hikes.'" *Id* at *3. The court found that the "factual allegations raise a plausible claim that the multi-million dollar bonuses approved by the directors in a time of the company's declining financial performance violated Cincinnati Bell's pay-for-performance compensation policy and were not in the best interests of Cincinnati Bell's shareholders and therefore constituted an abuse of discretion and/or bad faith." *Id.*

The court acknowledged that the defendants "may offer the affirmative defense of the business judgment rule at trial … or [on motion for] summary judgment." *Id.* However, the court emphasized that this defense is not "fodder for dismissal" at the pleadings stage. *Id.*

## The *Cincinnati Bell* Court Holds That Demand Is Futile

"[D]emand is presumptively futile 'where the directors are antagonistic, adversely interested, or involved in the transactions attacked.'" *Id.* at *4. "Here," the court found that the plaintiff had "pled specific facts to give reason to doubt that the directors could make unbiased, independent business judgments about whether to sue." *Id.* "Given that the director defendants devised the challenged compensation, approved the compensation, recommended shareholder approval of the compensation, and suffered a negative shareholder vote on the compensation," the court held that the plaintiff had "demonstrated sufficient facts to show that there is reason to doubt that these same directors could exercise their independent business judgment

over whether to bring suit against themselves for breach of fiduciary duty in awarding the challenged compensation." *Id.*

**The Court Also Rules That the Plaintiff States a Claim for Unjust Enrichment**

The *Cincinnati Bell* court found that the plaintiff had adequately alleged that three of the individual defendants "were unjustly enriched as a result of the 2010 executive compensation." *Id.* "[B]ecause [the] plaintiff ha[d] sufficiently pled facts of breach of fiduciary duty," the court explained that "it is 'axiomatic' that [the] plaintiff ha[d] also sufficiently pled a claim for unjust enrichment." *Id.* at *5.

# The Southern District of Texas Dismisses the BP Derivative Suit on Forum Non Conveniens Grounds

On September 15, 2011, the Southern District of Texas granted a motion to dismiss a shareholder derivative suit brought on behalf of nominal defendant BP, p.l.c., to recover "damages and other relief from various current and former officers and directors of BP and BP's United States subsidiary for alleged breaches of their fiduciary duties" in connection with the Deepwater Horizon explosion. *In re BP Shareholder Derivative Litig.*, 2011 WL 4345209, at *1 (S.D. Tex. Sept. 15, 2011) (Ellison, J.). Finding that "the English High Court is a far more appropriate forum for this litigation," the court "exercise[d] its discretion to dismiss [the complaint] on forum non conveniens grounds." *Id.* at *2.

## Background

The plaintiffs alleged that "the individual defendants [had] engaged in a pattern of disregard for the safety of BP's energy exploration operations," leading to "a series of safety violations spanning two decades" and "culminat[ing] in the devastating Deepwater Horizon explosion and subsequent oil spill in the Gulf of Mexico." *Id.* at *1. The plaintiffs brought claims under the United Kingdom Companies Act of 2006, which "governs the fiduciary duties that officers and directors owe English companies." *Id.* Specifically, the plaintiffs asserted that the individual defendants had "(1) acted ultra vires and caused BP to engage in unlawful conduct, and (2) failed to exercise independent judgment and due care by allowing BP to engage in dangerous activities without adequate process safety." *Id.*

The defendants moved to dismiss the complaint under the doctrines of forum non conveniens and international comity, among other grounds.

