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This edition of the Alert addresses a Supreme Court decision holding that courts must separately review the arbitrability of each claim in a complaint. We also discuss two opinions from the Second Circuit: one ruling that a class member in the *Ameriprise* litigation may arbitrate certain claims notwithstanding an intervening class settlement; and another affirming the dismissal of an auction rate securities action against Merrill Lynch. In addition, we discuss a Ninth Circuit decision holding that proof of materiality is not required for invoking the fraud-on-the-market presumption at the class certification stage.

We also address a Southern District of New York ruling dismissing the Madoff Trustee's claims against JPMorgan Chase and UBS on standing grounds, as well as a decision from the Western District of Washington holding that the PSLRA's safe harbor does not protect oral forward-looking statements made without accompanying cautionary language. Finally, we discuss the Delaware Chancery Court's denial of motions for expedited discovery and proceedings in two shareholder suits opposing merger transactions.

The Supreme Court Holds that Courts Must Separately Review the Arbitrability of Each Claim in a Complaint

On November 7, 2011, the Supreme Court held that "[a] court may not issue a blanket refusal to compel arbitration merely on the grounds that some of the claims [at issue] could be resolved by the court without arbitration." *KPMG LLP v. Cocchi*, 2011 WL 5299457, at *1 (Nov. 7, 2011) (per curiam). The Court held that "state and federal courts must examine with care the complaints seeking to invoke their jurisdiction in order to separate arbitrable from nonarbitrable claims." *Id.*

In the case before the Court, investors in funds managed by Tremont Group Holding, Inc. and Tremont Partners, Inc. had brought suit against auditor KPMG in Florida state court. The funds had "invested with financier Bernard Madoff and [had] allegedly lost millions of dollars as a result of a scheme to defraud." *Id.* The plaintiffs asserted four causes of action against KPMG: negligent misrepresentation; violation of the Florida Deceptive and Unfair Trade Practices Act ("FDUTPA"); professional malpractice; and aiding and abetting a breach of fiduciary duty.

In response, "KPMG moved to compel arbitration based on [an] audit services agreement that existed between it and the Tremont defendants." *Id.* The trial court denied the motion, and a Florida appellate court affirmed. The appellate court determined that "the arbitration clause could only be enforced if [the plaintiffs'] claims were derivative in that they arose from the services KPMG performed for the Tremont

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defendants pursuant to the audit services agreement." *Id.* at *2. Based on its finding that "the negligent misrepresentation and [ ] violation of FDUTPA claims were direct rather than derivative[,]" the appellate court upheld the trial court's ruling. *Id.*

The Supreme Court found that "[a] fair reading of the [appellate court's] opinion reveals nothing to suggest that the court came to the same conclusion about the professional malpractice and breach of fiduciary duty claims." *Id.* "Indeed, the [appellate] court said nothing about those claims at all." *Id.*

The Supreme Court explained that "[t]he Federal Arbitration Act reflects an 'emphatic federal policy in favor of arbitral dispute resolution.'" *Id.* (*quoting Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 631 (1985)). "[W]hen a complaint contains both arbitrable and nonarbitrable claims, the Act requires courts to 'compel arbitration of pendent arbitrable claims when one of the parties files a motion to compel, even where the result would be the possibly inefficient maintenance of separate proceedings in different forums.'" *Id.* (*quoting Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 217 (1985)). "[C]ourts must examine a complaint with care to assess whether any individual claim must be arbitrated." *Id.* "The failure to do so is subject to immediate review." *Id.*

Here, the Supreme Court found that the Florida appellate court had "failed to give effect to the plain meaning of the [Federal Arbitration Act]" by evaluating the arbitrability of only two of the four claims at issue. *Id.* at *3. The Court vacated the appellate court's decision and remanded the case for further proceedings consistent with its opinion.

The Second Circuit Holds That a Class Member in the *Ameriprise* Litigation May Arbitrate Certain Claims Notwithstanding an Intervening Class Settlement

On November 3, 2011, the Second Circuit "addressed … the effect of a class-action settlement on an individual class member's preexisting right to arbitrate certain claims." *In re American Express Fin. Advisors Sec. Litig.*, 2011 WL 5222784, at *1 (2d Cir. Nov. 3, 2011) (Sack, J.). In addition, the Second Circuit held that "a district court may properly enjoin arbitration proceedings that are not covered by a valid and binding arbitration agreement." *Id.* at *23.

