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This month's Alert discusses a Second Circuit decision holding that Section 16(b) does not apply to an insider's purchase and sale of different types of stock in the same company.

We also cover three decisions from the Ninth Circuit: one addressing the standard for pleading that aftermarket purchases are traceable to a particular offering for purposes of a Section 11 claim; a second holding that the Securities Litigation Uniform Standards Act ("SLUSA") does not preclude class actions alleging breach of a variable life insurance contract; and a third reinstating a securities fraud class action against VeriFone based on a holistic examination of the complaint's scienter allegations.

In addition, we address a decision from the Middle District of Tennessee dismissing a securities fraud class action against Biomimetic Therapeutics.

From the Delaware Supreme Court, we cover a decision holding that a large stockholder of Celera Corporation was entitled to opt out of a shareholder class action settlement of a suit brought in connection with Celera's acquisition by Quest Diagnostics.

Finally, we discuss the First Department's dismissal of a securities-related common law fraud action against Porsche on forum non conveniens grounds.

The Second Circuit Holds That Section 16(b) Does Not Apply to an Insider's Purchase and Sale of Different Types of Stock in the Same Company

On January 7, 2013, the Second Circuit held that "an insider's purchase and sale of shares of different types of stock in the same company does not trigger liability under § 16(b) of the Securities Exchange Act of 1934, where those securities are separately traded, nonconvertible, and come with different voting rights." *Gibbons v. Malone*, 2013 WL 57844, at *7 (2d Cir. Jan. 7, 2013) (Cabranes, J.) (internal citation omitted).

Background

Section 16(b) "provides for the disgorgement of profits that corporate insiders realize 'from any purchase and sale, or any sale and purchase, of any equity security of [the corporate] issuer … within any period of less than six months.'" *Id*. at *1 (quoting 15 U.S.C. § 78p(b) (alterations in original) (footnote

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omitted)). This provision is also known as the "short-swing profit rule." *Id*.

Between December 4, 2008 and December 17, 2008, John Malone, a director and large shareholder of Discovery Communications, Inc., made nine sales of Discovery's "Series C" stock and ten purchases of Discovery's "Series A" stock. "Discovery's Series A stock and Series C stock are different equity securities, are separately registered, and are traded separately on the NASDAQ stock exchange." *Id*. "The principal difference between the two securities is that Series A stock comes with voting rights—one vote per share—whereas Series C stock does not confer any voting rights." *Id*. "Series A stock and Series C stock are not convertible into each other." *Id*. Moreover, Series A stock and Series C stock sometimes trade at different prices.

A Discovery shareholder filed a derivative suit under Section 16(b) "seeking disgorgement of 'profits' that Malone realized from [his December 2008] transactions" in Series A and Series C stock. *Id*. In 2011, the Southern District of New York dismissed the action for failure to state a claim. The court "pointed out that, unlike other financial instruments that are treated as functionally equivalent under §16(b), Discovery's Series A stock and Series C stock are not convertible and do not have a fixed value relative to each other." *Id*. The plaintiff appealed.

The Second Circuit Holds That Section 16(b) Only Applies to the Purchase and Sale of the Same Security

The Second Circuit explained at the outset that if "paired transactions occur within a six month period, the paired transactions are … the type of insider activity that Section 16(b) was designed to prevent." *Id*. at *3 (quoting *Blau v. Lamb*, 363 F.2d 507, 517 (2d Cir. 1966) (Waterman, J.) (omission in original)). However, "transactions of securities that cannot be 'paired' are not within the scope of § 16(b)." *Id*. "The question presented [in this case] is whether a sale of one security and a purchase of a different security issued by the same company can be 'paired' under § 16(b)." *Id*.

The Second Circuit found that "Congress's use of the singular term 'any equity security' [in the text of Section 16(b)] supports an inference that transactions involving *different* equity securities cannot be paired under § 16(b)." *Id*. "The regulations promulgated by the SEC implicitly support this understanding of § 16(b) by noting that the statute covers the purchase and sale, or sale and purchase, of 'a security,' and by providing for an exception when the purchase and sale of 'such security' meets certain conditions." *Id*. "Accordingly," the Second Circuit held that "§ 16(b) applies to the purchase and sale, or sale [and] purchase, of 'the same security.'" *Id*. at *4 (quoting *Analytical Surveys, Inc. v. Tonga Partners, L.P.*, 684 F. 3d 36, 43 (2d Cir. 2012) (Livingston, J.)).

The Second Circuit Finds That Discovery's Series A Stock and Series C Stock Are Not "Economically Equivalent" for Purposes of Section 16(b)

The Second Circuit next considered the plaintiff's argument that "Discovery's Series A stock and Series C stock are 'the same security' for purposes of the

short-swing profit rule because those types of stock are 'economically equivalent.'" *Id.* The court did "not decide the issue," but observed that Section 16(b) "could apply to transactions where the securities at issue are not meaningfully distinguishable." *Id.* The court explained that "[r]ecognizing the equivalence of essentially indistinguishable securities would … comport with the purpose of the short-swing profit rule." *Id.* "When two types of stock are not meaningfully different, the risk of short-swing speculation is likely to be much higher than when those stocks are distinguishable." *Id.*

Here, however, the Second Circuit found "Discovery's Series A stock and Series C stock … readily distinguishable." *Id.* "Most importantly, Series A shares confer voting rights, whereas Series C shares do not." *Id.* "The two securities, therefore, are distinct not merely in name but also in substance." *Id.* The court noted that "[a]n insider could easily prefer one security over the other for reasons not related to short-swing profits." *Id.*

The Second Circuit also determined that the principle of economic equivalence did not apply because "the two securities at issue here are not convertible." *Id.* The court explained that "[t]he fixed-ratio convertibility feature is what distinguishes economically equivalent securities." *Id.* at *5. "[T]wo nonconvertible securities whose prices fluctuate relative to one another do not qualify as 'economically equivalent.'" *Id.*

The Second Circuit Holds That Section 16(b) Does Not Apply to Purchases and Sales of "Substantially Similar" Stock

Finally, the Second Circuit rejected the plaintiff's argument that Discovery's Series A stock and Series C stock are "sufficiently 'similar' to be paired under § 16(b)." *Id.* "[T]he statutory text appears to require sameness, not similarity." *Id.* at *6. Moreover, "Congress intended for § 16(b) to be 'a relatively arbitrary rule capable of easy administration.'" *Id.* (quoting *Reliance Elec. Co. v. Emerson Elec. Co.*, 404 U.S. 418, 422 (1972) (Stewart, J.)). The court explained that the plaintiff's "invitation to adopt a jurisprudence of 'similarity' runs contrary to this fundamental statutory purpose." *Id.*

The Second Circuit therefore affirmed the district court's dismissal of the plaintiff's Section 16(b) complaint against Malone.