## The Court Holds That the Plaintiffs' Choice of Forum Is Not Entitled to "Greater Deference"

"[W]hen a plaintiff sues in its home forum, that choice is generally entitled to greater deference in balancing the private conveniences of the parties because it is assumed to be convenient." *Id.* at *4. However, such "increased deference" is "not necessarily applied … where the plaintiffs are several of thousands of shareholders who could have brought the lawsuit on behalf of the corporation." *Id.*

The court found it significant that "more than 60 percent of BP's shareholders are not [American]." *Id.* at *5. "[E]ach of these foreign shareholders is equally entitled to bring the corporation's cause of action in a representative capacity, with an accompanying right to proceed in any one of their many home courts." *Id.* The court therefore declined to accord the plaintiffs' forum choice the "'greater deference' normally given home plaintiffs in balancing the convenience in a forum non conveniens case." *Id.*

## The Court Finds That English Courts Provide an Available and Adequate Alternative Forum

"To demonstrate that an alternative forum exists for purposes of forum non conveniens, a defendant must show that the proposed alternative is both available and adequate." *Id*. The *BP* court held that the availability requirement was met, conditional on proof that all of the individual defendants were subject to or would stipulate to the jurisdiction of the English courts. *Id*. at *6. The court also found it "undisputed" that "the courts of England provide an adequate forum in which to litigate [the plaintiffs'] claims." *Id*.

## The Court Determines That the Private Interest Factors "Only Slightly" Favor England

"'If the court concludes that [a] foreign forum is both available and adequate, it should then consider all of the relevant factors of private interest,'" including "(1) the relative ease of access to sources of proof; (2) the availability of compulsory process to secure the attendance of witnesses; (3) the cost of attendance for willing witnesses; and (4) all other practical problems that make trial of a case easy, expeditious and inexpensive." *Id*. at *2-3. The *BP* court found that these "private interest factors favor England only slightly as the more convenient forum." *Id*. at *6.

"[W]ith regard to relative access to sources of proof," the court held that "England is the more convenient forum" because "BP's Board of Directors meets in England and [ ] the records of their discussions and decisions are maintained there." *Id*. at *8. The court found that documents located in the United States regarding "the safety of BP's Gulf Coast operations" would be "of questionable relevance to the current inquiry into key management decisions made at the highest levels of BP by its Board of Directors headquartered in London." *Id*. Moreover, because the plaintiffs had alleged "a pattern of disregard for process safety spanning two decades and involving various BP operations," the court determined that "any potentially relevant documents regarding the Macondo [drilling] project [in the Gulf of Mexico] located in Texas and Louisiana are unlikely to outnumber the extensive corporate records located in England." *Id*.

As to the "cost and availability of mechanisms to secure attendance of witnesses," the court noted that "nonparty witnesses and a majority of party witnesses are likely to be found in England" while a "large minority of the individual defendants is American." *Id*. at *10. Thus, the court determined that this factor "weigh[s] only slightly in favor of England as the more convenient forum." *Id*.

## The Court Holds That the Public Interest Factors "Strongly Favor" Dismissal

"When a court cannot determine whether the private interest factors weigh in favor of dismissal, it must examine the public interest factors." *Id*. These factors include: "'(1) the administrative difficulties flowing from court congestion; (2) the local interest in

having localized controversies decided at home; (3) the familiarity of the forum with the law that will govern the case; (4) the avoidance of unnecessary problems of conflict of laws or the application of foreign law; and (5) the unfairness of burdening citizens in an unrelated forum with jury duty.'" *Id.* at *3. The court held that these factors "strongly favor England as the appropriate forum in which to proceed with this case." *Id.* at *15.

With respect to the first factor, the court noted that "shareholder derivative actions … typically generate increased administrative oversight duties for courts." *Id.* at *11. The court accordingly determined that "dismissing this derivative suit … would undoubtedly relieve a substantial burden on the [c]ourt's already ample caseload." *Id.*

As to the second factor, the *BP* court found that "[t]he English courts have a greater interest in resolving a dispute related to the internal governance of an English company, especially one about whether the company's directors violated their fiduciary duties." *Id.* at *12.

With respect to the third and fourth public interest factors, the *BP* court found that "this case is exceptional in that it would require the [c]ourt to interpret a recently enacted [English] statutory corporate governance scheme" with "little guidance from the English courts." *Id.* at *14.