Background

Investors John and Elaine Beland "brought various claims before Financial Industry Regulatory Authority ("FINRA") arbitrators against Ameriprise Financial Services, Inc. … for, *inter alia*, breach of fiduciary duty, breach of contract, fraud, and negligent misrepresentation related to the decline in value of various financial assets owned by the Belands and managed by Ameriprise." *Id.* at *1. The Belands

contended that Ameriprise had "fail[ed] to adhere to [their] conservative investment strategy" and had "'steer[ed]' … the Belands' assets into mutual funds that allowed Ameriprise to collect excessive fees." *Id.*

Ameriprise responded that "the Belands [had] released their claims by operation of a settlement agreement in a class-action suit that had proceeded" in the Southern District of New York. *Id.* Although the Belands were members of the class, "they took no action at the time of the settlement, failing to either opt out of the class or to submit a claim to share in the settlement funds." *Id.*

The terms of the settlement agreement provided that the district court "retained exclusive jurisdiction over disputes arising from the class litigation." *Id.* When FINRA arbitrators denied Ameriprise's motion to stay the Belands' arbitration, Ameriprise brought suit in the Southern District of New York "for an order to enforce the settlement agreement that would enjoin the Belands from pressing any of their claims before FINRA arbitrators." *Id.* The district court found that "the class settlement barred all of the Belands' arbitration claims," and therefore "ordered the Belands to dismiss their FINRA complaint with prejudice" (the "Enforcement Order"). *Id.*

The Second Circuit Court Holds That the Belands Are Entitled to Arbitrate Certain Claims Not Released by the Class Settlement

The "principal issue" before the Second Circuit was "whether any of the Belands' FINRA [c]laims survived the [c]lass [s]ettlement and are thus still subject to arbitration." *Id.* at *12. As an initial matter, the Second Circuit found that "Ameriprise [had] consented to arbitrate disputes with the Belands … by virtue of its membership in FINRA." *Id.* at *19. Because "[t]he scope of an agreement to arbitrate is a 'question of arbitrability' within the purview of the court," the Second Circuit determined that it could "properly undertake the task of determining the breadth of Ameriprise's consent to arbitrate." *Id.* at *20.

Turning to the facts, the court explained that "the [c]lass [s]ettlement extinguished not only the ability of [c]lass [m]embers to bring Released Claims against Ameriprise as a matter of substance, but also the [c]lass [m]embers' right to arbitrate those claims." *Id.* at *14. The Belands had "failed to opt out of the class" and "ha[d] not demonstrated 'excusable neglect' for that failure." *Id.* Accordingly, the Second Circuit concluded that the Belands "may not pursue any Released Claims against Ameriprise and its employees." *Id.*

The settlement agreement provides that: "'Released Claims' shall *not* include suitability claims *unless* such claims are alleged to arise out of the common course of conduct that was alleged, or could have been alleged, in the [a]ction … ." *Id.* at *17 (emphasis in original). The Second Circuit noted that "suitability claims are often brought 'as a distinct subset' of [S]ection 10(b) claims." *Id.* However, "because of the lack of a definition of the term ['suitability'] in the [c]lass [s]ettlement," the Second Circuit determined that "for the purposes of this appeal," it would "consider 'suitability' to serve more as a general description of the character of potential common-law claims … rather than a technical term denoting a specific type of [S]ection 10(b) claim." *Id.*

The Second Circuit found that the Belands had stated "a quintessential suitability claim" by alleging that Ameriprise and one of its financial consultants had "agreed to invest the Belands' funds 'in a conservative fashion,'" but "'[a] conservative asset allocation approach was not taken.'" *Id.* at *18. The court further held that this suitability claim did not "'arise out of the common course of conduct'" alleged in the class action. *Id.* at *17-18. "[T]he class action involved investors who 'were sold financial plans and/or advice that, instead of being tailored to their individual circumstances, contained standardized recommendations designed to steer them into investing in [the] [d]efendants' proprietary mutual funds [and certain other investments].'" *Id.* at * 18. "[T]he basis of the class action was the notion that '[inherent] conflicts of interest … and [relevant] compensation arrangements … were inadequately disclosed to investors.'" *Id.* The Second Circuit concluded that "[t]he Belands' claims that [their Ameriprise financial consultant] mismanaged their trusts contrary to their instructions and investment goals do not fall within that 'common course of conduct.'" *Id.*

Additionally, while the class period ended on April 1, 2006, "the Belands' complaint stretches all the way into 2009." *Id.* at *19. The Second Circuit found that a number of the Belands' claims were therefore "not Released Claims." *Id.* Accordingly, the court "vacat[ed] [that] portion of the Enforcement Order that purported to enjoin the Belands from presenting [non-Released Claims] to the FINRA arbitrators." *Id.* at *23.

