Simpson Thacher

SECURITIES LAW ALERT

DECEMBER 2012

This month's Alert addresses a Sixth Circuit decision affirming dismissal of negligent misrepresentation claims against three major rating agencies in connection with mortgage-backed securities, as well as a Southern District of New York opinion addressing the standard for remote tippee liability in insider trading prosecutions. We also review ten of the most notable circuit court decisions of 2012.

We wish you and yours a wonderful holiday season, and a happy new year.

The Sixth Circuit Affirms Dismissal of Negligent Misrepresentation Claims against Three Major Rating Agencies

On December 3, 2012, the Sixth Circuit affirmed dismissal of a complaint alleging claims for negligent misrepresentation and violations of the Ohio Securities Act against three major rating agencies ("the Agencies") in connection with losses arising from the plaintiffs' investments in mortgage-backed securities ("MBS"). *Ohio Police & Fire Pension Fund v. Standard & Poor's Fin. Servs. LLC*, 2012 WL 5990337 (6th Cir. Dec. 3, 2012) (Gibbons, J.) (*S&P II*). The Sixth Circuit found that the district court had properly held that (1) the Agencies did not owe the plaintiffs a duty of care, and (2) the ratings at issue did not constitute actionable misrepresentations.

Background

Between 2005 and 2008, five pension funds operated by the State of Ohio for public employees (the "Funds") invested heavily in MBS with ratings of 'AAA' or its equivalent. "The value of MBS collapsed during this period." *Id.* at *1. "In an effort to recoup some of [their] losses, the Funds brought suit against the Agencies under Ohio's 'blue sky' laws and a common law theory of negligent misrepresentation, alleging that the Agencies' ratings were false and misleading and that the Funds' reasonable reliance on those ratings caused their losses." *Id.*

The Securities Law Alert is edited by Paul C. Gluckow (pgluckow@stblaw.com/212-455-2653), Peter E. Kazanoff (pkazanoff@stblaw.com/212-455-3525) and Jonathan K. Youngwood (jyoungwood@stblaw.com/212-455-3539).

The Funds contended that the Agencies had become "'intimately involved in the issuance of [MBS]' by assisting arrangers in structuring their securities to achieve certain credit ratings." *Id.* at *2. An "Agency would earn its fee [only] if the desired rating issued," and "the arranger could reject the Agency's proposed rating" at "any point in [the] process." *Id.* The Funds argued that "this 'issuer pays' system compromised the integrity of the credit rating process," and "allege[d] that the Agencies did not properly disclose the weaknesses of [their] ratings." *Id.*

On September 26, 2011, the Southern District of Ohio dismissed the Funds' complaint in its entirety and with prejudice. *Ohio Police & Fire Pension Fund v. Standard & Poor's Fin. Servs.*, 813 F. Supp. 2d 871 (S.D. Oh. 2011) (Graham, J.) (*S&P I*). The court found that the ratings at issue "were predictive opinions" and that the Agencies could not "be held liable for alleged negligence in their methodologies" without "specific allegations of fraudulent intent" or a duty to the Funds. *Id.* at 873. The parties disagreed over whether Ohio or New York common law governed the negligent misrepresentation claims, but the court held that the Funds' claims failed under the law of either state. The Funds appealed the court's ruling.

The Sixth Circuit Finds the Agencies Owed No Duty of Care to the Funds

The Sixth Circuit held that "there is no sound basis under either Ohio or New York law for concluding that the Agencies owed a duty of care to the Funds in this case." *S&P II*, 2012 WL 5990337, at *10.

The court explained that "New York law 'strictly limits negligent misrepresentation claims to situations involving actual privity of contract between the parties or a relationship so close as to approach that of privity.'" *Id.* at *8 (citations omitted). In *Anschutz Corp. v. Merrill Lynch & Co.*, 690 F.3d 98, 114 (2d Cir. 2012) (Cabranes, J.), the Second Circuit dismissed negligent misrepresentation claims against rating agencies "similar to those made by the Funds in this case." *Id.* The Sixth Circuit found that here, "as in *Anschutz*, there are no allegations of contacts between the Funds and the Agencies establishing a relationship 'so close as to approach that of privity.'" *Id.* The *S&P II* court therefore "affirm[ed] the district court's holding that the Agencies did not owe the Funds a duty of care under New York law." *Id.*

The Sixth Circuit found that "[d]etermining whether a duty of care exists under Ohio law is not as straightforward." *Id.* at *9. "Ohio cases generally agree that speakers do not owe a duty of care to the 'extensive, faceless, and indeterminable investing public-at-large.'" *Id.* (quoting *Federated Mgmt. Co. v. Coopers & Lybrand*, 738 N.E. 2d 842, 856 (Oh. Ct. App. 2000) (Tyack, J.)). "'[L]iability may be imposed for negligent misrepresentation only if the disseminator of the information intends to supply it to a specific person or to a limited group of people.'" *Id.* (quoting *Amann v. Clear Channel Commc'ns, Inc.*, 165 Ohio App. 3d 291, 297 (Ohio Ct. App. 2006) (Hendon, J.)).

In *Haddon View Inv. Co. v. Coopers & Lybrand*, 70 Ohio St. 2d 154 (1982) (Brown, J.), the Ohio Supreme Court held that "accountants owe a duty of care not merely to their clients, but [also] to any 'third party [that] is a member of a limited class whose reliance on the accountant's representation is specifically foreseen.'" *S&P II*, 2012 WL 5990337, at *9. "Ohio courts

have [since] applied *Haddon View* in contexts where third parties closely linked to a person in privity with the defendant could reasonably be expected to rely on information the defendant provided to that person." *Id*. The Sixth Circuit explained that "[i]n practice, the rule appears to work in much the same way that New York's rule of privity or 'near privity' works." *Id*.

While the Funds argued that they were part of a "limited class" for purposes of the *Haddon View* exception, the Sixth Circuit found that "the complaint proves otherwise." *Id*. at *10. "Of the 308 MBS the Funds purchased, 254 of them were publicly available securities any investor could have acquired." *Id*. "This is precisely the sort of claim for representations made to the 'faceless' investing public that Ohio courts reject." *Id*. The Sixth Circuit emphasized that the Funds' claim was "not salvaged by the Agencies' alleged role in structuring funds, the creation of 'pre-sale' reports containing ratings that were used by arrangers to market MBS, or the contingent relationship between providing a desired rating and receiving rating fees." *Id*. "None of these considerations changes the fundamental reason for the failure of this claim: there is no 'special relationship' between the Funds and the Agencies." *Id*.

The Sixth Circuit noted that the complaint does not "plead … a distinction" between the 254 publicly offered MBS and the 54 MBS sold through private placement offerings to qualified institutional buyers. *Id*. "Even if the Funds were to limit their challenge to those MBS offered to 'qualified [institutional] investors,'" the Sixth Circuit found that "such a class [would] include[] thousands of investors who lack privity or a similarly close relationship to the Agencies, and [would] not [be] 'limited' in the sense understood by *Haddon View*." *Id*. The court explained that "[t]he *Haddon View* rule is a narrow exception to the general principle that privity limits the scope of liability for professional negligence," and emphasized that "Ohio courts have not been eager to expand it." *Id*.