Finally, the court held that American citizens "should not be burdened, as factfinders, with the exercise of applying complex English law to determine whether the individual defendants harmed an English company through unlawful acts and inadequate oversight," particularly when "the only party that stands to gain from the successful prosecution of this derivative action is BP itself, not [American] citizens." *Id.* at *14, 15.

The court concluded that "these public interest considerations counsel strongly in favor of dismissal," and accordingly granted the defendants' motion to dismiss on forum non conveniens grounds. *Id.* at *15.

# The Southern District of New York Holds that *American Pipe* Tolling Applies to Section 13's Three-Year Statute of Repose

On September 15, 2011, the Southern District of New York issued a ruling addressing the question of whether the filing of a class action tolls the three-year statute of repose applicable to claims under Sections 11 and 12(a)(2) of the Securities Act of 1933 pursuant to the tolling doctrine set forth in *American Pipe & Construction Co. v. Utah*, 414 U.S. 538 (1974). *In re Morgan Stanley Mortg. Pass-Through Certificates Litig.*, 2011 WL 4089580 (S.D.N.Y. Sept. 15, 2011) (Swain, J.). Although two recent Southern District of New York decisions have held that *American Pipe* tolling is inapplicable to statutes of repose, the *Morgan Stanley* court ruled that "*American Pipe* tolling may properly be applied to statutes of repose as well as to statutes of limitation." *Id.* at *17. The court further held that *American Pipe* tolling applies even where the original plaintiffs lacked standing.

## Background

In December 2008, the Public Employees' Retirement System of Mississippi brought suit in California state court "asserting securities fraud claims relating to the marketing and sale of mortgage-backed security … pass through certificates issued by Morgan Stanley Dean Witter Capital I Inc. and several Morgan Stanley Mortgage Loan Trusts." *Id.* at *1. The suit was eventually consolidated with another action in the Southern District of New York. In September 2009, the plaintiffs filed an amended complaint in the consolidated action. In August 2010, the Southern District of New York dismissed the complaint in part with leave to replead.

In September 2010, the plaintiffs filed a second amended complaint asserting claims on behalf of new plaintiffs with respect to securities that the original

plaintiffs did not own. Although Section 13's three-year statute of repose for claims under Sections 11 and 12(a)(2) had run prior to the filing of the second amended complaint, the plaintiffs argued that the new plaintiffs' claims were "timely under the [*American Pipe*] tolling doctrine," *id*. at *14, which holds that "the commencement of the original class suit tolls the running of the statute [of limitations] for all purported members of the class." *American Pipe*, 414 U.S. at 554. The defendants moved to dismiss the new plaintiffs' claims on the grounds that "*American Pipe* tolling does not apply to statutes of repose, nor to cases in which the original class representatives lacked standing to assert the claims." *Morgan Stanley*, 2011 WL 4089580, at *14.

## The *Morgan Stanley* Court Holds that *American Pipe* Tolling Is Applicable to Statutes of Repose

Because "it is settled law that statutes of repose are not susceptible to equitable tolling," the *Morgan Stanley* court determined that "the applicability of the *American Pipe* rule to the statute of repose here hinges on whether its tolling principle is equitable or legal in nature." *Id*. at *15. "Neither the Supreme Court nor the Second Circuit has addressed this question," but a majority of the lower courts has held that "*American Pipe* tolling 'is a species of legal tolling' … [that] applies to statutes of repose." *Id*. The *Morgan Stanley* court found this view "persuasive," explaining that "*American Pipe* tolling … does not 'extend equitable relief' based on an individualized assessment of fairness." *Id*. at *15-16. "Rather, the 'theoretical basis on which *American Pipe* rests is the notion that class members are treated as parties to the [original] class action'" and thus "'the limitations period does not run against them during that time.'" *Id*. at *16.