The Second Circuit Finds that Federal Courts Have the Power to Stay Arbitrations Where Appropriate

Neither party "dispute[d] the general principle that federal courts are vested with power under the [Federal Arbitration Act ("FAA")] to enjoin a pending arbitration where appropriate." *Id.* at *8. However, because "this question has never been explicitly resolved by [the Second Circuit]," the *Ameriprise* court opted to "address [the issue] in the course of [its] analysis." *Id.*

The *Ameriprise* court first considered the terms of the FAA, which do not "explicitly confer on the judiciary the authority to do what the district court's Enforcement Order purported to do here: enjoin a private arbitration." *Id.* at *21. The court next turned to Second Circuit precedent: "Our decisions do suggest … that, at least where the court determines … that the parties have not entered into a valid and binding arbitration agreement, the court has the authority to enjoin the arbitration proceedings." *Id.* Finally, the court looked to the First Circuit's decision in *Societe Generale de Surveillance, S.A. v. Raytheon European Mgmt. & Sys. Co.*, 643 F.2d 863 (1st Cir. 1981). There, the First Circuit held that "[t]o allow a federal court to enjoin an arbitration proceeding which is not called for by the contract interferes with neither the letter nor the spirit" of the FAA. *Societe Generale*, 643 F.2d at 868.

"[A]pply[ing] those principles here," the Second Circuit held that "the district court was not powerless to prevent one party from foisting upon the other an arbitration process to which the first party had no contractual right." *Ameriprise*, 2011 WL 5222784, at *22. "It makes little sense to us to conclude that district courts lack the authority to order the cessation of an arbitration by parties within its jurisdiction where such authority appears necessary in order for a court to enforce the terms of the parties' own agreement, as reflected in a settlement agreement." *Id.* The Second Circuit "affirm[ed] … that portion of the district court's Enforcement Order that enjoined the Belands' FINRA [a]rbitration as to the Released Claims." *Id.* at *23.

The Second Circuit Affirms the Dismissal of an Auction Rate Securities Class Action Against Merrill Lynch

On November 14, 2011, the Second Circuit affirmed the dismissal with prejudice of a putative class action suit brought against Merrill Lynch & Co., Inc. and Merrill Lynch, Pierce, Fenner & Smith, Inc. (collectively, "Merrill") alleging that "Merrill [had] engaged in a scheme to manipulate the [auction rate securities ("ARS")] market" in violation of Section 10(b) and Rule 10b-5(a) and (c). *Wilson v. Merrill Lynch & Co., Inc.*, 2011 WL 5515958, at *1 (2d Cir. Nov. 14, 2011) (Katzmann, J.). The Second Circuit held that "Merrill's disclosures of its [ARS] bidding practices preclude[d] [the plaintiff's] market manipulation claim." *Id.* at *17.

Background

"ARS are debt or equity interests issued by various public and private entities" with interest or dividend rates that are reset through periodic auctions. *Id.* at *1. According to the complaint, Merrill had allegedly "'followed a uniform policy of placing support bids if needed to prevent auction failures in every auction for which it was the sole or lead auction dealer.'" *Id.* at *2. These "support bids [allegedly] 'masked the liquidity risks inherent in [Merrill] ARS.'" *Id.* The plaintiff contended that "until the credit market deteriorated in the summer of 2007, Merrill invariably prevented ARS auctions from failing." *Id.* "On February 13, 2008, Merrill and all other major dealers [allegedly] withdrew their support from the ARS market." *Id.* "As a result, 87% of all [subsequent] ARS auctions [allegedly] failed." *Id.*

Merrill moved to dismiss the complaint based on "several public disclosures of its ARS auction practices." *Id.* at *3. Pursuant to the terms of a 2006 settlement with the SEC involving a number of ARS broker-dealers, Merrill "posted on its website a document describing its ARS practices and procedures." *Id.* at *4. Merrill also included "[c]ertain limited disclosures" in its ARS prospectuses. *Id.*

In March 2010, the Southern District of New York dismissed the complaint in its entirety with prejudice "on several grounds, including that Merrill's disclosures of its auction practices preclude[d] [the plaintiff's] claim that these practices were manipulative." *Id.* at *1. Specifically, the district court found that "the publicly disclosed information about Merrill's bidding practices was sufficient to defeat the allegation that these practices sent a false pricing signal to the market." *Id.* at *9. The plaintiff appealed.

The Second Circuit Holds That the Plaintiff Cannot State a Market Manipulation Claim In Light of Merrill's Disclosures

Section 10(b) prohibits the use of "any manipulative or deceptive device" "in connection with the purchase or sale of any security." 15 U.S.C. § 78j(b). The word "manipulative" is "virtually a term of art when used in connection with securities markets." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976). "The term refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity." *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 476 (1977).