The Sixth Circuit Finds That the Credit Ratings at Issue Are Not Actionable Misrepresentations

The Sixth Circuit found that "[t]he district court was also correct to dismiss [the Funds'] negligent misrepresentation claims because the complaint does not plausibly allege actionable misrepresentations." *Id*.

"Under Ohio law, '[an actionable] misrepresentation generally must relate to an existing or pre-existing fact which is susceptible of knowledge.'" *Id*. (quoting *Kondrat v. Morris*, 118 Ohio App. 3d 198, 207 (Oh Ct. App. 1997) (Karpinski, J.)). "A statement 'is actionable only when an affirmative false statement has been made.'" *Id*. (quoting *Leal v. Holtvogt*, 123 Ohio App. 3d 51, 75 (Ohio Ct. App. 1998) (Fain, J.)). "New York law imposes a similar requirement." *Id*. The Sixth Circuit held that under this standard, "credit ratings are not actionable misrepresentations." *Id*. The court explained that a "'credit rating is a predictive opinion, dependent on a subjective and discretionary weighing of complex factors,' and there is 'no basis upon which we could conclude that the credit rating itself communicates any provably false factual connotation.'" *Id*. (quoting *Compuware Corp. v. Moody's Investors Servs., Inc*., 499 F.3d 520, 529 (6th Cir. 2007) (Batchelder, J.)).

The Funds contended that "a 'fraudulently made' opinion could nonetheless be considered actionable." *Id*. at *11. "Based on publicly available information describing the Agencies' business practices, the Funds [drew] the inference that the Agencies did not believe the correctness of their ratings with respect to any MBS the Funds purchased over a three-year period." *Id*. The Sixth Circuit found this inference to be "an unreasonable one." *Id*. "General criticism of business practices does not provide a basis for concluding that the Agencies made actionable misrepresentations on any particular occasion." *Id*. The court explained that "[t]his is precisely the sort of complaint the Supreme Court's recent Rule 8 jurisprudence is designed to preclude." *Id*.

Even if the court were to "presume that a credit

rating can serve as an actionable misrepresentation," the Sixth Circuit held that "the Funds' complaint does not contain allegations that would permit a reasonable inference of wrongdoing." *Id.* at *12. "Accordingly," the court determined that "the Funds' negligent misrepresentation claims may be dismissed for failure to satisfy this element, as well." *Id.*

The Sixth Circuit Affirms Dismissal of Claims under the Ohio Securities Act

The Sixth Circuit held that the district court had correctly dismissed the Funds' claims under Sections 1707.41(A) and 1707.43(A) of the Ohio Securities Act. The Funds' Section 1707.41(A) "claim turn[ed] on whether or not the Agencies 'receive[d] the profits accruing from' the issuance and sale of MBS." *Id.* at *3 (quoting Ohio Rev. Code § 1707.41(A) (2012)). The Sixth Circuit found that "[t]he Agencies' rating fees were fixed costs of an MBS issue" and could not "be considered 'profits' for purposes of [S]ection 1707.41(A)." *Id.* at *4–5. As to the Funds' claim for rescission under Section 1707.43(A), the Sixth Circuit agreed with the district court that the claim must be dismissed for failure to plead "either a violation of the securities laws by the Agencies themselves or another party's violation of the laws that the Agencies 'participated in or aided.'" *Id.* at *7 (quoting *S&P I*, 813 F. Supp. 2d at 878).

The Southern District of New York Addresses the Standard for Remote Tippee Liability in Insider Trading Prosecutions

On November 19, 2012, the Southern District of New York addressed several "unsettled" questions of law concerning remote tippee liability in insider trading prosecutions. *United States v. Whitman*, 2012 WL 5505080, at *1 (S.D.N.Y. Nov. 19, 2012) (Rakoff, J.). First, the court found that "[t]he scope of an employee's duty to keep material non-public information confidential is defined by federal common law" rather than state law. *Id.* at *9. Second, the court held that in order for criminal liability to attach, a remote tippee must have both (1) "a general understanding that the inside information was obtained from an insider who breached a duty of confidentiality in exchange for some personal benefit," and (2) "a specific intent to defraud the company to which the information relates … of the confidentiality of that information." *Id.*

Background

On August 21, 2012, a jury convicted Doug Whitman of two counts of conspiracy to commit insider trading and two counts of substantive insider trading. "Specifically, the counts charged that Mr. Whitman [had] traded or agreed to trade on material inside information that he [had] received from tippees who had, in turn, obtained the information from inside employees at Polycom, Inc., Google, Inc., and Marvell Technology, Inc." *Id.* at *1. The court's November 19, 2012 decision "serve[d] to … amplify and elaborate [on] the [c]ourt's reasoning" in issuing its jury instructions in the Whitman case. *Id.*

The Court Holds That Federal Common Law Governs an Employee's Duty to Keep Material Non-Public Information Confidential

The court explained that the Whitman case was based on a modified version of the theory of insider trading liability set forth in *Dirks v. S.E.C.*, 463 U.S. 646 (1983) (Powell, J.).[1] Under this theory, "liability exists if [a] tipper breaches a fiduciary-like duty of trust and confidence owed to his employer and its shareholders to keep confidential … material nonpublic information that the tipper discloses to his tippee in return for a personal benefit, knowing that the tippee may trade on the information." *Id*. at *3. The court pointed out that "[t]he first question that this poses is, from whence does this duty arise?" *Id*. Specifically, "in a criminal prosecution under the federal securities laws," is "the scope of an employee's duty to keep material non-public information confidential … defined by state or federal law?"[2] *Id*. at *1.

Whitman contended that "fiduciary and quasi-fiduciary duties are normally a matter of state law." *Id*. at *4. However, the court concluded that "the duty in question is imposed and defined by federal law." *Id*. First, the court explained that "all the Supreme Court cases dealing with insider trading[] have implicitly assumed that the relevant fiduciary duty is a matter of federal common law, for they have described it and defined it without ever referencing state law." *Id*.[3] "Second," the court found that "nothing in the underlying legislation—the Securities Exchange Act of 1934—suggests that its requirements were designed to vary from state to state." *Id*. at *5. "On the contrary, its purpose was to provide full, and uniform, disclosure throughout the national securities markets." *Id*. Finally, the court noted that "general principles of state fiduciary law" could still serve as "helpful guidance for determining the parameters of the applicable federal common law to be applied." *Id*.

"[I]n instructing the jury in the instant case," the court had therefore "framed its instructions in terms of a federal common law duty of trust and confidence, derived from the federal insider-trading cases and owed, so far as disclosure of market-sensitive information is concerned, by all employees to their employers and shareholders." *Id*.