The *Morgan Stanley* court expressly disagreed with the Southern District of New York's decision in *Footbridge Ltd. Trust v. Countrywide Financial Corp.*, 770 F. Supp. 2d 618 (S.D.N.Y. 2011) (Castel, J), which is currently on appeal before the Second Circuit together with the Southern District's subsequent ruling in *In re Lehman Bros. Securities and ERISA Litigation*, 2011 WL 1453790 (S.D.N.Y. April 13, 2011) (Kaplan, J.). The *Footbridge* court determined that *American Pipe* tolling is "a species of equitable tolling" because "Rule 23 does not explicitly provide for tolling in connection with putative class actions." *Morgan Stanley*, 2011 WL 4089580, at *16. The *Morgan Stanley* court found the *Footbridge* view to be "directly at odds with the purposes of Rule 23" because of "the risk that potential class members would [then have to] flood the courts with duplicative [protective] motions" to secure their claims. *Id*. at *17.

## The *Morgan Stanley* Court Rules that *American Pipe* Tolling Applies Even Where the Original Plaintiffs Lacked Standing

The defendants also argued that that "*American Pipe* tolling is inoperative where the original plaintiff who brought the class action lacked standing." *Id*. Once again, the *Morgan Stanley* court noted that "there is no conclusive Supreme Court or Second Circuit authority" and the "lower courts are divided." *Id*. "Courts that have declined to apply tolling in such circumstances have cited its potential for abuse (specifically, that it

would encourage placeholder plaintiffs to file lawsuits first and locate appropriate representatives later)" as well as "concerns about the court's constitutional authority to toll a claim over which it had no subject matter jurisdiction." *Id*. "Courts that have applied tolling where the original plaintiff lacked standing have emphasized its furtherance of the policies of economy and efficiency that underpin *American Pipe*." *Id*.

The *Morgan Stanley* court found "the latter [view] more compelling," explaining that the "logic" of *American Pipe* "applies with equal force to cases in which the ultimate viability of the putative class action hinges on the question of whether the named representative has standing." *Id*. The court determined that "applying *American Pipe* in this context is fully consistent with the purposes of the statute of repose" because the original complaint—even if not initiated by the "appropriate party"—would have provided "'the essential information necessary to determine both the subject matter and the size of the prospective litigation'" within the limitations period. *Id*. at *18 (quoting *American Pipe*, 414 U.S. at 555).

The court stated that it was not "swayed by the argument that the absence of subject matter jurisdiction with respect to a named plaintiff who lacks standing precludes application of the *American Pipe* tolling to preserve the viability of the claims of putative class members who have standing." *Id*. Finding that "[t]his argument misapprehends the theory behind *American Pipe*," the court explained that "'members of the asserted class are treated for limitations purposes as having instituted their own actions'" at the time the original complaint was filed. *Id*.

The court further found that "[e]mbracing [the] [d]efendants' position would rob potential class members of much of the repose *American Pipe* aims to bestow and undermine the judicial economy goals of the doctrine." *Id*. "*American Pipe* tolling does not merely allow putative class members 'to wait on the sidelines' … [but rather,] such parties 'are *expected and encouraged* to remain passive during the early stages of the class action.'" *Id*. If the court were to adopt the defendants' approach, the court stated that "class members would be taking a tremendous risk by delaying intervention" in cases where "the law on standing was anything less than crystal clear." *Id*.

Although the *Morgan Stanley* court did acknowledge that "a blanket application of *American Pipe* tolling to cases where purported representatives lack standing holds the potential for abuse," the court found that this is not a case "where the representative so clearly lack[ed] standing that no reasonable class member would have relied." *Id*. Accordingly, the court held that the claims brought by the new plaintiffs are "timely under the *American Pipe* doctrine." *Id*. at *19.