"In order for market activity to be manipulative," the "conduct [at issue] must involve misrepresentation or nondisclosure." *Merrill Lynch*, 2011 WL 5515958, at *8. "The gravamen of manipulation is [the] deception of investors into believing that [the] prices at which they purchase and sell securities are determined by the natural interplay of supply and demand, not rigged by manipulators." *Gurary v. Winehouse*, 190 F.3d 37, 45 (2d Cir. 1999).

Here, Merrill had "disclosed that it would 'routinely' bid on its own account and that it 'may routinely' place such bids for the purpose of preventing [ARS] auctions from failing." *Merrill Lynch*, 2011 WL 5515958, at *12. Merrill had also "warned investors that its bidding might affect the clearing rate or the success of particular auctions." *Id.* The Second Circuit held that "[t]hese disclosures suffice[d]." *Id.*

The *Merrill Lynch* court noted that its "conclusion that Merrill's disclosures preclude[d] [the plaintiff's] market manipulation claim is fully consistent with, if not compelled by, [the Second Circuit's recent] decision in *Ashland, Inc. v. Morgan Stanley & Co.*, 652 F.3d 333 (2d Cir. 2011)." *Id.* at *13. There, the Second Circuit affirmed the dismissal of ARS-related Section 10(b) claims against Morgan Stanley on the grounds that the bank had "explicitly disclosed the very liquidity risks about which [the plaintiffs] claim[ed] to have been misled." *Ashland*, 652 F.3d at 338. "For the same reasons," the *Merrill Lynch* court explained, "it is difficult to see how investors in Merrill ARS, in light of Merrill's substantially similar website disclosures, could have reasonably assumed that the lack of auction failures was indicative of genuine market liquidity rather than Merrill's routine placement of support bids." *Merrill Lynch*, 2011 WL 5515958, at *13.

While the appeal was pending, the *Merrill Lynch* court "invited the SEC to submit a letter brief" to present "the agency's considered views on the particular questions that this case presents." *Id.* at *14. The SEC argued in its submission that "Merrill's disclosures were inadequate." *Id.* While the Second Circuit "acknowledge[d] that at least some deference to the agency's position is appropriate given the SEC's expertise and accountability[,]" the court explained that it was "unable to agree with the SEC's application of the legal principles governing Merrill's disclosures." *Id.* at *15. "Given our understanding of the complaint and this court's assessment of similar disclosures in *Ashland*," the Second Circuit declined to "adopt the SEC's characterization" of Merrill's disclosures. *Id.*

The Ninth Circuit Holds That Proof of Materiality Is Not Required for Invoking the Fraud-on-the-Market Presumption at the Class Certification Stage

On November 8, 2011, the Ninth Circuit addressed the question of "[w]hat … a plaintiff [must] do to invoke the fraud-on-the-market presumption in aid of class certification[.]" *Conn. Ret. Plans and Trust Funds v. Amgen Inc.*, 2011 WL 5341285, at *1 (9th Cir. Nov. 8, 2011) (Silverman, J.). The court held that a "plaintiff must (1) show that the security in question was traded

in an efficient market" and "(2) show that the alleged misrepresentations were public." *Id.* "As for the element of materiality," the *Amgen* court ruled that a "plaintiff must plausibly allege—but need not *prove* … —that the claimed misrepresentations were material." *Id.*

Background

The plaintiff brought suit against Amgen Inc., a biotechnology company, and several of Amgen's officers, alleging that the defendants had violated Sections 10(b) and 20(a) "by [allegedly] misstating and failing to disclose safety information about two Amgen products used to treat anemia." *Id.* The plaintiff contended that the defendants' "alleged misstatements and omissions … [had] inflated the price of Amgen's stock" and that subsequent "corrective disclosures [had] allegedly caused Amgen's stock price to fall." *Id.* at *2.

In 2009, the Central District of California granted the plaintiff's motion for class certification. The court found that the plaintiff had "successfully invoked the fraud-on-the-market presumption by showing that Amgen's stock traded in an efficient market (which Amgen conceded) and that the alleged misstatements were public (which Amgen did not contest)." *Id.* at *3. "The district court further held that at the class certification stage, [the plaintiff] did not need to *prove*—but rather could merely *allege*—that Amgen's supposed falsehoods were material. …" *Id.* The court "declined to afford Amgen an opportunity to rebut the presumption of reliance at the class certification stage, holding … that rebuttal of the presumption was a trial issue." *Id.*

The Ninth Circuit Rules That Plaintiffs Do Not Have to Prove Materiality for Class Certification Purposes

On appeal, Amgen argued that the plaintiff had "failed to carry [its] burden" under Rule 23(a) "because it did not *prove* that Amgen's supposedly false statements were material." *Id.* at *4. "If those misrepresentations were *im*material," the alleged misstatements "would not [have] affect[ed] Amgen's stock price in an efficient market, and thus no buyer could claim to have been misled by an artificially inflated stock price." *Id.*