The Ninth Circuit Addresses the Standard for Pleading That Aftermarket Purchases Are Traceable to a Particular Offering for Purposes of a Section 11 Claim

On January 2, 2013, the Ninth Circuit held that in cases where "a company has issued shares in multiple offerings under more than one registration statement," a plaintiff who purchased aftermarket shares must plead specific facts that "give rise to a reasonable inference that [its] shares are traceable" to a particular offering made under a specific registration statement in order to state a claim under Section 11 of the 1933 Act. *In re Century Aluminum Co. Sec. Litig.*, 2013 WL 11887, at *2–3 (9th Cir. Jan. 2, 2013) (Watford, J.) (*Century Aluminum II*).

Background

Section 11 "provides a cause of action to any person who buys a security issued under a materially false or misleading registration statement." *Id.* at *1. "Plaintiffs need not have purchased shares in the offering made under the misleading registration statement; those who purchased shares in the aftermarket have standing to sue provided they can trace their shares back to the

relevant offering." *Id*. "When all of a company's shares have been issued in a single offering under the same registration statement, this 'tracing' requirement generally poses no obstacle." *Id*. (quoting *Hertzberg v. Dignity Partners, Inc*., 191 F.3d 1076, 1082 (9th Cir. 1999)). "But when a company has issued shares under more than one registration statement, the plaintiff must prove that her shares were issued under the allegedly false or misleading registration statement, rather than some other registration statement." *Id*.

In the case at hand, the plaintiffs alleged that they had purchased aftermarket shares in Century Aluminum Company pursuant to a January 28, 2009 prospectus supplement issued in connection with a secondary offering of 24.5 million shares of Century Aluminum common stock. At the time of the secondary offering, "more than 49 million shares of Century Aluminum common stock were already in the market." *Id*. On March 3, 2011, the Northern District of California dismissed the plaintiffs' Section 11 claims with prejudice for failure "to plead facts to show how plaintiffs will be able to establish that their purchases are traceable to the Secondary Offering." *In re Century Aluminum Co. Sec. Litig*., 2011 WL 830174, at *5 (N.D. Cal. Mar. 3, 2011) (Illston, J.). The court found the plaintiffs' "naked allegations that their shares are 'traceable' to the Secondary Offering" "insufficient as a matter of law." *Id*. at *8. The plaintiffs appealed.

The Ninth Circuit Holds That Where a Company Has Issued Shares in Multiple Offerings under More Than One Registration Statement, Plaintiffs Must Allege Specific Facts Tracing Aftermarket Purchases to a Particular Offering

On appeal, the plaintiffs contended that "it was enough for them to allege, without more, that they [had] 'purchased Century Aluminum common stock directly traceable to the Company's Secondary Offering.'" *Century Aluminum II*, 2013 WL 11887, at *2. The Ninth Circuit recognized that "[s]ome district courts have held that this allegation suffices" to state a Section 11 claim and noted that "it probably did" before the Supreme Court's decisions in *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007) (Souter, J.) and *Ashcroft v. Iqbal*, 556 U.S. 662 (2009) (Kennedy, J.). *Century Aluminum II*, 2013 WL 11887, at *2. But the Ninth Circuit explained that "*Iqbal* and *Twombly* [have] moved us away from a system of pure notice pleading." *Id*. "In addition to providing fair notice, the complaint's allegations must now suggest that the claim has at least a plausible chance of success." *Id*.

The Ninth Circuit noted that "[t]he level of factual specificity needed to satisfy this pleading requirement will vary depending on the context." *Id*. "[A]lleging that the plaintiff's shares are 'directly traceable' to the offering in question might well suffice, even without 'further factual enhancement,' when all of the company's shares were issued in a single offering under a single registration statement." *Id*. (internal citation omitted) (quoting *Twombly*, 550 U.S. at 557). But "[w]hen a company has issued shares in multiple offerings under more than one registration statement," "a greater level of factual specificity will be needed" because "aftermarket purchasers usually will *not* be able to trace their shares back to a particular offering." *Id*. (quoting *Twombly*, 550 U.S. at 570). "Courts have long noted that tracing shares in this fashion is 'often

impossible,' because 'most trading is done through brokers who neither know nor care whether they are getting newly registered or old shares.'" *Id.* at *1 (quoting *Barnes v. Osofksky*, 373 F.2d 269, 271–72 (2d Cir. 1967)).

Since "[t]his case involves the latter scenario," the Ninth Circuit explained that the plaintiffs "had to allege facts from which [the court could] reasonably infer that their situation is different." *Id.* at *1–2. The Ninth Circuit found "the conclusory allegation that [the] plaintiffs [had] 'purchased Century Aluminum common stock directly traceable to the Company's Secondary Offering'" insufficient to "allow [the court] to draw a reasonable inference about anything because it is devoid of factual content." *Id.* at *2.

The plaintiffs claimed that they had in fact "offered further factual specificity, and point[ed] to allegations regarding the dates on which and the prices at which they [had] purchased their shares, as well as allegations concerning the trading volume of Century Aluminum stock on certain dates." *Id.* at *3. The Ninth Circuit determined that "[t]hese allegations do not give rise to a reasonable inference that [the] plaintiffs' shares are traceable to the secondary offering." *Id.* "Accepting the allegations as true, [the] plaintiffs' shares could have come from the secondary offering, but the 'obvious alternative explanation' is that they could instead have come from the pool of previously issued shares." *Id.* (quoting *Twombly*, 550 U.S. at 567). "Something more is needed, such as facts tending to exclude the possibility that the alternative explanation is true." *Id.*

The Ninth Circuit therefore affirmed the district court's dismissal of the plaintiffs' Section 11 claims.

