SIMPSON THACHER

SECURITIES LAW ALERT

FEBRUARY 2013

This month's Alert discusses the Supreme Court's grant of certiorari in three related cases in which the Court will address the scope of the "in connection with" requirement for the preclusion of state law-based securities fraud class actions under the Securities Litigation Uniform Standards Act ("SLUSA").

In addition, we discuss a Southern District of New York decision holding that the five-year statute of repose for Section 10(b) claims begins to run on the date of the last alleged misrepresentation. We also address a Southern District of Texas decision denying in part the defendants' motion to dismiss a securities fraud class action against BP in connection with the Deepwater Horizon spill.

Finally, we cover two rulings from the Delaware courts: a Delaware Supreme Court decision finding allegations of a board's failure to adopt a tax-deductible Section 162(m) plan for executive compensation insufficient to state a corporate waste claim; and a Chancery Court decision dismissing a shareholder class action against the board of BJ's Wholesale Club in connection with its private equity buyout.

Yesterday, the Supreme Court handed down two significant decisions. In *Amgen, Inc. v. Conn. Ret. Plans and Trust Funds* (11-1085), the Court held that plaintiffs relying on the fraud-on-the-market theory of reliance need not prove that a defendant's alleged misrepresentations were material in order to obtain class certification.* In *Gabelli v. SEC* (11-1274), the Court held that the five-year limitations period for government penalty actions set forth in 28 U.S.C. § 2462 begins to run "when a defendant's allegedly fraudulent conduct occurs" rather than "when the fraud is discovered." We will be discussing both rulings in the March edition of the Alert.

The Supreme Court Grants Certiorari to Address the Scope of SLUSA's "in Connection with" Requirement

SLUSA precludes class actions brought under state law alleging any "misrepresentation or omission of a material fact *in connection with* the purchase or sale of" nationally-traded securities. 15 U.S.C. § 78bb(f)(1) (emphasis added). In *Merrill Lynch, Pierce, Fenner &*

* The Firm will be publishing a memorandum on the *Amgen* decision later today.

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).

Smith Inc. v. Dabit, 547 U.S. 71 (2006), the Supreme Court held that SLUSA's "in connection with" requirement should be given the same "broad construction" as the "in connection with" requirement under Section 10(b) and Rule 10b-5. The *Dabit* Court held that for SLUSA purposes, "it is enough that the fraud alleged 'coincide' with a securities transaction—whether by the plaintiff or by someone else."

Courts have since found *Dabit*'s 'coincide' definition "not particularly descriptive." *Roland v. Green*, 675 F.3d 503 (5th Cir. 2012) (Prado, J.). "Each of the circuits that has tried to contextualize the 'coincide' requirement has come up with a slightly different articulation of the requisite connection between the fraud alleged and the purchase or sale of securities."

Most recently, the Fifth Circuit considered the scope of SLUSA's "in connection with" requirement in three related class actions alleging violations of state law with respect to R. Allen Stanford's multi-billion dollar Ponzi scheme. The Fifth Circuit followed the Ninth Circuit's approach in holding that "a misrepresentation is 'in connection with' the purchase or sale of securities if there is a relationship in which the fraud and the stock sale coincide or are *more than tangentially related*." Applying this test, the Fifth Circuit held that SLUSA did not preclude the Stanford class actions.

On January 18, 2013, the Supreme Court granted three separate petitions for certiorari to review the Fifth Circuit's decision. *Chadbourne & Parke LLP v. Troice* (12-79) (2013 WL 203548); *Proskauer Rose LLP v. Troice* (12-88) (2013 WL 203550); *Willis of Colorado Inc. v. Troice* (12-86) (2013 WL 203549).

Background

In 2009, the SEC brought suit against the Stanford Group Company, as well as number of other Stanford corporate entities, including the Stanford International Bank ("SIB"), for "allegedly perpetrating a massive Ponzi scheme." The Stanford companies had allegedly sold a high volume of certificates of deposit ("CDs") "by promising above-market returns and falsely assuring investors that the CDs were backed by safe, liquid investments." For well over a decade, SIB allegedly "represented that it [had] consistently earned high returns on its investment of CD sales proceeds." In reality, "SIB had to use new CD sales proceeds to make interest and redemption payments on pre-existing CDs, because it did not have sufficient assets, reserves and investments to cover its liabilities." At the SEC's request, the district court placed the Stanford companies' assets in receivership.