The Ninth Circuit rejected Amgen's argument, holding that "plaintiffs need not *prove* materiality to avail themselves of the fraud-on-the-market presumption of reliance at the class certification stage." *Id.* at *6. Rather, plaintiffs seeking class certification "need only allege materiality with sufficient plausibility to withstand a 12(b)(6) motion." *Id.*

The *Amgen* court explained that materiality is a merits issue on which "the plaintiffs' claims stand or fall together—the critical question in the Rule 23 inquiry." *Id.* at *4. "If the misrepresentations turn out to be material, then the fraud-on-the-market presumption makes the reliance issue common to the class, and class treatment is appropriate." *Id.* "But if the misrepresentations turn out to be immaterial, then *every* plaintiff's claim fails on the merits … and there would be no need for a trial on each plaintiff's individual reliance." *Id.*

"By contrast, the elements of the fraud-on-the-market presumption—whether the securities market was efficient and whether the defendant's purported falsehoods were public—are not elements of the merits of a securities fraud claim." *Id.* If plaintiffs cannot meet the requirements of the fraud-on-the-market presumption, the case would be "inappropriate for a class proceeding" but the plaintiffs could still "seek to prove reliance individually." *Id.*

The Ninth Circuit's Decision Widens an Existing Circuit Split on the Plaintiffs' Burden to Establish Materiality at the Class Certification Stage

Like the Ninth Circuit, the Seventh Circuit has "held that proving materiality is not a precondition to invoking the fraud-on-the-market presumption at the class certification stage." *Id.* at *5 (*citing Schleicher v. Wendt*, 618 F.3d 679, 685 (7th Cir. 2010)). "The Third Circuit [also] agrees" with this view. *Id.* (*citing In re DVI, Inc. Sec. Litig.*, 639 F.3d 623, 631 (3d Cir. 2011)).

However, the First, Second and Fifth Circuits "require a plaintiff to prove materiality at the class certification stage." *Id.* (*citing In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474, 481 (2d Cir. 2008); *Oscar Private Equity Invs. v. Allegiance Telecomm., Inc.*, 487 F.3d 261, 264 (5th Cir. 2007), *abrogated on other grounds by Erica P. John Fund v. Halliburton Co.,* 131 S. Ct. 2179, 2183, 2186 (2011); *In re PolyMedica Corp. Sec. Litig.*, 432 F.3d 1, 8 n.11 (1st Cir. 2005)). These circuits rely on a footnote in *Basic Inc. v. Levinson*, 485 U.S. 224, 248 n.27 (1998) (stating that "[t]he Court of Appeals held that in order to invoke the [fraud-on-the-market] presumption, a plaintiff must allege and prove … that the misrepresentations were material"). *Id.*

In *Schleicher*, the Seventh Circuit determined that this footnote in *Basic* does not resolve the question of whether proof of materiality is required for class certification. "All note 27 does … is state that the court of appeals deemed materiality essential; the Justices did not adopt it as a precondition to class certification." *Schleicher*, 618 F.3d at 687.

The Ninth Circuit found that the Seventh Circuit's "reading of *Basic* … enjoys support from the Supreme Court's more recent formulations of the [fraud-on-the-market] presumption in *Erica P. John Fund* and *Dukes* [*v. Wal-Mart Stores, Inc.*, 131 S.Ct. 2541 (2011)], which require the plaintiff to show that the stock was traded in an efficient market but do not mention materiality as a requirement." *Amgen*, 2011 WL 5341285, at *5.

The Ninth Circuit Finds That the District Court Properly Refused to Consider Amgen's Truth-on-the-Market Defense at the Class Certification Stage

Amgen also argued on appeal that "the district court [had] erred by not affording it an opportunity to rebut the fraud-on-the-market presumption at the class certification stage" with the "truth-on-the-market" defense. *Id.* at *6. Specifically, Amgen had "sought to introduce evidence that FDA announcements and analyst reports about Amgen's business [had already] publicized the truth about the safety issues looming over Amgen's drugs, and thus that Amgen's alleged misrepresentations could not have affected the stock price." *Id.*

The Ninth Circuit explained that "the truth-on-the-market defense is a method of refuting an alleged misrepresentation's *materiality*." *Id.* Because "a plaintiff need not prove materiality at the class certification stage," the Ninth Circuit ruled that "the district court correctly refused to consider Amgen's truth-on-the-market defense at the class certification stage." *Id.*

The Southern District of New York Dismisses the Madoff Trustee's Claims Against JPMorgan Chase and UBS on Standing Grounds