1. "[I]n *Dirks*, the defendant, Raymond Dirks, an officer of a New York broker-dealer, received information from Ronald Secrist, a 'whistleblower' who disclosed inside information about fraud at his former company, Equity Funding of America. Dirks did not himself trade on this information, but he repeated the information to clients of his company, who thereupon liquidated their holdings. The SEC censured Dirks, but the Supreme Court reversed, holding that because Secrist, the tipper, did not disclose the information for his personal benefit, there was no breach of fiduciary duty (in the sense of self-dealing at the shareholders' expense), and thus there was no derivative breach by Dirks, the immediate tippee (let alone by the secondary tippees, the clients)." *Whitman*, 2012 WL 5505080, at *2 (internal citations omitted).

2. The court clarified that this question "should not be confused with the question of what is material nonpublic information," because that is "largely a factual issue." *Id*. at *3. "[T]he relevant precedents deal with [the] issue" of what constitutes material nonpublic information "as a matter of federal law and hold that a fact is 'material' … if there is 'a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Id*. (quoting *Basic Inc. v. Levinson*, 485 U.S. 224, 231 (1988) (Blackmun, J.)).

3. The court pointed to *Dirks*, 463 U.S. 646; *Chiarella v. United States*, 445 U.S. 222 (1980) (Powell, J.); *Carpenter v. United States*, 484 U.S. 19 (1987) (White, J.); and *United States v. O'Hagan*, 521 U.S. 642 (1992) (Ginsburg, J.).

The Court Finds That a Remote Tippee Must Know That the Tipper Personally Benefited by Disclosing the Information at Issue

The court then turned to the question of what a secondary tippee, "who obtained his information from the direct tippees," must know "about the tipper's breach of duty to be criminally liable?" *Id.* "The Government argued that it needed only to show that the defendant knew (or recklessly disregarded) that the information he was obtaining was an unauthorized disclosure by some insider tipper, but not that he also knew of any benefit provided to the tipper." *Id.* However, the court found that "the purpose of a prosecution premised, as here, on a *Dirks* approach is to protect shareholders against self-dealing by an insider who exploits for his own gain the duty of confidentiality he owes to his company and its shareholders." *Id.* The court held that "the tippee must have knowledge that such self-dealing occurred, for, without such a knowledge requirement, the tippee does not know if there has been an 'improper' disclosure of insider information." *Id.* at *6.

Notably, the court found "no reason to require that the tippee know the details of the benefit provided." *Id.* Instead, "it is sufficient if he understands that some benefit, however modest, is being provided in return for the information." *Id.*

The court acknowledged that there may be "cases where a remote tippee's knowledge that the tipper was receiving some sort of benefit might be difficult to prove." *Id.* "If, however, this is an unfortunate 'loophole,' it is a product of the topsy-turvy way the law of insider trading has developed in the courts and cannot be cured short of legislation." *Id.*

The Court Holds That a Remote Tippee Must Have a Specific Intent to Defraud the Company of the Confidentiality of its Information

Finally, the court addressed the question of "whether criminal insider trading in violation of Rule 10b-5 requires 'specific intent,' and, if so, in what sense." *Id.* at *7. In this case, the court had "instructed the jury that, in order to convict, the Government had to prove, *inter alia*, that the defendant [had] 'acted knowingly, willfully, and with an intent to defraud,' and that 'an intent to defraud' meant 'an intent to deprive the company in question of the confidentiality of its information.'" *Id.* (certain internal quotation marks omitted).

The court explained that "[t]he intent specified by Congress for criminal liability for violations of the Securities Exchange Act of 1934 is 'willfully.'" *Id.* (quoting 15 U.S.C. § 78ff(a) (2012)). "'Willful' is a word of many meanings, but it takes its meaning from the specific violation charged." *Id.* "[W]here, as in this case, the Government charges a scheme to defraud under subdivision (a) of Rule 10b-5," the court determined that "proving specific intent to defraud is necessary." *Id.*

In a case in which the corporate insider himself trades company shares, the court found that a "specific intent to defraud" "would mean an intent to harm shareholders." *Id.* at *9. "[I]n a misappropriation case it would mean an intent to harm one's employer." *Id.* And in a "modified-*Dirks*-like case, such as this one," a "specific intent to defraud" means "an intent to deprive the company and its shareholders of the confidentiality of its material nonpublic information." *Id.*

Notable Circuit Court Decisions of 2012

The past year has been remarkable for the number of interesting securities law decisions to emerge from the circuit courts. In the pages that follow we review ten of the most noteworthy circuit court decisions of 2012.

From the First Circuit, we discuss a decision addressing the scope of the duty to disclose after the Supreme Court's decision in *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309 (2011) (Sotomayor, J.).

From the Second Circuit, we discuss six decisions: one setting forth the requirements for pleading a "domestic transaction" within the meaning of the Supreme Court's ruling in *Morrison v. Nat'l Australia Bank Ltd.*, 130 S. Ct 2869 (2010) (Scalia, J.); another holding that the standard for opinion liability established for Securities Act claims in *Fait v. Regions Fin. Corp.*, 655 F.3d 105 (2d Cir. 2011) (Parker, Jr., J.) also applies to claims under Sections 10(b) and 20(a) of the Exchange Act; a third addressing the standards for tipper and tippee liability in insider trading actions brought under the misappropriation theory; a fourth holding that price recovery does not defeat an inference of economic loss in securities fraud suits; a fifth determining that the SEC need not establish proximate causation in aiding and abetting actions brought under Section 20(e); and finally, a sixth addressing the standard for pleading a failure to disclose "known uncertainties" under Item 303 of Regulation S-K.

From the Seventh Circuit, we address a decision applying the Supreme Court's ruling in *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011) (Thomas, J.) to hold that defendants cannot face Rule 10b-5 liability for failing to correct misstatements "made" by others.

From the Eighth Circuit, we discuss a decision concluding that plaintiffs cannot rely solely on misrepresentations or omissions to state a "scheme liability" claim under Rules 10b-5(a) and (c).

Finally, from the Tenth Circuit, we address a decision that considers what a plaintiff must prove in order to meet Rule 10b-5's loss causation requirement.

The First Circuit Addresses the Scope of the Duty to Disclose Post-*Matrixx*

In *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309 (2011) (Sotomayor, J.), the Supreme Court declined to adopt a bright-line rule requiring pharmaceutical companies to disclose only statistically significant adverse event reports. Reaffirming the "total mix" of information standard for materiality set forth in *Basic Inc. v. Levinson*, 485 U.S. 224, 231–32 (1988) (Blackmun, J.), the Court held that "the materiality of adverse event reports is a 'fact-specific' inquiry that requires consideration of the source, content, and context of the reports." *Matrixx*, 131 S. Ct. at 1321 (internal citation omitted). However, the Court clarified that "[a]pplication of *Basic*'s 'total mix' standard does not mean that pharmaceutical manufacturers must disclose all reports of adverse events." *Id.*

The Court emphasized that "§ 10(b) and Rule 10b-5(b) do not create an affirmative duty to disclose any and all material information." *Id.* "Disclosure is required under these provisions only when necessary to make … statements made, in the light of the circumstances under which they were made, not misleading." *Id.* (internal quotation marks and citations omitted). "Even with respect to information that a reasonable investor might consider material, companies can control what they have to disclose under these provisions by controlling what they say to the market." *Id.* at 1322.