## The Southern District of New York Rejects the "Listing Theory" of Liability for "Foreign-Cubed" Claims in the UBS Securities Fraud Action

On September 13, 2011, the Southern District of New York dismissed Section 10(b) claims brought by plaintiffs who purchased UBS shares on foreign exchanges, finding that an issuer's cross-listing of foreign-traded shares on the New York Stock Exchange ("NYSE") is not sufficient to give rise to Section 10(b) liability under the Supreme Court's ruling in *Morrison v. National Australia Bank*, 130 S. Ct. 2869 (2010). *In re UBS Sec. Litig.*, 2011 WL 4059356 (S.D.N.Y. 000Sept. 13, 2011).[1]

### Background

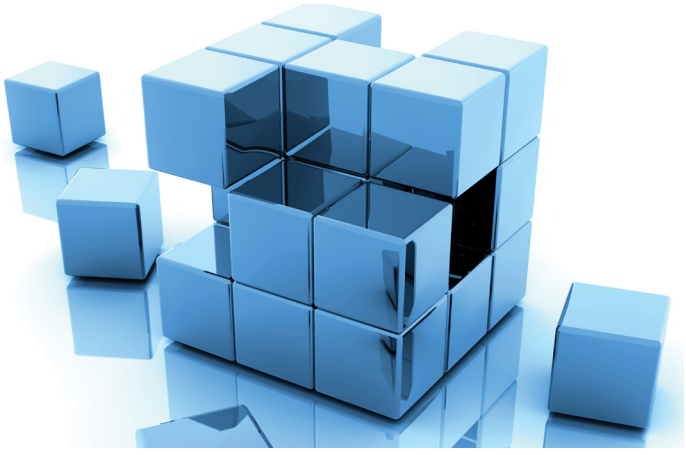
The plaintiffs brought suit in December 2007, alleging "false and misleading statements concerning UBS's investment in mortgage-backed securities and

1. Simpson Thacher represents the underwriters in this case.

other purportedly high-risk assets." *Id.* at *1. Of the four lead plaintiffs, three were "foreign institutional investors which [had] purchased shares of UBS stock on exchanges outside of the United States." *Id.* The fourth plaintiff was a United States entity which had "also purchased some of its UBS ordinary shares pursuant to purchase orders that were executed on a foreign exchange." *Id.*

Prior to the *Morrison* ruling, the defendants had moved to dismiss the foreign plaintiffs' claims, arguing that "pursuant to the Second Circuit's 'conduct' and 'effects' tests, the [c]ourt lacked subject-matter jurisdiction." *Id.* While the defendants' motion was pending, the Supreme Court handed down its decision in *Morrison*, which "reject[ed] the Second Circuit's 'conduct' and 'effects' tests in favor of a 'transactional' test" for determining the extraterritorial reach of Section 10(b). *Id.* at *2. The *UBS* court subsequently "ordered the parties to 'first brief [the] [d]efendants' motions to dismiss on the basis of the *Morrison* decision only.'" *Id.*

On August 31, 2010, the defendants moved to dismiss "'all claims [under the Exchange Act] arising out of [the] [p]laintiffs' purchases of UBS stock on foreign exchanges'" on *Morrison* grounds. *Id.* "These claims [fell] into two distinct categories: (i) claims asserted by [f]oreign [p]laintiffs who [had] purchased UBS stock on a foreign exchange ('foreign-cubed' claims), and (ii) claims asserted by OPEB, a domestic institutional investor, to the extent that such claims arise out of OPEB's purchase of UBS stock on a foreign exchange ('foreign-squared' claims)." *Id.*



## The Southern District of New York Dismisses the "Foreign-Cubed" Claims on *Morrison* Grounds

"Despite *Morrison*'s seemingly clear holding that § 10(b) was not intended to regulate foreign securities exchanges," the plaintiffs contended that "their foreign-cubed claims [were] not foreclosed because here, unlike in *Morrison*, the securities that the [f]oreign [p]laintiffs [had] purchased on foreign exchanges were also cross-listed on the NYSE." *Id.* at *4. "In support of their so-called 'listing theory,'" the plaintiffs "point[ed] to the following language in *Morrison*[:]"

> [I]t is in our view only transactions in *securities listed on domestic exchanges*, and domestic transactions in other securities, to which § 10(b) applies … The transactional test we have adopted—whether the purchase or sale is made in the United States, *or involves a security listed on a domestic exchange*—meets [the] requirement [that § 10(b) avoid regulation of foreign securities exchanges].