On November 1, 2011, the Southern District of New York dismissed common law claims brought by the Trustee for the Securities Investor Protection Act ("SIPA") liquidation of Bernard L. Madoff Investment Securities LLC ("BMIS") against certain JPMorgan Chase entities (the "JPMorgan Defendants") and certain UBS entities (the "UBS Defendants") on behalf of BMIS's customers. *Picard v. JPMorgan Chase & Co.*, 2011 WL 5170434 (S.D.N.Y. Nov. 1, 2011) (McMahon, J.). The *JPMorgan Chase* court found that the Trustee "lacks standing to pursue his common law claims against [the JPMorgan and UBS] Defendants." *Id.* at *3. The Trustee's remaining claims, which were brought under the federal Bankruptcy Code, were returned to the Bankruptcy Court for further proceedings.

Background

The Trustee argued that "the JPMorgan Defendants, as Madoff and BMIS's primary banker, knew, should have known, or consciously avoided discovering, that BMIS was not engaged in lawful securities trading, but was illegally misappropriating customer funds." *Id.* at *1. Based on this alleged "failure," the Trustee contended that "the JPMorgan Defendants substantially assisted, or knowingly participated in [Madoff's] scheme, breaching duties they owed to BMIS's customers, and aiding and abetting BMIS's breach of such duties." *Id.*

In a separate action against the UBS Defendants, the Trustee alleged that the UBS Defendants "were aware that BMIS was likely engaged in fraud, but despite that knowledge sponsored two 'feeder funds' that invested heavily [in] BMIS." *Id.* at *2. The Trustee claimed that "UBS … lent the prestige of its name to the funds, and created the appearance of overseeing them[,]" while

"willfully turning a blind eye [to Madoff's activities] in order to collect lucrative fees for servicing the funds." *Id.*

The Trustee asserted a variety of common law claims against the JPMorgan and UBS Defendants, including aiding and abetting BMIS's fraud, breach of fiduciary duty, conversion, unjust enrichment, and contribution. "[W]ith respect to all causes of action except contribution," the Trustee sought "damages on behalf of BMIS's customers, rather than BMIS itself." *Id.* Both the JPMorgan Defendants and the UBS Defendants moved to dismiss the Trustee's complaints, arguing that "the Trustee lacks standing to bring common law claims on behalf of BMIS's customers because he is limited under Chapter 11 of the Bankruptcy Code and SIPA to vindicating the interests of BMIS only." *Id.*

While briefing on these motions was underway, another judge in the Southern District of New York dismissed the Trustee's substantially similar common law claims against HSBC and several of its affiliates for lack of standing. *Picard v. HSBC Bank PLC*, 454 B.R. 25, 30 (S.D.N.Y. 2011) (Rakoff, J.) (holding, *inter alia*, that "[n]either the language nor the structure of SIPA supports [the] conjecture" that the Trustee has "authority, beyond that afforded to a bankruptcy trustee, to bring common law claims against third parties on behalf of [BMIS's] customers").

The *JPMorgan Chase* Court Finds That the Trustee Has No Standing to Assert Claims on Behalf of BMIS's Customers Against the JPMorgan and UBS Defendants

Citing with approval the reasoning in the *HSBC* decision, the *JPMorgan Chase* court found that the Trustee has no standing to bring common law claims against the JPMorgan and UBS Defendants on behalf of BMIS's customers for a number of reasons.

First and foremost, the court emphasized that "the Trustee lacks standing under the Bankruptcy Code, as incorporated into SIPA, to pursue claims that properly belong to creditors—here, BMIS's customers." 2011 WL 5170434, at *3. "'It is well settled that a bankruptcy trustee has no standing generally to sue third parties on behalf of the estate's creditors, but may only assert claims held by the bankrupt corporation itself.'" *Id.* (*quoting Shearson Lehman Hutton, Inc. v. Wagoner*, 944 F.2d 114, 118 (2d Cir. 1991)). The *JPMorgan Chase* court found "no indication in either the Bankruptcy Code or SIPA that Congress intended to give the Trustee power to pursue claims that are not the property of the debtor." *Id.*

Second, the court held that "the Trustee cannot pursue these common law claims on behalf of the debtor, BMIS" under "the equitable doctrine of *in pari delicto*, which 'mandates that the courts will not intercede to resolve a dispute between two wrongdoers.'" *Id.* at *4 (*quoting Kirschner v. KPMG LLP*, 938 N.E.2d 941, 950 (N.Y. 2010)). Since Madoff's "wrongdoing as BMIS's agent is imputed to BMIS itself," the *JPMorgan Chase* court determined that "(1) BMIS could not have sued [the JPMorgan and UBS] Defendants for the alleged scheme, and (2) the Trustee—standing in the shoes of BMIS—cannot do so either." *Id.*

Third, the *JPMorgan Chase* court ruled that the Trustee "fails to adequately allege a right to relief under New York's contribution statute" because contribution is only available when defendants face "'common liability for the same injury.'" *Id.* at *10-11 (*quoting N.Y. State Elec. & Gas Corp. v. FirstEnergy Corp.*, 2007 WL 1434901, at *8 (N.D.N.Y. May 11, 2007)). Here, the Trustee's obligation to pay "BMIS customers … arises, not from state law, but from SIPA; but the [b]anks' liability to BMIS's customers, if any, arises, not from SIPA, but from New York tort law." *Id.* at *11.