In *In re Boston Scientific Corp. Sec. Litig.*, 686 F.3d 21 (1st Cir. 2012) (Boudin, J.), the First Circuit cited *Matrixx* in affirming dismissal of a securities fraud suit alleging that Boston Scientific Corporation and several of its officers had failed to disclose information concerning the termination of several members of the company's cardiac rhythm management device

sales team. The First Circuit stated that the duty to disclose "extends to omissions only where affirmative statements are made and the speaker fails to reveal those facts that are needed so that what was revealed would not be so incomplete as to mislead." *Id.* at 27 (internal quotation marks, alterations, and citation omitted).

The First Circuit explained that the reason "[w]hy companies do not have to disclose immediately all information that might conceivably affect stock prices is apparent: the burden and risks to management of an unlimited and general obligation would be extreme and could easily disadvantage shareholders in numerous ways (*e.g.*, if a new invention were prematurely disclosed to competitors or a take-over plan to the target company)." *Id.* at 27–28. "So the securities laws forbid false or misleading statements in general but impose more specific disclosure obligations only in particular circumstances." *Id.* at 28.

The Second Circuit Sets Forth the Requirements for Pleading a "Domestic Transaction" under *Morrison*

In *Morrison v. Nat'l Australia Bank Ltd.*, 130 S. Ct 2869 (2010) (Scalia, J.), the Supreme Court held that Section 10(b) only applies to "transactions in securities listed on domestic exchanges and domestic transactions in other securities." *Id.* at 2874. While courts have had little difficulty applying the first prong of *Morrison*'s transactional test, courts have grappled with the second prong. *See, e.g.*, *Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60, 67 (2d Cir. 2012) (Katzmann, J.) (*Absolute Activist II*) (noting that the *Morrison* opinion "provides little guidance as to what constitutes a domestic purchase or sale"); *Stackhouse v. Toyota Motor Co.*, 2010 WL 3377409, at *1 (C.D. Cal. July 16, 2010) (Fischer, J.) (noting that the court's ruling "does not directly address what is meant by 'domestic transactions'").

In *Absolute Activist II*, the Second Circuit "interpret[ed] *Morrison*'s second prong and determine[d] under what circumstances the purchase or sale of a security that is not listed on a domestic exchange should be considered 'domestic' within the meaning of *Morrison*." *Absolute Activist II*, 677 F.3d at 66–67. The Second Circuit held that in order "to sufficiently allege a domestic securities transaction in securities not listed on a domestic exchange" under *Morrison*, "a plaintiff must allege facts suggesting that irrevocable liability was incurred or title was transferred within the United States." *Id.* at 68. The Second Circuit offered as examples of such allegations "facts concerning the formation of the contracts, the placement of purchase orders, the passing of title, or the exchange of money" within the United States. *Id.* at 70.

The Second Circuit explicitly "reject[ed] other potential tests proposed by the parties" for determining the existence of a "domestic transaction" under *Morrison*. *Id.* at 68. The court held that "the location of the broker … does not necessarily demonstrate where a contract was executed," and rejected the plaintiffs' assertion that "the identity of the securities should be used to determine whether a securities transaction is domestic." *Id.* The court also found no basis for the defendants' argument that "a transaction cannot be considered domestic" where "the buyer and seller are both foreign entities." *Id.* at 69. Finally, the court found that "the transactional test announced in *Morrison* does not require that each defendant alleged to be involved in a fraudulent scheme engage in conduct in the United States." *Id.*

The *Absolute Activist II* test has led to fact and allegation-specific assessments as to whether or not a case concerns a "domestic transaction" within the meaning of the *Morrison* opinion. For example, in *S.E.C. v. Gruss*, 859 F. Supp. 2d 653 (S.D.N.Y. 2012) (Sweet, J.), the court applied *Absolute Activist II* to find that a complaint "allege[d] that [an] inter-fund transaction occurred domestically and not abroad" where "all of the alleged exchanges of money took place in the U.S., and not in the Cayman Islands." *Id.* at 665–66. In *SEC v. ICP Assset Mgmt., LLC*, 2012 WL 2359830 (S.D.N.Y. June 21, 2012) (Kaplan, J.), the court rejected the defendants' argument on summary judgment that "'[t]he *Morrison* transactional test is not satisfied by the conduct of entities in the United States facilitating private transactions between foreign funds.'" *Id.* at *2. The court found the evidence "sufficient to at least permit the inference that the trades complained of were domestic transactions within the meaning" of *Absolute Activist II*. *Id.* Recently, in *Bayerische Landesbank v. Barclays Capital, Inc.*, 2012 WL 5383572 (S.D.N.Y. Nov. 5, 2012) (Stanton, J.), the court relied on *Absolute Activist II* to deny a motion to dismiss Section 10(b) claims involving securities not listed on an American stock exchange where the plaintiff had made "at least a plausible showing" that the plaintiff purchased the securities at issue in New York. *Id.* at *1.

But in *MVP Asset Mmgt. (USA) LLC v. Vestbirk*, 2012 WL 2873371 (E.D. Cal. July 12, 2012) (Burrell, Jr., J.), the court applied *Absolute Activist II* to find the plaintiffs' allegations that "certain funds were transferred in between New York-based banking institutions" "insufficient to establish the existence of a domestic transaction, as required under Section 10(b)." *Id.* at *7. And in *Pope Investments II, LLC v. Deheng Law Firm*, 2012 WL 3526621 (S.D.N.Y. Aug. 15, 2012) (Stanton, J.), the court relied on *Absolute Activist II* to dismiss securities fraud claims where the plaintiffs alleged that a Chinese law firm had "drafted the Securities Purchase Agreement, presumably in China, and they [did] not allege where that agreement was negotiated or signed." *Id.* at *7

The Second Circuit Holds That *Fait*'s Standard for Opinion Liability Applies to Claims under Sections 10(b) and 20(a) of the Exchange Act

In *Fait v. Regions Fin. Corp.*, 655 F.3d 105 (2d Cir. 2011) (Parker, Jr., J.), the Second Circuit held that "when a plaintiff asserts a claim under [S]ection 11 or 12 [of the Securities Act of 1933] 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.* at 110. Less than a year later, in *City of Omaha v. CBS Corporation*, 679 F.3d 64 (2d Cir. 2012) (per curiam) (*CBS II*), the Second Circuit held that *Fait*'s "reasoning applies under Sections 10(b) and 20(a) of the [Securities Exchange Act of 1934], as these claims all share a material misstatement or omission element." *Id.* at 67–68.