Investors in SIB CDs subsequently brought a series of class action suits under state law against various defendants, including the Stanford Trust Company; the SEI Investments Company, which served as the administrator for the Stanford Trust Company; SIB's insurance brokers; and certain of SIB's lawyers (collectively, the "Stanford Class Actions"). These suits were consolidated for pretrial proceedings in the Northern District of Texas. The defendants contended that SLUSA precluded the plaintiffs' suits.

The Northern District of Texas Relies on the Eleventh Circuit's Interpretation of SLUSA's "in Connection with" Requirement to Find that SLUSA Precludes the Stanford Class Actions

The "central question" in dispute was whether the plaintiffs alleged misrepresentations or omissions "*in connection with* the purchase or sale of a covered security" under SLUSA. The Northern District of Texas determined that "the SIB CDs were not 'covered securities' within the meaning of SLUSA because SIB never registered the CDs, nor were they traded on a national exchange." However, the court found that this "did not end the SLUSA" inquiry because the Supreme Court in *Dabit* urged courts to employ a "broad construction" of SLUSA's "in connection with"

requirement.

In view of the absence of controlling Fifth Circuit authority on the scope of the "in connection with" requirement, the Northern District of Texas decided to apply the Eleventh Circuit's test, as laid out in *Instituto de Prevision Militar v. Merrill Lynch (IPM)*, 546 F.3d 1340 (11th Cir. 2008), which provides that SLUSA's "in connection with" requirement is met if the complaint alleges either a "fraud that induced [the plaintiff] to invest with [the defendants]" or "a fraudulent scheme that coincided with and depended upon the purchase or sale of securities."

The court determined that the plaintiffs "had alleged two distinct factual bases connecting the fraud to transactions in covered securities." First, the court found that the plaintiffs had "sufficiently alleged that their 'CD Purchases were induced by a belief that the SIB CDs were backed in part by investments in SLUSA-covered securities.'" Second, the court concluded that the plaintiffs' allegations "reasonably impl[ied] that the Stanford scheme coincided with and depended upon the [p]laintiffs' sale of SLUSA-covered securities to finance SIB CD purchases'" insofar as "the [alleged] fraud was a scheme targeting recent retirees who were urged to" roll over their retirement account funds into IRAS "fully invested" in Stanford CDs.

Because the court found that SLUSA's "in connection with" requirement had been met, the court held that SLUSA precluded the Stanford Class Actions. The plaintiffs appealed.

The Fifth Circuit Holds that SLUSA Does Not Preclude the Stanford Class Actions Based on the Ninth Circuit's Interpretation of SLUSA's "in Connection with" Requirement

On appeal, the Fifth Circuit found "tension in the law between following the Supreme Court's command that 'in connection with' must be interpreted broadly" and its concurrent cautionary instruction in *SEC v. Zandford*, 535 U.S. 813 (2002) against an overbroad construction. Bearing this tension in mind, the Fifth Circuit considered the Eleventh Circuit's approach to SLUSA's 'in connection with' requirement.

The Fifth Circuit explained that the first prong of the Eleventh Circuit's test—whether the fraud induced the plaintiffs to invest with the defendants—"examines the allegations from the plaintiffs' perspective by asking essentially whether the plaintiffs thought they were investing in covered securities or investing because of (representations about) transactions in covered securities." The Fifth Circuit determined that "[v]iewing the allegations from the plaintiffs' perspective … asks the wrong question." "By tying the 'coincide' requirement to 'inducement,'" the Eleventh Circuit's test "unnecessarily imports causation into a test whose language ('coincide') specifically disclaims it."

In the Fifth Circuit's view, the second prong of the Eleventh Circuit's test—whether the fraudulent scheme coincided with and depended upon the purchase or sale of covered securities—is "more faithful" to the Court's analysis in *Dabit*, which focused "on the relationship between the defendants' fraud and the covered securities transaction without regard to the fraud's effect on the plaintiffs." The

Fifth Circuit explained that "the defendant-oriented perspective is the proper point of view from which to consider the allegations," but nevertheless found the Eleventh Circuit's approach to be "too stringent a standard."