Fourth, the *JPMorgan Chase* court found no basis for the Trustee's bailment and subrogation theories of standing. "SIPA does not create or contemplate a bailment relationship," the court explained, and "the Trustee's theory of common law bailment ignores that he was not in possession of [the BMIS customers'] property when it was [allegedly] damaged by [the JPMorgan and UBS] Defendants." *Id.* at *18. The court further held that "the Trustee lacks standing to pursue equitable subrogation rights of SIPC, to the extent they exist, [because] to do so would undermine the SIPA distribution scheme." *Id.*

Finally, the *JPMorgan Chase* court found meritless the Trustee's "novel theory of standing" based on 11 U.S.C. § 544(a), which empowers the Trustee to "stand in the shoes of a hypothetical judgment creditor that extended credit to BMIS at the commencement of its bankruptcy in order to seek certain recoveries from third parties." 2011 WL 5170434, at *4. The Trustee contended that this "power allows him to effectively step into the shoes of

all BMIS's actual creditors for the purpose of pursuing common law claims against [the JPMorgan and UBS] Defendants." *Id.* Rejecting this argument, the *JPMorgan Chase* court determined that the Trustee's "theory is not supported by the statute's text and history or by any persuasive case law, and its adoption would undermine the limitations on trustee standing established in *Caplin* [*v. Marine Midland Grace Trust Co. of N.Y.*, 406 U.S. 416 (1972)] and enforced by courts in this and other circuits for nearly forty years." *Id.*

The Western District of Washington Holds That the PSLRA's Safe Harbor Does Not Protect Oral Forward-Looking Statements Made Without Accompanying Cautionary Language

On October 6, 2011, the Western District of Washington denied in part a motion to dismiss a securities fraud action against Coinstar, Inc. and several of the company's executives. *In re Coinstar Inc. Sec. Litig.*, 2011 WL 4712206 (W.D. Wash. Oct. 6, 2011) (Pechman, J.). The court held, *inter alia*, that the "safe harbor" provisions of the Private Securities Litigation Reform Act ("PSLRA") do not protect oral earnings projections made without accompanying cautionary language.

Background

Redbox, Coinstar's wholly-owned subsidiary, generates "[a]pproximately eighty percent of Coinstar's revenues." *Id.* at *1. The complaint alleged that the defendants had "provided misleading [earnings] guidance … while being aware of factors adversely affecting Coinstar's Redbox [DVD-rental] business." *Id.* The defendants allegedly "reiterated th[is] misleading guidance during various conferences in November 201[0]." *Id.*

On January 13, 2011, Coinstar "notified the public of a shortfall … . of [approximately] eleven percent in its 4Q10 earnings." *Id.* Within a day of the announcement, Coinstar's stock price lost 27 percent of its value. "[W]hen Coinstar issued a press release [on February 3, 2011] announcing its actual 4Q10 and FY10 financial results, Coinstar's stock price again decreased … ." *Id.*

The *Coinstar* Court Declines to Dismiss Claims Concerning Oral Earnings Projections Unaccompanied by Cautionary Language

During two analyst conferences held in November 2010, Coinstar's Chief Financial Officer had allegedly "reiterated … earnings projections without providing any cautionary language." *Id.* at *7. The defendants asked the court to take "judicial notice of PowerPoint slides used at the November conferences which referred analysts to SEC filings," which in turn contained cautionary language. *Id.* However, the *Coinstar* court "decline[d] to consider" the PowerPoint slides on the grounds that "they [were] not included as part of the pleadings and [the] [p]laintiff contest[ed]

their authenticity." *Id.* "Considering the transcripts alone," the court determined that the "[d]efendants' statements did not contain sufficient cautionary language for the safe harbor provision to apply." *Id.*