The *CBS II* court relied on *Fait* to affirm the dismissal of a securities fraud action against CBS Corporation and several individual defendants concerning the timing of an impairment charge to the value of CBS's goodwill. The *CBS II* court noted that the *Fait* plaintiffs, like the *CBS II* plaintiffs, claimed that "various statements concerning goodwill were false and misleading due to [the] defendants' failure to conduct timely interim impairment testing." *Id.* at 67 (citing *Fait*, 655 F.3d at 108, 110). The *Fait* court "rejected [this] argument, reasoning that the 'plaintiff's allegations regarding goodwill d[id] not involve misstatements or omissions of material fact, but rather misstatements regarding … opinion.'" *Id.* (quoting *Fait*, 655 F.3d at 110) (alterations in the *CBS II* opinion).

Because the *Fait* plaintiffs did not allege that the defendants' statements regarding goodwill were subjectively false at the time they were made, the *Fait* court held that the plaintiffs had "not adequately alleged actionable misstatements or omissions regarding goodwill." *Fait*, 655 F.3d at 112. Similarly, in *CBS II*, the court found the complaint "devoid even of

conclusory allegations that [the] defendants did not believe in their statements of opinion regarding CBS's goodwill at the time they made them." *Id*. at 68.

In *Ross v. Lloyds Banking Grp., PLC*, 2012 WL 4891759 (S.D.N.Y. Oct. 16, 2012) (Castel, J.), the Southern District of New York relied on *CBS II* to dismiss Section 10(b) claims arising out of Lloyds Banking Group, PLC's acquisition of Halifax Bank of Scotland. The court found that Lloyds' "characterization that the combined entity would have 'very strong liquidity,' was an opinion," and determined the complaint did "not plausibly allege that the opinion was not sincerely held" as required under *CBS II*. *Id*. at *6.

The Second Circuit Addresses the Standards for Tipper and Tippee Liability in Insider Trading Actions Brought under the Misappropriation Theory

The classical theory of insider trading prohibits a corporate insider "from trading shares of that corporation based on material non-public information in violation of the duty of trust and confidence insiders owe to shareholders." *SEC v. Obus*, 693 F. 3d 276, 285 (2d Cir. 2012) (*Obus II*) (Walker, Jr., J.). "A second theory, grounded in misappropriation, targets persons who are not corporate insiders but to whom material non-public information has been entrusted in confidence and who breach a fiduciary duty to the source of the information to gain a personal profit in the securities market." *Id*. "The insider trading case law is not confined to insiders or misappropriators who trade for their own account" but also "reach[es] situations where the insider or misappropriator tips another who trades on the information." *Id*.

In *Obus II*, the Second Circuit addressed the standard for tipper and tippee liability in insider trading actions brought under the misappropriation theory. The Second Circuit held that:

> [T]ipper liability requires that (1) the tipper had a duty to keep material non-public information confidential; (2) the tipper breached that duty by intentionally or recklessly relaying the information to a tippee who could use the information in connection with securities trading; and (3) the tipper received a personal benefit from the tip.

Id. at 289. The court explained that "the tipper must know that the information that is the subject of the tip is non-public and is material for securities trading purposes, or act with reckless disregard of the nature of the information." *Id*. at 286. "[T]he tipper must [also] know (or be reckless in not knowing) that to disseminate the information would violate a fiduciary duty." *Id*.

The Second Circuit noted that "a defendant cannot be held liable for negligently tipping information." *Id*. at 287 (citing *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 & n. 12 (1976) (Powell, J.)). While "[t]he line between unactionable negligence and actionable recklessness is not a bright one[,]" the *Obus II* court explained that "a tipper cannot avoid liability merely by demonstrating that he did not know to a certainty that the person to whom he gave the information would trade on it." *Id*. "'One who intentionally places such ammunition in the hands of individuals able to use it to their advantage on the market has the requisite state of mind.'" *Id*. (quoting *Elkind v. Liggett & Myers, Inc.*, 635 F.2d 156, 167 (2d Cir. 1980) (Mansfield, J.)).

Turning to tippee liability, the Second Circuit held that the following elements must be met:

> [T]he tipper breached a duty by tipping confidential information; (2) the tippee knew or had reason to know that the tippee improperly obtained the information (i.e., that the information was obtained through the tipper's breach); and (3) the tippee, while in knowing possession of the material non-public information, used the information by trading or by tipping for his own benefit."

Id. at 289.

In *Dirks v. SEC*, 463 U.S. 646 (1983) (Powell, J.), the Supreme Court held that a tippee has a duty to abstain from trading (or to disclose the information to the source) "'only when the insider has breached his fiduciary duty … and the tippee knows or should know that there has been a breach.'" *Id*. at 660. The Second Circuit "reconcile[d]" the holdings in *Dirks* and *Hochfelder* by "recogniz[ing] that the two cases were not discussing the same knowledge requirement when they announced apparently conflicting scienter standards." *Obus II*, 693 F.3d at 288.

"*Dirks'* knows or should know standard pertains to a tippee's knowledge that the tipper breached a duty … by relaying confidential information." *Id*. "This is a fact-specific inquiry turning on the tippee's own knowledge and sophistication, and on whether the tipper's conduct raised red flags that confidential information was being transmitted improperly." *Id*. "*Hochfelder*'s requirement of intentional … conduct pertains to the tippee's eventual use of the tip through trading or further dissemination of the information." *Id*.

The *Obus II* court held that tippee liability can therefore "be established if a tippee knew or had reason to know that confidential information was initially obtained and transmitted improperly (and thus through deception), and if the tippee intentionally or recklessly traded while in knowing possession of that information." *Id*.

In *Whitman*, 2012 WL 5505080 (see pages 4–6 above), the Southern District of New York considered *Obus II* in reaching its decision.

The Second Circuit Holds That Price Recovery Does Not Defeat an Inference of Economic Loss in Securities Fraud Suits

In *Acticon AG v. China North East Petroleum Holdings Ltd.*, 692 F.3d 34 (2d Cir. 2012) (Straub, J.) (*Acticon*), the Second Circuit held that "the fact that a stock's share price recovered soon after the fraud became known" does not "defeat[] an inference of economic loss" in a securities fraud suit. *Id*. at 35–36.

Prior to the *Acticon* decision, courts had relied on the Supreme Court's opinion in *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336 (2005) (Breyer, J.) to conclude "as a matter of law that a purchaser suffers no economic loss if he holds stock whose post-disclosure price has risen above the purchase price—even if that price had initially fallen after the corrective disclosure was made." *In re China North East Petroleum Holdings Ltd. Sec. Litig.*, 819 F. Supp. 2d 351, 352 (S.D.N.Y. 2011) (Cedarbaum, J.). These courts reasoned that "a price fluctuation without any realization of an economic loss [was] functionally equivalent to the Supreme Court's rejection of an artificially inflated purchase price alone as economic loss." *Malin v. XL Capital Ltd.*, 2005 WL 2146089, at *4 (D. Conn. Sept. 1, 2005) (Dorsey, J.).