The Ninth Circuit Holds That SLUSA Does Not Preclude Class Actions Alleging Breach of a Variable Life Insurance Contract

On January 2, 2013, the Ninth Circuit addressed the question of whether the Securities Litigation Uniform Standards Act ("SLUSA") "displace[s] class actions alleging breach of a variable universal life insurance contract." *Freeman Invs., L.P. v. Pacific Life Ins. Co.*, 2013 WL 11884, at *1 (9th Cir. Jan. 2, 2013) (Kozinski, C.J.). In the case before it, the plaintiffs "allege[d] that their insurer [had] promised one thing and delivered another." *Id.* at *6. The Ninth Circuit found that theirs was a "straightforward contract claim that doesn't rest on misrepresentation or fraudulent omission." *Id.* The court therefore held that "[t]he class claims for breach of contract and breach of the duty of good faith and fair dealing [were] not precluded by SLUSA, even if such claims relate[d] to the purchase or sale of a covered security"—namely, a variable universal life insurance contract. *Id.*

Background

The plaintiffs had purchased variable universal life insurance policies from Pacific Life Insurance Company.[1] "Pacific guarantees its customers a minimum insurance benefit, and policyholders also allocate a portion of their premiums to a separate [investment] account whose value fluctuates over time." *Id.* at *1. "Each month, Pacific assesses a 'cost of insurance' charge, which it collects by redeeming

1. "Variable universal [life] insurance differs in important ways from term life insurance, which protects against risk of death for a finite period and provides no continuing benefit once that time expires." *Id.* at *1. "Variable universal insurance lasts for the duration of the policyholder's life and allows him to share in the gains (or losses) generated by the investment of premiums." *Id.*

units of the separate account." *Id.*

The plaintiffs contended that Pacific had levied excessive "cost of insurance" charges in violation of their contracts. They argued that "'cost of insurance' is an industry term of art and that they understood the fee would be calculated according to industry standards." *Id.* The plaintiffs "brought a class action in federal district court alleging breach of contract, breach of the duty of good faith and fair dealing[,] and unfair competition" under California law. *Id.*

"Pacific moved to dismiss the complaint, arguing that the class action was precluded by SLUSA." *Id.* "SLUSA bars private plaintiffs from bringing (1) a covered class action (2) based on state law claims (3) alleging that [a] defendant made a misrepresentation or omission or employed any manipulative or deceptive device (4) in connection with the purchase or sale of (5) a covered security." *Id.* at *2. The parties agreed that the "case involve[d] (1) a covered class action, (2) state law claims and (5) a covered security" for purposes of SLUSA. *Id.* at *2. However, they "hotly dispute[d] the two remaining elements" of a "(3) misrepresentation or omission (4) in connection with the purchase or sale of securities." *Id.*

The Central District of California dismissed the complaint on SLUSA grounds, holding that "allegations of excessive charges, hidden loads and *concealment* clearly amount, at the least, to an allegation that [Pacific] *omitted* facts in connection with the purchase of securities, if not allegations of outright misrepresentations made by [Pacific]." *Id.* at *1. The plaintiffs appealed.

The Ninth Circuit Holds That the Plaintiffs Did Not Allege Misrepresentations or Omissions as Required for SLUSA Preclusion

The Ninth Circuit first considered whether the plaintiffs had alleged misrepresentations or omissions within the meaning of SLUSA. The court found that the plaintiffs' complaint, when "[s]tripped to its essence," "alleges that Pacific charged them too much for life insurance and, as a result, reduced the value of their investments." *Id.* at *2. "Specifically, they claim[ed] that 'cost of insurance' is a term of art that refers to 'the portion of premiums from each policyholder set aside to pay claims.'" *Id.* The plaintiffs "allege[d] that they [had] expected Pacific to calculate the cost of insurance charge 'based on industry accepted actuarial determinations,' but the company [instead allegedly] deviated from industry norms and debited an amount 'in excess of true mortality charges.'" *Id.*

The Ninth Circuit determined that these allegations "raise[d] a dispute about the meaning of a key contract term." *Id.* "[T]he success of [the plaintiffs'] claim will turn on whether they can convince the court or jury that theirs is the accepted meaning in the industry." *Id.* "To succeed on this claim," the Ninth Circuit explained, the plaintiffs would not have to "show that Pacific misrepresented the cost of insurance or omitted critical details." *Id.* at *3. Rather, they would only have to "persuade the court that theirs is the better reading of the contract term." *Id.*

The Ninth Circuit found that "[j]ust as plaintiffs cannot avoid SLUSA through crafty pleading, defendants may not recast contract claims as fraud

claims by arguing that they 'really' involve deception or misrepresentation." *Id.* at *3. The Ninth Circuit therefore held that "the breach of contract claim survives SLUSA, as does the class claim for breach of the duty of good faith and fair dealing, itself a species of contract claim." *Id.*

The Ninth Circuit Dismisses the Plaintiffs' Unfair Competition Claims Based on SLUSA's "in Connection with" Requirement

The Ninth Circuit next turned to the plaintiffs' unfair competition claims. The court noted that "California Business & Professions Code § 17200, on which [the] plaintiffs base a separate claim, defines unfair competition as 'any unlawful, unfair or fraudulent business act or practice.'" *Id.* The Ninth Circuit explained that this claim only survives SLUSA if "the charged conduct didn't occur 'in connection with' the purchase or sale of a covered security." *Id.*

The Ninth Circuit observed that "[a] variable universal life insurance policy is a hybrid creature that has characteristics of both insurance products and investment securities." *Id.* at *4 (citation and internal quotation marks omitted). "In some cases, plaintiffs may raise claims that survive SLUSA because they target only the insurance features of the policy." *Id.* "But not here … [where] Pacific collect[ed] the cost of insurance charge by redeeming units of the separate [investment] account." *Id.* "Each inflated charge not only 'coincide[d]' with the sale of securities; it also deplete[d] the value of the investment." *Id.* Thus, "[t]o the extent [the] plaintiffs allege[d] that Pacific engaged in fraud or misrepresentation that drained their investments," the Ninth Circuit held that "SLUSA stands in the way." *Id.* The court therefore "affirm[ed] the dismissal of the class claim for unfair competition in violation of California law." *Id.*