Notably, the *Coinstar* court held that the PSLRA's safe harbor did protect oral statements "reiterating earnings projections" in the course of an October 28, 2011 analyst call. *Id.* at *5. During that call, the Coinstar executives had orally "advised investors that actual results may differ materially from expectations and [had] referred investors to Coinstar's latest 10-K and 10-Q filings for a full list of risk factors." *Id.* The plaintiffs contended that the safe harbor still did not apply because "mere reference to public filings is not sufficient cautionary language." *Id.* Rejecting this argument, the *Coinstar* court explained that "[t]he PSLRA does not require that cautionary language physically accompany forward-looking oral statements." *Id.* Rather, "oral forward-looking statements are protected as long as accompanied by an oral statement referring people to 'a readily available written document' that contains cautionary language and risk factors." *Id.*

The Delaware Chancery Court Denies Motions for Expedited Discovery and Proceedings in Two Shareholder Suits Opposing Merger Transactions

When shareholders bring suit in opposition to mergers and acquisitions transactions, they often bring motions for expedited discovery and proceedings. Two rulings from the Delaware Chancery Court denying such motions suggest that the hurdle for achieving expedited discovery may be getting higher.

On November 3, 2011, the Chancery Court issued a ruling from the bench denying the shareholders' motion to expedite discovery and proceedings in an action challenging an agreement between C&D Technologies, Inc. and affiliates of Angelo, Gordon & Co., L.P., C&D's 65% stockholder, pursuant to which Angelo Gordon will acquire all outstanding C&D shares not already owned by Angelo Gordon or its affiliates.[1] The shareholders claimed that C&D's information statement, which was filed with the SEC following the execution of the merger agreement, contained insufficient disclosures. The Chancery Court found that the shareholders had failed to make an adequate showing of any colorable disclosure claim, and thus, there was no threat of irreparable harm to the plaintiffs if the motions were denied.

Similarly, on August 25, 2010, the Chancery Court denied a motion for expedited proceedings in an action brought by shareholders of Alloy, Inc. challenging a going-private merger transaction pursuant to which ZelnickMedia[2] and certain co-investors, including Matthew C. Diamond and James K. Johnson, Jr., Chief Executive Officer and Chief Operating Officer of Alloy, respectively, obtained ownership of Alloy. In connection with the transaction, Diamond and Johnson also negotiated employment agreements

1. Simpson Thacher represents Angelo Gordon in this matter.
2. Simpson Thacher represented ZelnickMedia and a number of other defendants in this matter.

for them to continue as Chief Executive Officer and Chief Operating Officer of Alloy after the transaction. Prior to the merger, Diamond and Johnson were Alloy's only employee directors. Neither Diamond nor Johnson served on the special committee responsible for reviewing the transaction.

After the transaction closed on November 9, 2010, the shareholders continued to litigate. On October 13, 2011, the Chancery Court granted the defendants' motion to dismiss the complaint in its entirety. *In re Alloy, Inc. S'holder Litig.*, 2011 WL 4863716 (Del. Ch. Oct. 13, 2011) (Parsons, V.C.). The court's decision was not appealed and has become final. With respect to the shareholders' unfairness claims, the court held that the plaintiffs had "failed to allege well-pleaded facts sufficient to support a reasonable inference that either a majority of the board or the [s]pecial [c]ommittee was so interested in the [m]erger or so lacking in independence from Diamond and Johnson that their negotiation and approval of the [m]erger constituted a breach of the fiduciary duty of loyalty." *Id.* at *10. The court found no basis for the shareholders' assertion that the Alloy board's financial advisor had "'skewed its valuation in favor of the [m]erger[,]'" nor could the court "conclude that [the] price [paid by ZelnickMedia] was 'so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith.'" *Id.* at *10, *12. Lastly, the court determined that it could not "infer that the board [had] acted in bad faith because of the benefits inuring to Diamond and Johnson." *Id.* at *12. The court explained that there was a "plausible and legitimate explanation for the board's decision to approve the benefits to Diamond and Johnson," namely that "ZelnickMedia wanted to ensure that those members of Alloy's management with the best knowledge and expertise regarding the [c]ompany continued to manage its affairs after the [m]erger and that they were properly incentivized to do so." *Id.*

As to the shareholders' disclosure claims, the Chancery Court held that the exculpatory provision in Alloy's certificate of incorporation "preclude[d] … [any] claim for money damages for disclosure violations that were made in good faith—*i.e.*, for failures to disclose resulting from a breach of the fiduciary duty of care rather than from breaches of loyalty or good faith." *Id.* at *14. Here, the court found that "there is no evidence that, in authorizing the disclosures, the Alloy directors [had] breached their duty of loyalty or acted in bad faith." *Id.*

Finally, because the Chancery Court concluded that the complaint "does not state any claim for breach of fiduciary duty against the directors of Alloy," the court also "dismiss[ed] the claims for aiding and abetting against the defendants who were not affiliated with Alloy." *Id.* at *1.

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