The Second Circuit in *Acticon* found that the Supreme Court's holding in *Dura* was "by its own terms … quite limited." *Acticon*, 692 F.3d at 40. The *Dura* Court did "not alter or abandon the traditional out-of-pocket measure for damages." *Id*. "Rather, the Court merely clarified that a securities fraud plaintiff who purchased stock at an inflated purchase price must still prove that she suffered an economic loss, and that that loss was proximately caused by [the] defendant's misrepresentation." *Id*. The *Dura* Court explained that "as a matter of pure logic, at the moment the transaction takes place, the plaintiff has suffered no loss; the inflated purchase payment is offset by ownership of a share that *at that instant* possesses equivalent value." *Dura*, 544 U.S. at 342.

The Second Circuit in *Acticon* observed that "a

share of stock that has regained its value after a period of decline is not functionally equivalent to an inflated share that has never lost value." *Acticon*, 692 F.3d at 41. "This analysis takes two snapshots of the plaintiff's economic situation and equates them without taking into account anything that happened in between; it assumes that if there are any intervening losses, they can be offset by intervening gains." *Id.* The *Acticon* court found it "improper to offset gains that the plaintiff recovers after the fraud becomes known against losses caused by the revelation of the fraud if the stock recovers value for completely unrelated reasons." *Id.* "Such a holding would place the plaintiff in a worse position than he would have been absent the fraud." *Id.*

The Second Circuit explained that "[i]n the absence of fraud, the plaintiff would have purchased the security at an uninflated price and would have also benefited from the unrelated gain in stock price." *Id.* "If we credit an unrelated gain against the plaintiff's recovery for the inflated purchase price, he has not been brought to the same position as a plaintiff who was not defrauded because he does not have the opportunity to profit (or suffer losses) from 'a second investment decision unrelated to his initial decision to purchase the stock.'" *Id.* (quoting *Harris v. Am. Inv. Co.*, 523 F.2d 220, 228 (8th Cir. 1975) (Bright, J.), *cert. denied*, 423 U.S. 1054 (1976)).

In *George v. China Auto. Sys., Inc.*, 2012 WL 3205062 (S.D.N.Y. Aug. 8, 2012) (Forrest, J.), the Southern District of New York applied *Acticon* to find that the plaintiffs in the case had "adequately pleaded that the purported misrepresentations … negatively impacted the value of the securities at issue." *Id.* at *11. The court found, *inter alia*, that the defendant's argument that the plaintiffs could not "show loss causation because [the company's] stock price rose subsequent to the Class Period" was "foreclosed" by the Second Circuit's decision in *Acticon*. *Id.* at *12.

The Second Circuit Determines That the SEC Need Not Establish Proximate Causation in Aiding and Abetting Actions Brought under Section 20(e)

"Section 20(e) of the Securities Exchange Act of 1934 allows the SEC, but not private litigants, to bring civil actions against aiders and abettors of securities fraud." *SEC v. Apuzzo*, 689 F.3d 204, 211 (2d Cir. 2012) (Rakoff, J.) (*Apuzzo II*) (citing 15 U.S.C. § 78t(e) (2012)) "The SEC may bring such an action against 'any person that knowingly provide[d] substantial assistance' to a primary violator of the securities laws." *Id.* (quoting 15 U.S.C. § 78t(e)).

In *Apuzzo II*, the Second Circuit rejected the defendant's contention that Section 20(e)'s "substantial assistance" requirement "should … be defined as proximate cause." *Id.* at 212. The court explained that this "argument ignores the difference between an SEC enforcement action and a private suit for damages." *Id.* "'Proximate cause' is the language of private tort actions; it derives from the need of a private plaintiff, seeking compensation, to show that his injury was proximately caused by the defendants' actions." *Id.* "But, in an enforcement action, civil or criminal, there is no requirement that the government prove injury, because the purpose of such actions is deterrence, not compensation." *Id.*

The Second Circuit further explained that Section 20(e) "was passed in the wake of [*Cent. Bank of Denver,*

N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164 (1994) (Kennedy, J.)] precisely to allow the SEC to pursue aiders and abettors who, under the reasoning of *Central Bank*, were not themselves involved in the making of the false statements that proximately caused the plaintiffs' injuries." *Id*. at 213. "This statutory mandate would be undercut if proximate causation were required for aider and abettor liability in SEC enforcement actions." *Id*. Because "the activities of an aider and abettor are rarely the direct cause of the injury brought about by the fraud," the Second Circuit found that "many if not most aiders and abettors would escape all liability if such a proximate cause requirement were imposed[.]" *Id*.

The *Apuzzo II* court "clarif[ied] that, in enforcement actions brought under [Section 20(e)], the SEC is not required to plead or prove that an aider and abettor proximately caused the primary securities law violation." *Id*. at 213. The court further held that "the appropriate standard for determining the substantial assistance component of aider and abettor liability in an SEC civil enforcement action" is the formulation Judge Learned Hand set forth in *United States v. Peoni*, 100 F.2d 401 (2d Cir. 1938) (Hand, J.). *Apuzzo II*, 689 F3d at 213. In *Peoni*, Judge Hand "stated that in order for a criminal defendant to be liable as an aider and abettor, the Government must … prove 'that he in some sort associate[d] himself with the venture, that [the defendant] participate[d] in it as something that he wishe[d] to bring about, [and] that he [sought] by his action to make it succeed.'" *Id*. at 212 (quoting *Peoni*, 100 F.2d at 402).

The Second Circuit Addresses the Standard for Pleading a Failure to Disclose "Known Uncertainties" under Item 303 of Regulation S-K

In *Panther Partners Inc. v. Ikanos Communications, Inc.*, 681 F.3d 114 (2d Cir. 2012) (Parker, J.) (*Panther Partners*), the Second Circuit vacated a district court order denying leave to amend a complaint alleging that Ikanos Communications Inc. and certain of its officers, directors, and underwriters had violated Sections 11, 12(a)(2) and 15 of the Securities Act of 1933 by failing to disclose "known defects in the [c]ompany's semiconductor chips" in the offering materials for Ikanos's March 2006 secondary offering (the "Secondary Offering"). *Id*. at 116. The Second Circuit held that "the proposed complaint stated a claim because it plausibly alleged that the defects constituted a known trend or uncertainty that the [c]ompany reasonably expected would have a material unfavorable impact on revenues" under Item 303 of SEC Regulation S-K. *Id*.

Regulation S-K provides standard instructions for filing forms under the Securities Act of 1933 and the Securities Exchange Act of 1934, such as a company's 10-K and 8-K . Item 303 of Regulation S-K provides in relevant part as follows:

> Describe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations.

17 C.F.R. § 229.303(a)(3)(ii)(2012).

The Second Circuit explained that "Item 303's disclosure obligations, like materiality under the federal securities laws' anti-fraud provisions, do not turn on restrictive mechanical or quantitative inquiries." *Panther Partners*, 681 F.3d at 122. Citing the SEC's interpretive release, the court pointed out that Item 303 "imposes a disclosure duty 'where a trend, demand, commitment, event or uncertainty is both [1] presently known to management and [2] reasonably likely to have material effects on the registrant's financial condition or results of operations.'" *Id*. at 120 (quoting *Management's Discussion and Analysis of Financial Condition and Results of Operations*, Securities Act Release No. 6835, Exchange Act Release No. 2, 831,

Investment Company Act Release No. 16,961, 43 SEC Docket 1330 (May 18, 1989)).