The Fifth Circuit instead adopted the test articulated by the Ninth Circuit in *Madden v. Cowen & Co.*, 576 F.3d 957 (9th Cir. 2009), which provides that misrepresentations are 'in connection with' the purchase or sale of covered securities for SLUSA purposes if "the fraud and the stock sale coincide or are *more than tangentially related*." The Fifth Circuit found that "[t]his articulation nicely deals with the Court-expressed tension in *Zandford*" and "incorporates the significant policy and legislative intent considerations" that "militate against an overbroad formulation" of SLUSA's "in connection with" requirement.

Turning to the Stanford Class Actions, the Fifth Circuit determined that "the [SIB] CDs were uncovered securities" but found that this "does not end [the] inquiry." Rather, the Fifth Circuit went on to "closely examine the schemes and purposes of the frauds alleged."

The plaintiffs claimed that they had invested in the SIB CDs at least in part because the CDs were backed by 'covered securities.' However, the Fifth Circuit found that "the references to SIB's portfolio being backed by 'covered securities'" were "merely tangentially related to the 'heart,' 'crux,' or 'gravamen' of the defendants' fraud." The Fifth Circuit concluded that "the heart, crux, and gravamen of [the defendants'] allegedly fraudulent scheme was representing to the [plaintiffs] that the CDs were a 'safe and secure' investment that was preferable to other investments for many reasons," including their "liquidity" and "consistently high rates of return." The court emphasized that "[t]he CDs were debt assets that promised a fixed rate of return not tied to the success of any of SIB's purported investments." The SIB CDs were "not mere 'ghost entities' or 'cursory pass-through vehicles' to invest in covered securities."

The Fifth Circuit also found that "the fact that some of the plaintiffs sold some 'covered securities' in order to put their money in the [SIB] CDs was not more than tangentially related to the fraudulent scheme" and therefore "provide[d] no basis for SLUSA preclusion." The court explained that while "it was necessary for [the] fraud for the defendants to have the [plaintiffs] invest their assets into the CDs," there was "no similar focus … on the sale of covered securities."

Finally, with respect to the plaintiffs' aiding and abetting claims against certain of SIB's lawyers (the "Proskauer Defendants"), the Fifth Circuit determined that there were in fact "misrepresentations involved." The court explained that "the Proskauer Defendants [had] allegedly misrepresented to the SEC the Commission's ability to exercise its oversight over Stanford and SIB," thereby "obstruct[ing] any chance of an SEC investigation uncovering the fraud." However, the Fifth Circuit determined that these misrepresentations were "one level removed from the misrepresentations made by" the primary violators and were therefore "not more than tangentially related to the purchase or sale of covered securities."

The Fifth Circuit reversed and held that SLUSA did not preclude the plaintiffs' claims.

The Supreme Court Grants Certiorari to Review the Fifth Circuit's Decision

Three different sets of defendants separately petitioned for certiorari of the Fifth Circuit's decision.[1] The Court granted all three petitions this past January. The question presented in each case concerns the scope of SLUSA's "in connection with" requirement.

- *Chadbourne & Parke LLP v. Troice*: The question presented is "whether SLUSA precludes a state-law class action alleging a scheme of fraud that involves misrepresentations about transactions [i]n SLUSA-covered securities."
- *Willis of Colorado Inc. v. Troice*: The question presented is "whether a covered state law class action complaint that unquestionably alleges 'a' misrepresentation 'in connection with' the purchase or sale of a SLUSA-covered security nonetheless can escape the application of SLUSA by including other allegations that are farther removed from a covered securities transaction."
- *Proskauer Rose LLP v. Troice*: The question presented is whether SLUSA "prohibit[s] private class actions based on state law only where the alleged purchase or sale of a covered security is 'more than tangentially related' to the 'heart, crux or gravamen' of the alleged fraud."

The Court declined to grant certiorari as to questions concerning SLUSA preclusion for aiding and abetting securities fraud claims.

The Court will hear all three cases during a one-hour oral argument in October Term 2013. A date for argument has not yet been set.

1. Two of the law firms that had formerly represented SIB each filed a petition for certiorari. The third petition was brought by two of SIB's former insurance brokers, as well SEI Investments Company.