The Ninth Circuit Reinstates a Securities Fraud Class Action against VeriFone Based on a Holistic Evaluation of the Scienter Allegations

On December 21, 2012, the Ninth Circuit reinstated a securities fraud class action against VeriFone Holdings, Inc. in connection with the company's December 2007 restatement based on a holistic evaluation of the complaint's scienter allegations. *In re VeriFone Holdings, Inc. Sec. Litig.*, 2012 WL 6634351 (9th Cir. Dec. 21, 2012) (McKeown, J.). The Ninth Circuit explained that "any one allegation" in the complaint "may not compel an inference of scienter" when "[v]iewed in isolation." *Id.* at *1. But when viewed holistically, the Ninth Circuit found the inference that VeriFone's CEO, former CFO, and VeriFone itself "were deliberately reckless as to the truth of their financial reports and related public statements … at least as compelling as any opposing inference." *Id.* (citation and internal quotation marks omitted).

Background

VeriFone acquired Lipman Electronic Engineering Ltd. in November 2006 and "touted the merger as likely to improve its financial condition, increasing its *pro forma* gross margin expectations from 41–44% to 42–47%." *Id.* at *1–2. For the first three quarters following the merger, "VeriFone reported gross margins of 47.1%, 48.1%, and 48.2%, respectively, allowing the company to claim the merger was an immediate success." *Id.* at *2. "It is undisputed that these reports were false." *Id.*

In each of these quarters, VeriFone's CEO and CFO allegedly "received accurate reports at quarter-end indicating that VeriFone had not met its financial targets." *Id.* at *11. "Each time, they [allegedly] addressed these 'unacceptable' results by providing [VeriFone's supply chain controller, Paul Periolat]

with [suggested] accounting adjustments necessary to conform results to expectations." *Id*. "Periolat entered these adjustments almost to the dollar." *Id*. VeriFone's CEO and CFO allegedly "monitored and checked on the adjustments, particularly their impact on margins and earnings." *Id*. However, they "appear not to have asked Periolat whether the adjustments were based in fact or even why changes of that magnitude were necessary in the first place." *Id*. "Their overriding concern was [allegedly] avoiding the 'unmitigated disaster' of missed earnings targets." *Id*.

Then, "[o]n December 3, 2007, VeriFone announced that its consolidated financial statements for 1Q07, 2Q07, and 3Q07 should not be relied upon due to errors in accounting." *Id*. at *2. "On the day of the restatement, VeriFone shares dropped over 45%." *Id*. at *3. Plaintiffs subsequently brought several securities fraud class actions against VeriFone. These cases were consolidated, with National Elevator Industry Pension Fund designated as lead plaintiff.

In March 2011, the Northern District of California dismissed National Elevator's complaint with prejudice on the grounds that the "allegations failed to raise a strong inference of scienter with respect to any of the defendants." *Id*. at *3. "In reaching this conclusion, the district court grouped individual allegations by topic and discussed their sufficiency." *Id*. "After determining that the allegations associated with each grouping were insufficient to establish scienter, the district court engaged in a one-paragraph holistic analysis, stating that '[t]here are many allegations in this case, but they fare no better when read in combination than when read independently.'" *Id*. National Elevator appealed the district court's ruling as to VeriFone's CEO, former CFO, and VeriFone itself.

The Ninth Circuit Finds That the Allegations, Viewed Holistically, Give Rise to a Strong Inference of Deliberate Recklessness

The Ninth Circuit explained that in *Tellabs, Inc. v. Makor Issues & Rights, Ltd*., 551 U.S. 308 (2007) (Ginsburg, J.), the Supreme Court "clarified the appropriate inquiry for determining whether a plaintiff's allegations are sufficient as to scienter." *VeriFone*, 2012 WL 6634351, at *4. "The relevant inquiry is 'whether *all* of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard.'" *Id*. (quoting *Tellabs*, 551 U.S. at 323).

The Ninth Circuit further observed that in *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1324 (2011) (Sotomayor, J.), "the Supreme Court reiterated that courts must 'review all the allegations holistically' when determining whether scienter has sufficiently been pled." *VeriFone*, 2012 WL 6634351, at *5 (quoting *Matrixx*, 131 S. Ct. at 1324) (internal quotation marks omitted). "Other than this general directive," however, "the [*Matrixx*] Court did not prescribe a particular analysis that a court must undertake, nor did it purport to alter the scienter analysis previously articulated in *Tellabs*." *Id*.

The Ninth Circuit noted that "[p]rior to *Matrixx*," courts in the Ninth Circuit "adhered to a dual inquiry" in which they would first "determine whether any

of the plaintiff's allegations, standing alone, [were] sufficient to create a strong inference of scienter." *Id.* (quoting *Zucco Partners, LLC v. Digimarc Corp.*, 552 F.3d 981, 992 (9th Cir. 2009) (Bybee, J.)). Courts would then "conduct a 'holistic' review of the same allegations to determine whether the insufficient allegations combine[d] to create a strong inference of intentional conduct or deliberate recklessness." *Id.* (quoting *Zucco Partners*, 552 F.3d at 992).