In *Panther Partners*, the Second Circuit found it significant that the proposed complaint added the "critical allegations" that Sumitomo Electric and NEC "accounted for 72% of Ikanos's revenues in 2005" and that "Ikanos knew at the time it was receiving an increasing number of calls from these customers that it would be unable to determine which chip sets contained defective chips." *Id.* at 121. "The reasonable and plausible inferences from these allegations are not simply that Ikanos quite possibly would have to replace and write off a large volume of its chip sets, but also that it had jeopardized its relationship with clients who at that time accounted for the vast majority of its revenues." *Id.*

The Second Circuit found that "[i]t goes without saying that such 'known uncertainties' could materially impact revenues." *Id.* at 121–22. "In light of these allegations," the Second Circuit determined that "the Registration Statement's generic cautionary language that '[h]ighly complex products such as those [Ikanos] offer[s] frequently contain defects and bugs' was incomplete … [and] did not fulfill Ikanos's duty [under Item 303] to inform the investing public of the particular, factually-based uncertainties of which it was aware in the weeks leading up to the Secondary Offering." *Id.* at 122.

In *McKenna v. SMART Techs. Inc.*, 2012 WL 3589655 (S.D.N.Y. Aug. 21, 2012) (Forrest, J.), the Southern District of New York applied the Second Circuit's holding in *Panther Partners* to deny the defendants' motion to dismiss a securities fraud complaint alleging violations of Sections 11, 12(a)(2) and 15 of the Securities Act. The plaintiffs alleged that several months prior to Smart Technologies, Inc.'s IPO, the company "'was experiencing a precipitous *decline* in the demand for its interactive whiteboards, as the [c]ompany's sales pipeline essentially began to dry up.'" *Id.* at *1. The court found the complaint "plausibly allege[d] that the (imminent) decline in demand, and its potential impact on [the company's] business, 'constituted a known trend or uncertainty that [the company] reasonably expected would have a material unfavorable impact on revenues or income.'" *Id.* at *4 (quoting *Panther Partners*, 681 F.3d at 121).

The Seventh Circuit Holds That Defendants Cannot Face Liability under *Janus* for Failing to Correct Misstatements "Made" by Others

Rule 10b-5 renders it unlawful for "any person, directly or indirectly" to "*make* any untrue statement of material fact" in connection with the purchase or sale of securities. 17 C.F.R. § 240.10b-5(b) (emphasis added). In *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011) (Thomas, J.), the Supreme Court held that for 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. "Without control, a person or entity can merely suggest what to say, not 'make' a statement in its own right." *Id.*

In *Fulton Cnty. Emp. Ret. Sys. v. MGIC Inv. Corp.*, 675 F.3d 1047 (7th Cir. 2012) (Easterbrook, C.J.), the Seventh Circuit relied on *Janus* to hold that MGIC Investment Corp. and its managers could not be liable under Rule 10b-5 for alleged misstatements made by two executives of C-BASS, an entity in which MGIC

held a 46% stake, during an MGIC earnings call. The plaintiff contended that "MGIC and the three MGIC managers named as defendants [were] directly liable under § 10(b) … and Rule 10b-5, because by inviting [the C-BASS executives] to speak [during the earnings call,] MGIC effectively 'made' their statements itself." *Id*. at 1051 (internal citations omitted).

The Seventh Circuit found that the plaintiff's "line of argument [could not] be squared with" *Janus*, "which holds that the 'maker' of a statement is the person with ultimate authority over the language." *Id*. (quoting *Janus*, 131 S. Ct. at 2296). The Seventh Circuit held that the C-BASS executives, "not MGIC or its officers, had ultimate authority over their own statements" under *Janus*. *Id*. The court found it significant that the plaintiff did "not contend that MGIC directed [the C-BASS executives] to say what they did" or that "as a condition of participating in MGIC's earnings call, [the C-BASS executives] promised to support the MGIC party line (if there was one)." *Id*. Rather, the Seventh Circuit determined that the C-BASS executives "appear[ed] to have been independent agents, speaking for themselves (and of course for C-BASS, over which as CEO and COO they had day-to-day control)." *Id*.

The plaintiff "propose[d] to get around *Janus* … by asserting that MGIC had a duty to correct any errors [the C-BASS executives] made." *Id*. Rejecting this contention, the Seventh Circuit found that "no statute or rule creates such a duty—if there were one, *Janus* … itself would have come out the other way." *Id*. at 1051–52. In *Janus*, the plaintiff unsuccessfully sought to hold Janus Capital Management ("JCM") liable for statements that appeared in the prospectuses of Janus Investment Fund; JCM allegedly played a significant role in preparing the prospectuses. The Supreme Court held that JCM could not face Section 10(b) liability because Janus Investment Fund "determined the prospectus[es'] contents[,]" not JCM. *Fulton County*, 675 F.3d at 1052 (discussing *Janus*, 131 S. Ct. at 2304).

The Seventh Circuit noted that JCM "could have issued a press release denouncing or correcting the prospectus[es] but didn't." *Id*. Similarly, MGIC "could have added its own footnotes or corrections to what [the C-BASS executives] said, but it [was] [still] no more liable than was [JCM] for keeping silent when someone else spoke." *Id*.

The Eighth Circuit Holds That Plaintiffs Cannot Rely Solely on Misrepresentations or Omissions to State a Scheme Liability Claim under Rules 10b-5(a) and (c)

The "scheme liability" provisions of Rule 10b-5 render it unlawful to "employ any device, scheme, or artifice to defraud" or to "engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5(a) & (c) (2012).

In *Pub. Pension Fund Grp. v. KV Pharm. Co.*, 705 F. Supp. 2d 1088 (E.D. Mo. 2010) (Jackson, J.), the district court dismissed scheme liability claims against certain individual officers of KV Pharmaceutical Company on the grounds that "misrepresentation claims under Rule 10b-5(b) cannot simply be recast as scheme liability claims under Rules 10b–5(a) and (c) unless a plaintiff alleges [that] a defendant 'participated in a scheme that encompassed conduct beyond misrepresentation.'" *Public Pension Fund Group v. KV Pharm. Co.*, 679 F.3d 972, 987 (8th Cir. 2012) (Bye, J.) (*KV II*) (quoting *Pub. Pension Fund Grp.*, 705 F. Supp. 2d at 1104).