The Court's Decision Could Resolve Questions Arising from Differing Circuit Court Interpretations of SLUSA's "in Connection with" Requirement

As the Fifth Circuit in *Roland* recognized, each of the circuit courts that has addressed SLUSA's "in connection with" prerequisite by "tr[ying] to contextualize the 'coincide' requirement has come up with a slightly different articulation of the requisite connection between the fraud alleged and the purchase or sale of securities (or representation about the purchase or sale of securities)." In *Romano v. Kazacos*, 609 F.3d 512 (2d Cir. 2010), the Second Circuit stated that it had previously "considered the 'coincide' requirement" and "concluded that SLUSA's 'in connection with' standard is met where … [the] plaintiff's claims 'necessarily allege,' 'necessarily involve,' or 'rest on' the purchase or sale of securities." In *Segal v. Fifth Third Bank, N.A.*, 581 F.3d 305 (6th Cir. 2009), the Sixth Circuit found SLUSA's "modest" "in connection with" requirement satisfied where the plaintiff's allegations did not "merely 'coincide' with [covered] securities transactions" but went beyond the 'coincide' requirement and "depend[ed] on them." In *Madden*, the Ninth Circuit held that SLUSA's "in connection with" requirement is satisfied where "the fraud and the stock sale coincide or are *more than tangentially related*." The Fifth Circuit in *Roland* followed the Ninth Circuit's approach. Finally, in *IPM*, the Eleventh Circuit held that SLUSA's "in connection with" requirement is met if the complaint alleges either a "fraud that induced [the plaintiff] to invest with [the defendants]" or "a fraudulent scheme that coincided with and depended upon the purchase or sale of securities."

The Supreme Court's decision will likely clarify *Dabit*'s "'coincide' with" standard for applying SLUSA's "in connection with" requirement, yielding more consistency in SLUSA preclusion decisions.

The Southern District of New York Holds That the Five-Year Statute of Repose for Section 10(b) Claims Begins to Run on the Date of the Last Alleged Misrepresentation

On February 13, 2013, the Southern District of New York held that the five year statute of repose for Section 10(b) claims begins to run "on the date upon which the last alleged misrepresentation or omission was made," rather than the date of "the transaction that forms the basis of the § 10(b) claim at issue." *Intesa Sanpaolo S.p.A. v. Credit Agricole Corporate and Inv. Bank*, 2013 WL 525000 (S.D.N.Y. Feb. 13, 2013) (Sweet, J.). The court dismissed as untimely Section 10(b) claims brought within five years of the date of a credit-default swap transaction because more than five years had elapsed since the defendants' last alleged misrepresentations in connection with that transaction.

Background

On April 24, 2007, Intesa Sanpaolo entered into a credit-default swap with Credit Agricole Corporate and Investment Bank and Credit Agricole Securities (U.S.A.) Inc. (collectively, "Calyon"), pursuant to which "Intesa made what was effectively a $180 million investment" in Pyxis ABS, a collateralized debt obligation (the "Pyxis Swap"). Intesa claimed that it had relied on Calyon's representations that "Pyxis' collateral would be selected by an independent collateral manager acting in good faith in the best interests of those betting on Pyxis' success." In reality, however, Pyxis' collateral was allegedly "selected by a secretive hedge fund called Magnetar that was betting heavily against Pyxis' success, and therefore had every incentive to design Pyxis to fail."

Not long after Intesa invested in Pyxis, "the CDO's

constituent collateral began to falter, which in turn caused Pyxis to default on payments to its noteholders." Intesa ultimately "lost the entirety of its $180 million investment."

On April 6, 2012, Intesa brought Section 10(b) claims against Calyon and Pyxis' collateral manager, The Putnam Advisory Company, LLC. The defendants moved to dismiss Intesa's claims as untimely pursuant to 28 U.S.C. § 1658(b), which provides that Section 10(b) claims "may be brought not later than the earlier of: (1) 2 years after the discovery of the facts constituting the violation; or (2) 5 years after such violation."

The Court Finds Intesa's Claims Timely Under the First Prong of Section 1658(b)

In determining "whether Intesa's § 10(b) claims were timely," the Southern District of New York first considered "when Intesa [could] be said to have discovered the facts constituting the violation" for purposes of the two year statute of limitations set forth in Section 1658(b)(1). The court noted that under the Supreme Court's decision in *Merck & Co., Inc. v. Reynolds*, 559 U.S. 633 (2010), facts showing scienter are among those facts "constituting the violation." The court further explained that pursuant to the standard set forth in *City of Pontiac Gen. Emps.' Ret. Sys. v. MBIA,*

Inc., 637 F.3d 169 (2d Cir. 2011),[2] facts showing scienter "are deemed 'discovered' … when the plaintiff has uncovered (or when a reasonably diligent plaintiff *would have* uncovered) enough information about the defendant's knowledge or intent 'to state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.'"