"Post-*Matrixx*," courts in the Ninth Circuit "have employed varied approaches" to the scienter analysis. *Id.* "[S]ome discuss first the sufficiency of specific allegations and then conduct a holistic review, while others conduct only a holistic analysis." *Id.* "Because the Court in *Matrixx* did not mandate a particular approach," the Ninth Circuit explained that "a dual analysis remains permissible so long as it does not unduly focus on the weakness of the individual allegations to the exclusion of the whole picture." *Id.* at *6. However, the court emphasized "[t]he risk … that a piecemeal analysis will obscure a holistic view." *Id.*

"To avoid potential pitfalls that may arise from conducting a dual analysis," the Ninth Circuit "approach[ed] [the *VeriFone*] case through a holistic review of the allegations to determine whether they combine[d] to create a strong inference of intentional conduct or deliberate recklessness." *Id.* "In doing so, however," the court did not "simply ignore the individual allegations and the inferences drawn from them." *Id.*

The Ninth Circuit determined that "National Elevator's allegations, viewed holistically, give rise to a strong inference that [Verifone's CEO, former CFO,] and VeriFone were deliberately reckless to the truth or falsity of their statements regarding VeriFone's financial results, particularly gross margin percentages." *Id.* at *11. "Upon receiving accurate reports that VeriFone's margins and earnings were short of projections," Verifone's CEO and former CFO "repeatedly 'remedied' the problem by directing [allegedly] baseless adjustments to the company's financial statements" and then "failing to inquire further once projections were met." *Id.* at *13. The Ninth Circuit found that "[i]t defies common sense that for three straight quarters following a merger, when preliminary reports came in substantially below expectations," "the correct 'adjustments' … also happened to be the precise amounts [VeriFone's CEO and former CFO] had identified as necessary to hit earnings targets." *Id.* at *11. "When compared to the inference that VeriFone was grossly negligent and overwhelmed during the Lipman integration," as the defendants argued, the Ninth Circuit found "the inference that [VeriFone's CEO and former CFO], and by extension VeriFone, were deliberately reckless to the truth or falsity of the financial reports … equally compelling." *Id.* at *13.

The Ninth Circuit therefore reversed the district court's dismissal of the complaint. The court explained that "[t]he district court … [had] not err[ed] as a matter of law by first engaging in an individualized discussion of the complaint's allegations and then summarily concluding that 'in combination' the allegations did not sufficiently allege scienter." *Id.* at *6. Rather, the district court's "error [lay] in its undue discounting of the claims and the conclusion that an inference of deliberate recklessness was not warranted." *Id.*

The Middle District of Tennessee Dismisses a Securities Fraud Action against Biomimetic Therapeutics in an Opinion of Interest to Life Sciences Companies

On January 10, 2013, the Middle District of Tennessee dismissed a securities fraud class action alleging that Biomimetic Therapeutics, Inc. ("BMTI") had misrepresented clinical trial results for its flagship product, Augment™ Bone Grafting ("Augment"), as well as Augment's likelihood of approval by the Food and Drug Administration ("FDA"). *Sarafin v. Biomimetic Therapeutics, Inc.*, 2013 WL 139521 (M.D. Tenn. Jan. 10, 2013) (Sharp, J.).

In the "context of FDA approval cases," the court noted that the safe-harbor protections afforded defendants under the Private Securities Litigation Reform Act ("PSLRA") are "particularly appropos." *Id.* at *15. The court also explained that companies do not necessarily have to disclose deficiency letters from the FDA because those letters are simply "request[s] for more information" rather than "final FDA decision[s]." *Id.* at *18.

Background

Augment is a "fully synthetic, off-the-shelf bone growth factor for the surgical treatment of foot and ankle bone defects." *Id.* at *1. Augment is "a key to BMTI's success as a company." *Id.* "For Augment to become a successful device used in bone grafting operations in the United States, however, it needs FDA approval." *Id.*

"BMTI conducted a clinical trial of Augment that …. was designed to evaluate Augment's effectiveness and safety in foot and ankle fusion surgeries." *Id.* at *2. "Under the binding protocol presented to the FDA, the 'primary effectiveness analysis'" of the study was to be conducted using an Intent-to-Treat ("ITT") population. *Id.* "However, and unbeknownst to the FDA, BMTI based its analysis upon a 'modified Intent to Treat' ('mITT') population that was a subset of the ITT population from which certain patients were excluded." *Id.* "The switch in the population database skewed the results, making them more favorable than they would have been under the originally proposed protocol." *Id.* "While Augment was considered effective in the mITT population, it did not achieve statistical significance for effectiveness in the ITT population." *Id.*

"The FDA expressed concerns about Augment and the clinical study in a series of discussions with [BMTI] at various points in the [Premarket Approval ('PMA')] process, and detailed the concerns in a September 3, 2010 Deficiency Letter to BMTI." *Id.* at *4. The FDA advised BMTI that it had "not provided an adequate justification for using [an] mITT [patient population] instead of [an] ITT [patient population]." *Id.* "Concerns were also raised by the FDA in briefing documents published on May 10, 2011, in advance of [a] public meeting before [a] panel of experts." *Id.* at *5.

On May 12, 2011, an expert panel returned a "narrow vote" in favor of Augment's safety and effectiveness. *Id.* "The narrow vote on [Augment's] benefits and risks [made] it highly unlikely that [Augment] [would] receive FDA approval without … additional trials." *Id.* (internal quotation marks omitted). Following the vote, BMTI shares "drop[ped] nearly 12%." *Id.* at *7. BMTI's stock price dropped further when the FDA posted a summary of the expert panel meeting several days later.

The plaintiffs subsequently brought suit alleging that BMTI had "knowingly and/or recklessly made material misrepresentations to investors about the clinical trial results for" Augment, "as well as the prospects for [FDA] approval of Augment." *Id.* at *1. As an example of the allegedly "rosy picture" BMTI painted, the plaintiffs pointed to a press release BMTI issued five days after the FDA's deficiency letter stating

that "the FDA [had] raised no unexpected issues that would impact … potential approval of Augment." *Id.* at *6. The press release quoted BMTI's CEO as feeling "even more confident" about Augment's PMA. *Id.*

BMTI moved to dismiss the plaintiffs' complaint.

The Plaintiffs Failed to Allege That BMTI Knowingly or Recklessly Engaged in a "Bait-and-Switch" with Respect the Patient Population for the Augment Study

"In opposing dismissal," the plaintiff's key argument was that "BMTI engaged in a 'bait-and-switch'" by representing that the FDA had approved an mITT population as the primary study population when the FDA had actually approved the use of an ITT study population. *Id.* at *9. The court, however, found that "BMTI did, in fact, have a basis to represent that [an mITT] population was the primary study population approved by the FDA." *Id.* at *10. Specifically, "[i]n response to a request from the FDA to correct deficiencies identified in a conditional approval letter, BMTI [had] provided … a new protocol which revised the definition of the study's ITT population."