On appeal, the Eighth Circuit found that "[t]he only scheme liability allegations in the investors' complaint which arguably [were] *not* merely conclusory [were] those which incorporate[d] the allegations regarding the misrepresentations or omissions" at issue. *Id*. The Eighth Circuit noted that "[b]oth the Second and the Ninth Circuits have held [that] '[a] defendant may only be liable as part of a fraudulent scheme based upon misrepresentations and omissions under Rules 10b–5(a) or (c) when the scheme also encompasses conduct

beyond those misrepresentations or omissions.'" *Id.* (quoting *WPP Lux. Gamma Three Sarl v. Spot Runner, Inc.*, 655 F.3d 1039, 1057 (9th Cir. 2011) (Gwin, J.) and citing *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 177 (2d Cir. 2005) (Jacobs, J.)). In *KV II*, the Eighth Circuit "join[ed] the Second and Ninth Circuits in recognizing [that] a scheme liability claim must be based on conduct beyond misrepresentations or omissions actionable under Rule 10b–5(b)." *Id.*

The Eleventh Circuit Considers What a Plaintiff Must Prove to Meet Rule 10b-5's Loss Causation Requirement

In *Hubbard v. BankAtlantic Bancorp, Inc.*, 688 F.3d 713 (11th Cir. 2012) (Tjoflat, J.), the Eleventh Circuit affirmed the district court's decision granting the defendants' post-trial motion for judgment as a matter of law in a securities fraud action alleging that BankAtlantic Bancorp, Inc. ("Bancorp") and its management "had misrepresented the level of risk associated with commercial real estate loans held by its subsidiary, BankAtlantic." *Id.* at 716. The Eleventh Circuit concluded that "the evidence was insufficient to support a finding of loss causation, an element required to make out a securities fraud claim under Rule 10b-5." *Id.*

The Eleventh Circuit explained that "when an investor buys stock at an artificially inflated price and resells at a lower price, the price decline, and the investor's consequent loss, may result in part from factors other than the dissipation of fraud-induced inflation." *Id.* at 725. The lower price "'may reflect, not the earlier misrepresentation, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events, which taken separately or together account for some or all of that lower price.'" *Id.* (quoting *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 343 (2005) (Breyer, J.)). "Thus, to succeed in a fraud-on-the-market case, it is not enough to point to a decline in the security's price after the truth of the misrepresented matter was revealed to the public." *Id.* at 726. "The plaintiff must also offer evidence sufficient to allow the jury to separate portions of the price decline attributable to causes unrelated to the fraud[.]" *Id.*

Here, the Eleventh Circuit found that "BankAtlantic and Bancorp were particularly susceptible to any deterioration in the Florida real estate market" because "BankAtlantic's assets were concentrated in loans tied to Florida real estate." *Id.* at 729. "To support a finding that Bancorp's misstatements were a substantial factor in bringing about its losses," the plaintiffs "had to present evidence that would give a jury some indication, however rough, of how much of the decline in Bancorp's stock price resulted not from the fraud but from the general downturn in the Florida real estate market." *Id.* The Eleventh Circuit found that the plaintiffs "failed to do so." *Id.* at 730. "None of [the plaintiffs'] evidence excluded the possibility that class members' losses resulted not from anything specific about BankAtlantic's commercial real estate portfolio that Bancorp hid from the public, but from market forces that it had warned of—and that would likely have caused significant losses for an investor in any bank with a significant credit portfolio in commercial real estate in Florida in 2007." *Id.* The Eleventh Circuit held that "Bancorp [was] therefore entitled to judgment as a matter of law." *Id.*

NEW YORK

Bruce D. Angiolillo
212-455-3735
bangiolillo@stblaw.com

Mark G. Cunha
212-455-3475
mcunha@stblaw.com

Paul C. Curnin
212-455-2519
pcurnin@stblaw.com

Michael J. Garvey
212-455-7358
mgarvey@stblaw.com

Paul C. Gluckow
212-455-2653
pgluckow@stblaw.com

Nicholas Goldin
212-455-3685
ngoldin@stblaw.com

David W. Ichel
212-455-2563
dichel@stblaw.com

Peter E. Kazanoff
212-455-3525
pkazanoff@stblaw.com

Joshua A. Levine
212-455-7694
jlevine@stblaw.com

Linda H. Martin
212-455-7722
lmartin@stblaw.com

Joseph M. McLaughlin
212-455-3242
jmclaughlin@stblaw.com

Lynn K. Neuner
212-455-2696
lneuner@stblaw.com

Barry R. Ostrager
212-455-2655
bostrager@stblaw.com

Thomas C. Rice
212-455-3040
trice@stblaw.com

Mark J. Stein
212-455-2310
mstein@stblaw.com

Alan C. Turner
212-455-2472
aturner@stblaw.com

Mary Kay Vyskocil
212-455-3093
mvyskocil@stblaw.com

George S. Wang
212-455-2228
gwang@stblaw.com

David J. Woll
212-455-3136
dwoll@stblaw.com

Jonathan K. Youngwood
212-455-3539
jyoungwood@stblaw.com

LOS ANGELES

Michael D. Kibler
310-407-7515
mkibler@stblaw.com

Chet A. Kronenberg
310-407-7557
ckronenberg@stblaw.com

PALO ALTO

Alexis S. Coll-Very
650-251-5201
acoll-very@stblaw.com

James G. Kreissman
650-251-5080
jkreissman@stblaw.com

WASHINGTON, D.C.

Peter H. Bresnan
202-636-5569
pbresnan@stblaw.com

Cheryl J. Scarboro
202-636-5529
cscarboro@stblaw.com

Peter C. Thomas
202-636-5535
pthomas@stblaw.com

Simpson Thacher's securities litigation team "'is superior on all counts.'"

— Chambers USA

The contents of this publication are for informational purposes only. Neither this publication nor the lawyers who authored it are rendering legal or other professional advice or opinions on specific facts or matters, nor does the distribution of this publication to any person constitute the establishment of an attorney-client relationship. Simpson Thacher & Bartlett LLP assumes no liability in connection with the use of this publication.

UNITED STATES

New York
425 Lexington Avenue
New York, NY 10017
+1-212-455-2000

Houston
2 Houston Center
909 Fannin Street
Houston, TX 77010
+1-713-821-5650

Los Angeles
1999 Avenue of the Stars
Los Angeles, CA 90067
+1-310-407-7500

Palo Alto
2475 Hanover Street
Palo Alto, CA 94304
+1-650-251-5000

Washington, D.C.
1155 F Street, N.W.
Washington, D.C. 20004
+1-202-636-5500

EUROPE

London
CityPoint
One Ropemaker Street
London EC2Y 9HU
England
+44-(0)20-7275-6500

ASIA

Beijing
3919 China World Tower
1 Jian Guo Men Wai Avenue
Beijing 100004
China
+86-10-5965-2999

Hong Kong
ICBC Tower
3 Garden Road, Central
Hong Kong
+852-2514-7600

Seoul
West Tower, Mirae Asset Center 1
26 Eulji-ro 5-gil, Jung-gu
Seoul 100-210
Korea
+82-2-6030-3800

Tokyo
Ark Hills Sengokuyama Mori Tower
9-10, Roppongi 1-Chome
Minato-Ku, Tokyo 106-0032
Japan
+81-3-5562-6200

SOUTH AMERICA

São Paulo
Av. Presidente Juscelino Kubitschek, 1455
São Paulo, SP 04543-011
Brazil
+55-11-3546-1000