Here, Calyon argued that "facts sufficient to establish a strong inference of fraud were 'widely publicly available' long before April 6, 2010"—"*i.e.*, more than two years before Intesa first asserted its 10(b) claim." As support for this contention, Calyon cited a number of articles that allegedly revealed "critical" information, such as the fact that "Magnetar had been involved in the creation of Pyxis."

The court determined that this information, standing alone, was "not *sufficient*" to "set forth a coherent and … cogent scienter narrative." While the articles set forth "critical" facts relevant to the issue of scienter, they were "bereft of numerous pieces of information, … such as the existence of a secret agreement of which Putnam and Calyon were aware that granted Magnetar power to control the extent of the Pyxis portfolio." The court found that this additional information was contained in emails that "became available to Intesa only after they were cited in and attached to a submission made on March 3, 2011, in an action in the Northern District of New York." "Since certain facts relevant to scienter were first revealed" in those emails, the court held that Section "1658(b)'s two-year post-discovery deadline on Intesa's § 10(b) claims [had] not yet expired."

The Court Holds That the Five Year Statute of Repose Under Section 1658(b)(2) Has Expired for Intesa's Section 10(b) Claims

The court next considered whether Intesa's claims were timely under the second prong of Section 1658(b), which provides that Section 10(b) claims "may be brought not later than … 5 years after such violation." At the outset of its analysis, the court held that the "violation" referred to in Section 1658(b)(2) "is deemed to have occurred on the date upon which the last alleged misrepresentation or omission was made."

The court rejected Intesa's contention that "a 'violation' for 1658(b) purposes is the transaction that forms the basis of the § 10(b) claim at issue (rather than the [last] alleged misrepresentation)." In support of this argument, Intesa cited to the Second Circuit's summary order in *Arnold v. KPMG LLP*, 334 F. App'x. 349 (2d Cir. 2009). The *Arnold* court held that the "statute of repose in federal securities law claims 'starts to run on the date the parties have committed themselves to complete the purchase or sale transaction.'"[3] Notably, the *Arnold* court found the plaintiff's "contention that the period of repose begins to run at the time of the last alleged misrepresentation (even when made after the final purchase or sale of the securities) … devoid of merit."

2. Please click here for our discussion of *Pontiac* in the March 2011 edition of the Alert.

3. The Second Circuit in *Arnold* considered whether the plaintiff's Section 10(b) claims were timely under an earlier version of Section 1658(b), pursuant to which Section 10(b) claims had to be brought "within one year after the discovery of the facts constituting the violation and within three years after such violation."

The Southern District of New York found *Arnold* "inapposite to the instant case because it addresse[d] a scenario where the alleged misrepresentation was made after the purchase." Here, "the last alleged misrepresentation occurred in March 2007, … more than a month *prior* to the Pyxis Swap." Further, the court emphasized that "*Arnold* is an unpublished summary order, and therefore does not constitute binding precedent."

Intesa alternatively argued that the five-year statute of repose did not begin running until the date of the Pyxis Swap (April 24, 2007) because the defendants' alleged "fraudulent concealment continued up to (and well beyond) the date that Intesa became irrevocably committed to the Pyxis Swap." The court rejected this contention as well, explaining that "applying the concept of a continuing omission to the five-year deadline would essentially render that element of 1658(b) a nullity with respect to any securities fraud case that does not involve a corrective disclosure." Suppose for example that an individual purchased stock in February 2007 "in reliance upon an offering memorandum that contained a material omission that was never subsequently acknowledged or corrected." In that scenario, "the five-year deadline *would not have even begun running on the claim*" under Intesa's "continuing omission" theory. The court found that "[t]his could not have been the intention of Congress in drafting 1658(b)'s five-year deadline."