Id. "[W]hile the [new] protocol mislabeled the study population as an ITT group, the substantive definition clearly established [an mITT] population that excluded those unable to be treated." *Id.* The FDA later approved this new protocol but advised BMTI that it should give "serious consideration" to referring to the patient population as an mITT population rather than an ITT population (among other suggested changes). *Id.*

The court also found it significant that "BMTI did not hide the ITT patient results, and acknowledged the confusion which had been generated between the classifications of patient populations." *Id.* at *11. For example, an October 13, 2009 press release announcing "positive" statistical results from an Augment study acknowledged that the results were based on an mITT population, but also disclosed the results for an ITT population. *Id.* at 5. "The issue of the mITT versus ITT patient population was also the subject of a lot of discussion at a data results conference call between BMTI executives and financial analysts when the press release was issued." *Id.* at *12.

"Based upon the foregoing," the court found "no basis for holding BMTI liable for securities fraud as a result of the alleged 'bait-and-switch.'" *Id.* at *13. "The press release and subsequent earning[s] call and data results conference do not suggest a knowing and deliberate intent to deceive or defraud, let alone highly unreasonable conduct on the part of BMTI." *Id.* at *14. "BMTI, perhaps, could have characterized things differently, but what it disclosed was sufficient." *Id.*

Finally, the court found it "imperative to note that BMTI [had] never suggested that the approval of Augment by the FDA was assured." *Id.* "Quite the contrary, BMTI repeatedly and consistently warned that there were no guarantees that Augment would be approved and that there were risks and uncertainties inherent in the prospect." *Id.* The court emphasized that BMTI had set forth "extended disclosures" that statements in the October 13, 2009 press release, as well as comments made during the subsequent conference call, constituted "forward-looking statements" within the PSLRA's safe harbor provision." *Id.* at *15. The court

explained that the PSLRA's safe harbor protections are "particularly appropos in the context of FDA approval cases because everyone knows that the process of obtaining the FDA's approval for a new drug is fraught with uncertainty, and it will not always be clear to parties setting out to seek FDA approval for their new product exactly which kinds of information, and in what quantities, it will take to win that agency's approval." *Id*. (internal quotation marks, alterations, and citations omitted).

Allegations That BMTI Had Cut Corners in the Augment Studies Do Not Raise an Inference of Scienter

"In addition to the alleged 'bait-and-switch,'" the plaintiffs also contended that BMTI had been "cutting corners by failing to conduct certain tests or studies." *Id*. at *16. The court determined that "BMTI's effort to reduce costs does not suggest fraud." *Id*. It also found that "[t]he notion that BMTI would recklessly forego necessary tests and studies or hide adverse events makes little sense." *Id*. at *17. The plaintiffs themselves asserted that "Augment [was] BMTI's flagship product and necessary to the compan[y's] success, begging the question [of] why [BMTI] would sabotage all of the company's efforts to that point." *Id*.

Companies are Not Necessarily Obligated to Disclose the Scope and Content of an FDA Deficiency Letter

The plaintiffs further argued that the September 2010 FDA deficiency letter "alone is evidence that [BMTI] knew full well of the serious deficiencies that plagued [its] clinical trials, which were not disclosed to investors." *Id*. at *18. The court observed that "whether a company has an affirmative duty to disclose the scope and content of a deficiency letter appears to be open to question." *Id*. "What is clear, however, is that a deficiency letter is not a final FDA decision, but a request for more information, and, in fact, 'very few' PMA are approved without the issuance of a deficiency letter." *Id*. "Also clear is that it simply cannot be that every critical comment by a regulatory agency has to be seen as material for securities law reporting purposes, because to think otherwise would be to insist on a flood of data that would overwhelm the market and would ironically be, in the end, actually uninformative." *Id*. (internal quotation marks and citation omitted).

Accordingly, the court dismissed the plaintiffs' complaint in its entirety and without leave to amend.

The Delaware Supreme Court Holds That a Large Stockholder Was Entitled to Opt Out of a Shareholder Class Action Settlement

On December 27, 2012, the Delaware Supreme Court held that the Chancery Court had abused its discretion in denying a large stockholder of Celera Corporation the right to opt out of a shareholder class action settlement of a suit challenging Celera's acquisition by Quest Diagnostics. *In re Celera Corp. S'holder Litig*., 2012 WL 6707736 (Del. Dec. 27, 2012) (Ridgely, J.). The Delaware Supreme Court explained that the Chancery Court "could not deny a discretionary opt-out right where the policy favoring a global settlement was outweighed by due process concerns." *Id*. at *13.

Background

In February 2011, Celera Corporation began merger negotiations with Quest Diagnostics. BVF Partners, a hedge fund and one of Celera's largest shareholders, "informed the [Celera] Board that it would attempt to block any transaction unless Celera's drug assets … were sold separately." *Id*. at *2. Alternatively, "BVF requested that the [Quest] deal provide some way for shareholders to participate in any future value attributable to those assets." *Id*. "Celera relayed BVF's requests to Quest, but Quest refused to consider them." *Id*.

"In March of 2011, the [Celera] Board convened to consider final approval of Celera's acquisition by Quest." *Id*. at *3. "[T]he Board relied on a financial analysis prepared by Credit Suisse, which … concluded that Quest's offer of $8.00 per share was fair." *Id*. On March 17, 2011, the parties entered into a merger agreement. "BVF continued to voice its concerns that $8.00 per share was too low and that Celera's passive drug royalties were being undervalued." *Id*. at *4.

"Less than a week after the merger was announced," one of Celera's shareholders, the New Orleans Employees' Retirement System ("NOERS"), brought suit challenging the acquisition. NOERS asserted breach of fiduciary duty claims against Celera's directors, and aiding and abetting claims against Quest. On April 17, 2011, the parties entered into "a non-binding Memorandum of Understanding ('MOU') that contemplated a negotiated settlement to be presented to the Court of Chancery." *Id*. "The terms of the MOU neither increased the offer price nor otherwise addressed monetary components" of the Celera–Quest agreement. *Id*. Rather, "the MOU provided for various 'therapeutic' benefits." *Id*.