*Id.* (quoting *Morrison*, 130 S. Ct. at 2884, 2886 (emphasis added)). The plaintiffs claimed that "'Justice Scalia's deliberate choice of the word 'listed' … is more than enough to support the undeniable conclusion that § 10(b) reaches transactions in securities that are registered on a U.S. exchange (no matter where the trade is actually executed).'" *Id.*

The Southern District of New York found the plaintiffs' "hyper-technical parsing" of the *Morrison* decision to be "in stark tension with the language of the opinion as a whole," which "makes clear that [the Court's] concern was … the location of the securities *transaction* and not the location of an exchange where the security may be dually listed." *Id.* at *5. Under

the plaintiffs' "listing theory," a Section 10(b) suit "could be brought by *any* plaintiff who purchased stock on any securities exchange against *any* issuer, as long as the stock at issue was cross-listed on an American exchange." *Id.* The *UBS* court explained that this "reading of *Morrison* … cannot be harmonized with the *Morrison* Court's clear intention to limit the extraterritorial reach of § 10(b)." *Id.*

The plaintiffs defended their approach on the grounds that the defendants, "by cross-listing securities on multiple exchanges, … [had] necessarily consented to 'regulation in the multiple jurisdictions in which the ordinary shares are registered.'" *Id.* at *6. But the *UBS* court found that "the issue here is not whether [the] [d]efendants, by listing shares of stock on the NYSE, consented to regulation by the United States government." *Id.* Rather, the question is "whether Congress intended a private right of action to apply extraterritorially such that it reaches transactions that are executed on foreign exchanges." *Id.* "The *Morrison* Court unambiguously found that Congress had no such intention." *Id.*

Finally, the plaintiffs argued that "an issuer's mere listing of a stock on an American exchange is sufficient 'domestic conduct' to avoid implication of the presumption against extraterritoriality.'" *Id.* The *UBS* court found that this argument "merely articulates the principles underlying the Second Circuit's 'conduct test' that the *Morrison* Court squarely rejected." *Id.* "As the [*Morrison*] Court stressed, 'the presumption against extraterritoriality would be a craven watchdog indeed if it retreated to its kennel whenever *some* domestic activity is involved in the case.'" *Id.* (quoting *Morrison*, 130 S. Ct. at 2884). Here, "the [f]oreign [p]laintiffs fail[ed] to allege any domestic conduct at all other than [the] [d]efendants' listing of UBS stock on an American exchange." *Id.* "Given the *Morrison* Court's clear instruction that 'the focus of the Exchange Act is … upon purchases and sales of securities in the United States,'" the Southern District of New York held that "the [f]oreign [p]laintiffs' claims plainly fail[ed] to allege a domestic connection sufficient to invoke § 10(b)." *Id.*

The *UBS* court's rejection of the plaintiffs' "listing theory" of Section 10(b) liability is "consistent with the [rulings of the] overwhelming majority of other courts to have addressed the issue." *Id.* at *5. *See, e.g., In re Alstom SA Sec. Litig.*, 741 F. Supp. 2d 469, 472 (S.D.N.Y. 2010) (Marrero, J.) (holding that the listing theory "presents a selective and overly-technical reading of *Morrison* that ignores the larger point of the decision"); *In re Vivendi Universal S.A. Sec. Litig.*, 765 F. Supp. 2d 512, 531 (S.D.N.Y. 2011) (Holwell, J.) (finding "no indication that the *Morrison* majority read Section 10(b) as applying to securities that may be cross-listed on domestic and foreign exchanges … where the purchase and sale does not arise from the domestic listing"); *In re Royal Bank of Scotland Grp. PLC Sec. Litig.*, 765 F. Supp. 2d 327, 336 (S.D.N.Y. 2011) (Batts, J.) (explaining that "[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*").