"Following the parties' adoption of the MOU," it came to light that Credit Suisse had erroneously interpreted a Tufts University study when valuing Celera's assets. *Id*. at *5. BVF filed a notice of its intent to object to the settlement "before the merger had closed and before the final settlement agreement had been submitted to the Court of Chancery." *Id*. "BVF argue[d] that [Credit Suisse's] error in the interpretation of the Tufts study [had] resulted in the under-valuing of Celera's assets." *Id*. at *3. "BVF [further] asserted that the MOU's therapeutic benefits were of no value to it" and what BVF wanted were "monetary damages that reflected … the real value of [Celera's] stock and Celera's passive drug royalties." *Id*. at *5.

When "[t]he merger officially closed on May 17, 2011," BVF was Celera's largest shareholder. BVF and the other remaining shareholders of Celera were cashed out at $8.00 per share. However, "NOERS was not one of the shareholders cashed out on May 17, because it [had] sold its shares on May 13" for $8.0457 per share. *Id*. "NOERS' sale of its stock occurred after the Board approved of the merger, after the adoption of the MOU, and after some of the therapeutic benefits under the MOU had been realized." *Id*.

"Approximately four months after the merger, NOERS and the defendants entered into a proposed [Settlement Agreement]." *Id*. "The Settlement Agreement was expressly conditioned on the class being certified with no opt-out rights, so that members of the class could not independently pursue any other legal claim against the defendants." *Id*. "BVF objected to the proposed settlement." *Id*. at *6. "On March 23, 2012, over BVF's objection, the Court of Chancery certified the class as a non-opt out class under Court

of Chancery Rule 23(b)(1) and (b)(2)." *Id*.

The Chancery Court found that "NOERS' careless and cavalier sale of all of its stock in Celera a few days before the short-form merger was effected definitely call[ed] into question its suitability to serve as a class representative." *Id*. (quoting *In re Celera Corp. S'holder Litig.*, 2012 WL 1020471, at *1 (Del. Ch. Mar. 23, 2012) (Parsons, V.C.) (*Celera I*)). Nevertheless, the court concluded that "NOERS still satisfie[d], if only barely, the requirement for an appropriate class representative." *Id*. (quoting *Celera I*, 2012 WL 1020471, at *16). "[T]he court certified NOERS as the class representative, did not allow BVF to opt out of the class, and approved the Settlement Agreement as fair and reasonable." *Id*. BVF appealed.

The Delaware Supreme Court Finds That the Chancery Court Did Not Abuse Its Discretion in Certifying NOERS as the Class Representative

"BVF claim[ed] that NOERS was an inappropriate class representative because NOERS lacked standing to represent the class once it sold its shares in Celera." *Id*. The Delaware Supreme Court "agree[d] with the Court of Chancery that NOERS ha[d] standing to represent the class." *Id*. at *1. The court explained that "NOERS still owned its stock at the time the Board approved the merger and when the MOU was executed." *Id*. at *8. Further, the court found that NOERS "fit[ ] squarely within the broad definition of the class contained in the Settlement Agreement." *Id*. The Delaware Supreme Court expressly "decline[d] to adopt a rule of law that a shareholder class representative in a breach of fiduciary duty action must own stock in the corporation continuously through the final class certification." *Id*. at *1.

The court found "unconvincing" "BVF's other arguments regarding NOERS' certification as class representative," and held that "it was not an abuse of discretion for the Court of Chancery to certify NOERS as the class representative." *Id*. at *1, *7.

The Delaware Supreme Court Holds That the Chancery Court Abused Its Discretion in Not Permitting BVF to Opt Out of the Class

The Delaware Supreme Court found that the Chancery Court "did not abuse its discretion in certifying the class under Rule 23(b)(1) and (b)(2)," rather than as an opt-out class under Rule 23(b)(3). *Id*. at *1.

However, the Delaware Supreme Court determined that "the Court of Chancery [had] erred in denying BVF a discretionary opt-out right." *Id*. at *11. The court explained that "circumstances may arise where discretionary opt-out rights should be granted, such as where the class representative does not adequately represent the interests of particular class members, triggering due process concerns." *Id*. at *12. "Occasions where courts have granted discretionary opt-out rights include: when the claims of an objector seeking to opt out are sufficiently distinct from the claims of the class as a whole and an opt out is appropriate to facilitate the fair and efficient conduct of the action." *Id*.

"[I]n this case," the Delaware Supreme Court found that "the objective of complete peace through a non opt-out settlement [was] outweighed by the due process concerns" involved. *Id*. at *13. Specifically, "the class representative was 'barely' adequate, the objector was a significant shareholder prepared independently to prosecute a clearly identified and supportable claim for substantial money damages, and the only claims realistically being settled at the time of the certification hearing nearly a year after the merger were for money damages." *Id*. (footnote omitted). "Under these particular facts and circumstances," the Delaware Supreme Court held, "the Court of Chancery had to provide an opt-out right." *Id*.

The First Department Dismisses a Securities-Related Common Law Fraud Action against Porsche on Forum Non Conveniens Grounds

On December 27, 2012, the First Department dismissed on forum non conveniens grounds an action for fraud and unjust enrichment brought by an international group of hedge funds against Porsche Automobil Holding SE. *Viking Global Equities, LP v. Porsche Automobil Holding SE*, 2012 WL 6699216 (N.Y. App. Div. 1st Dep't. Dec. 27, 2012) (Friedman, J.P., Acosta, Renwick, Richter, Román, JJ.) (*Porsche III*). Prior to filing their state court action, the hedge fund plaintiffs had brought Section 10(b) claims against Porsche in the Southern District of New York. The district court dismissed these claims in 2010 based on the Supreme Court's decision in *Morrison v. National Australia Bank Ltd*., 130 S. Ct. 2869 (2010) (Scalia, J.).

Background

Porsche and Volkswagen AG ("VW") are both German car manufacturers. "In 1960, the German government enacted legislation (the 'VW Act') to shield VW from a hostile takeover." *Viking Global Equities, LP v. Porsche Automobil Holding SE*, 2012 WL 3640684, at *1 (N.Y. Sup. Ct. Aug. 6, 2012) (Ramos, J.) (*Porsche II*). "Under the VW Act, any acquirer, such as Porsche, needed to own 80% of VW's shares in order to effectuate a takeover, rather than the typical 75% threshold under German law." *Id*. "In 2004, the European Commission determined that the VW Act violated European Union law." *Id*. "In 2005, based upon its expectation that the VW Act would be amended, Porsche … [allegedly] secretly sought to acquire 75% of VW's shares so that it could take control of VW." *Id*. "Porsche purportedly believed that it would not be able to achieve this 75% ownership level unless it deceived

the market about its intentions and holdings." *Id*.

"Throughout 2008, Porsche issued several press releases and made direct statements to [the hedge fund] plaintiffs … concerning its intentions regarding its ownership interest in VW." *Id*. "In reliance upon Porsche's representations that it did not intend to attempt a takeover of VW, and thus believing that the share price of VW would decline, the [hedge fund] plaintiffs decided to short VWs stock" through securities-based swap agreements referencing VW's share price (the "VW Swap Agreements"). *Id*. at *2. "[The] [p]laintiffs became concerned when VW's stock price began to increase unexpectedly and significantly." *Id*. Porsche allegedly reassured the hedge fund plaintiffs that it did not intend to seek a controlling stake in VW, and continued to make public statements to that effect. However, on October 26, 2008, Porsche announced that it had accumulated a total of 74.1% of VW shares and stated that its "aim [was] to increase [its VW stake] to 75 percent in 2009, paving the way to a domination agreement." *Id*.

"Following the October 26, 2008 press release, the price of VW spiked so high that VW briefly became the most valuable corporation in the world by stock market value, as a result of the short squeeze prices prevailing in the market." *Id*. at *3. "In order to cover [their] short positions, [the hedge fund] plaintiffs had to pay markedly more for VW shares, suffering more

than a billion dollars in losses, while Porsche achieved massive profits on its trading in VW." *Id.*

The hedge fund plaintiffs subsequently brought suit against Porsche and two of its former executives in the Southern District of New York, alleging claims under Section 10(b) and for common law fraud. *Elliott Assocs. v. Porsche Automobile Holding SE*, 759 F. Supp. 2d 469 (S.D.N.Y. 2010) (Baer, J.) (*Porsche I*). Porsche moved to dismiss the complaint based the Supreme Court's decision in *Morrison*, which held that Section 10(b) applies only to "transactions in securities listed on domestic exchanges, and domestic transactions in other securities." *Id.* at 473 (quoting *Morrison*, 130 S. Ct. at 2884).

The Southern District of New York Finds That the VW Swap Agreements Were "Economically Equivalent to the Purchase of VW Shares" on a Foreign Exchange

The Southern District of New York "consider[ed] the economics of the [VW Swap Agreements] to determine how to apply *Morrison* to securities-based swaps that reference stocks traded abroad." *Id.* at 475. The court found that the plaintiffs' own allegations confirmed that the VW Swap Agreements "were economically equivalent to the purchase of VW shares." *Id.* at 476. Accordingly, the *Porsche* court concluded that "the economic reality is that [the] [p]laintiffs' swap agreements [were] essentially 'transactions conducted upon foreign exchanges and markets,' and not 'domestic transactions' that merit the protection of § 10(b)." *Id.* (quoting *Morrison*, 130 S. Ct. at 2882, 2884).

The *Porsche I* court explained that it was "loathe to create a rule that would make foreign issuers with little relationship to the U.S. subject to suits here simply because a private party in this country entered into a derivatives contract that references the foreign issuer's stock." *Id.* The plaintiffs appealed the district court's decision; the appeal is pending before the Second Circuit.

A New York State Court Declines to Dismiss Porsche's State Law Claims on Forum Non Conveniens Grounds

Following the district court's dismissal, the hedge fund plaintiffs brought suit in New York state court asserting claims for common law fraud and unjust enrichment. Porsche moved to dismiss on the ground of forum non conveniens.

The court found that "Porsche [had] not met the heavy burden of demonstrating that this action should be dismissed on the ground of forum non conveniens." *Porsche II*, 2012 WL 3640684, at *4. First, the court found that the plaintiffs had "establish[ed] a factual nexus between this action and New York." *Id.* "At issue in this action are the multiple representations that Porsche purportedly made directly to [the] plaintiffs in New York." *Id.* Moreover, the plaintiffs "allege[d] that they [had] evaluated all of Porsche's public statements and oral communications, … conducted their due diligence and made their investment decisions in New York." *Id.*

"As for the location of potential witnesses," the court found that "all five of the critical witnesses that [the] plaintiffs identify from their side either

reside or have offices in New York." *Id*. "Although the critical witnesses that [Porsche] identifies all reside in Germany," the court noted that "large corporations such as Porsche with ample resources have minimal difficulty bringing foreign witnesses or documents to New York courts." *Id*.

"Further," the court found it significant that "Porsche and its wholly-owned affiliates[ ] regularly transact business in New York, and in general, have extensive operations in the United States, with sales in excess of $1.5 billion, [and] employ over two hundred people here." *Id*.

"Finally," the court "reject[ed] Porsche's characterization of the issues in this action as the manipulation of the German stock market and the trade of German securities." *Id*. at *5. "At the core of the plaintiffs' claims are whether New York courts may hold responsible a foreign entity, who conducts business globally, for fraudulent misrepresentations purportedly aimed at New York plaintiffs." *Id*. The court held that "New York clearly has a vested interest in such an action." *Id*.

The First Department Reverses, Finding an "Inadequate Connection" to New York

On appeal, the First Department reversed. It found that "the only alleged connections between the action and New York [were] the phone calls between [the] plaintiffs in New York and a representative of [Porsche] in Germany." *Porsche III*, 2012 WL 6699216, at *1. The court determined that "these connections failed to create a substantial nexus with New York, given that the events of the underlying transaction otherwise occurred entirely in a foreign jurisdiction." *Id*.

The First Department explained that Porsche and "most plaintiffs are not New York residents," and "the VW stock is traded only on foreign exchanges." *Id*. Moreover, "many of the witnesses and documents are located in Germany, which has stated its interest in the underlying events and provides an adequate alternative forum." *Id*. "In light of th[e] inadequate connection between the events of the transaction and New York," the First Department held that Porsche had "met its heavy burden to establish that New York was an inconvenient forum" and dismissed the plaintiffs' complaint. *Id*.

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