## The Southern District of New York Also Dismisses the "Foreign-Squared" Claims

The plaintiffs contended that "even if the [c]ourt dismiss[ed] their foreign-cubed claims, the claims asserted by investors who purchased their shares of UBS stock from within the United States survive *Morrison*, regardless of whether the stock was purchased on a domestic or foreign exchange." *Id.* at *7. "According to [the] [p]laintiffs, an investor in the United States who purchases common shares of a foreign company from a foreign exchange 'satisfies *Morrison*'s transactional test because this constitutes a 'purchase … of any other security in the United States.'" *Id.*

The *UBS* court found this argument "unavailing," explaining 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 § 10(b)." *Id.* "To the contrary, the *Morrison* Court 'clearly sought to bar claims based on purchases and sales on foreign exchanges, even [where] the purchasers [are] American.'" *Id.* (quoting *Vivendi*, 765 F. Supp. 2d at 532).

The *UBS* court further held that "an investor's mere allegation that he suffered injury in the United States is insufficient to bring the investor's claim within the scope of § 10(b)." *Id.* at *8. "As other post-*Morrison* courts have found, 'the location of the harm to a plaintiff is independent of the location of the securities transaction that produced the harm.'" *Id.* (quoting *Plumbers' Union Local No. 12 Pension Fund v. Swiss Reinsurance Co.*, 753 F. Supp. 2d 166, 178 (S.D.N.Y. 2010)). Accordingly, the court dismissed the "foreign squared" claims in addition to the "foreign cubed claims."

## The Southern District of New York Criticizes Plaintiffs' Counsel for "Epic Failures" in the Smith Barney Transfer Agent Litigation

On August 31, 2011, after "six years of hard-fought and costly litigation" involving shares of the Smith Barney Capital Preservation Fund, lead plaintiffs' counsel informed the Southern District of New York that "the [l]ead [p]laintiff [had] never purchased any of the securities at issue." *See In re: Smith Barney Transfer Agent Litig.*, No. 05 Civ. 7583, slip op. at 1, 4 (S.D.N.Y. Sept. 22, 2011) (Pauley, J.). Instead, the lead plaintiff "'had actually purchased shares of the remarkably similarly named Smith Barney Capital Preservation Collective Trust (which is not part of this litigation).'" *Id.* at 4.

On September 22, 2011, the Southern District of New York granted the lead plaintiff's motion to withdraw in a scathing opinion chastising the lead plaintiffs' counsel for its "failure to confirm the most basic fact—that its client purchased the securities at issue in this action." *Id.* "Lead [c]ounsel is well aware of the costs associated with such [a large class action] litigation," the court explained, "and should have conducted sufficient due diligence before embarking on this six-year detour and frolic." *Id.* at 5.

The court also criticized the lead plaintiffs' counsel for attempting to pass off such a "remarkable revelation" as "a mere administrative matter." *Id.* at 1, 4. "[T]his was not a blue-booking error or a formatting glitch." *Id.* at 7. Rather, it was a threshold mistake that had "resulted in a considerable waste of time and resources" and would have a "seismic" impact on the case going forward. *Id.* at 4.

While the court's harshest words were directed towards the lead plaintiffs' counsel, the court noted that "Smith Barney and its attorneys [also] share[d] responsibility for such a fundamental oversight." *Id.* at 5. "Astonishingly, defense counsel failed to ask their clients whether [the lead plaintiff] had invested in any of the Smith Barney funds and, if so, specifically which ones." *Id.* "And Smith Barney was in a perfect position to know … [because] Smith Barney maintained its own records concerning the identity of investors in the Smith Barney Capital Preservation mutual fund." *Id.* at 5-6. "Had Smith Barney simply checked its records, it would have avoided six years of sparring with a phantom opponent." *Id.* at 6.

The Southern District of New York concluded that these "epic failures … offer a cautionary lesson for securities litigators" and "highlight the need for diligence at all stages of litigation." *Id.* at 1.

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