"Accordingly," the court held that "the 'violation' in this case for 1658(b) purposes is considered to have occurred on the date of the latest misrepresentation or omission alleged." The last alleged misrepresentation by Calyon was made on March 6, 2007, "when the Calyon sent Intesa an allegedly fraudulent valuation of Pyxis." The last alleged misrepresentation made by Putnam was made on October, 2, 2006, "the date of publication of the Offering Memorandum, which incorporated by reference the Collateral Management Agreement." Because Intesa first asserted its Section 10(b) claims against the defendants on April 6, 2012, the court held that "those claims are untimely pursuant to 1658(b)(2) with respect to both Calyon and Putnam."

The court further explained that under Section 1658(b), "a plaintiff's § 10(b) claim is untimely if it is asserted subsequent to the expiration of the *earlier* of the two-year post-discovery deadline and five-year post-violation deadline." Although "the two-year deadline has not yet run" on Intesa's Section 10(b) claims, "the five-year deadline ran in October 2011 for Putnam and in March 2012 for Calyon." The court therefore dismissed Intesa's Section 10(b) claims as untimely.

The Southern District of Texas Declines in Part to Dismiss a Securities Fraud Class Action Against BP in Connection with the Deepwater Horizon Spill

On February 6, 2013, the Southern District of Texas denied in part the defendants' motion to dismiss a securities fraud class action alleging that various BP entities and certain BP executives and officers had made misrepresentations concerning "the Deepwater Horizon drilling project and the safety of BP's operations generally." *In re BP p.l.c. Sec. Litig.*, 2013 WL 487011 (S.D. Tex. Feb. 6, 2013) (Ellison, J.) (*BP III*). The

court found that the plaintiffs had adequately alleged material misrepresentations made with scienter by BP's CEO. However, the court dismissed all claims against the head of BP's Exploration and Production business unit, as well as most claims based on unattributed corporate statements.

Background

On February 14, 2011, a group of plaintiffs from New York and Ohio (the "NY/OH plaintiffs") filed a consolidated class action complaint against various BP entities and several individual defendants alleging claims under Sections 10(b) and 20(a) of the Exchange Act, as well as Rule 10b-5, in connection with the Deepwater Horizon spill. On February 13, 2012, the Southern District of Texas held that the Supreme Court's decision in *Morrison v. Nat'l Austl. Bank Ltd.*, 130 S. Ct. 2869 (2010) precluded claims involving BP securities traded solely on a foreign exchange. *In re BP p.l.c. Sec. Litig.*, 843 F. Supp. 2d 712 (S.D. Tex. 2012).[4] The court further determined that some, but not all, of the alleged misrepresentations were actionable. In a separate decision issued on the same day, the court dismissed in its entirety a different complaint issued by a subset of the NY/OH plaintiffs (the "Ludlow plaintiffs"). *In re: BP p.l.c. Sec. Litig.*, 852 F. Supp. 2d 767 (S.D. Tex. 2012). Both decisions granted the plaintiffs leave to replead.

The NY/OH plaintiffs and the Ludlow plaintiffs subsequently filed a joint amended complaint on behalf of a class of purchasers of BP American Depositary Shares, which are sold on the New York Stock Exchange. The complaint included new allegations largely concerning BP's Operating Management Systems ("OMS"), a set of safety standards BP implemented following a deadly explosion at the company's Texas City refinery in 2005. The purpose of OMS was "to optimize BP's process safety protocols and make them uniform and consistent across all of BP's operations." *BP III*.

BP also established a Group Operations Risk Committee (the "GORC") to act as the "overall steward of the OMS implementation project." BP's CEO, Anthony B. Hayward, served as Chair of the GORC. Andrew G. Inglis, head of BP's Exploration and Production business unit, also served on the GORC. "The GORC—including Hayward and Inglis—played a pivotal role in reviewing and approving the structure and scope of OMS." "The framework approved by GORC specified that OMS would be implemented on BP-owned and operated entities only—a facet of the design that the committee specifically discussed before its approval." OMS did not fully apply to contractor-owned rigs, such as the *Deepwater Horizon* rig in the Gulf of Mexico.

"OMS became … the centerpiece of many public speeches, reports, and statements heralding a sea change within BP on the issue of process safety." However, the plaintiffs alleged that none of these statements specified that OMS was largely limited to BP-owned and operated assets. "Due to this omission," the plaintiffs claimed that "thirteen public statements regarding the scope and roll-out of OMS were materially misleading to investors and misrepresented

4. Please click here for our discussion of the court's decision in the February 2012 edition of the Alert.

BP's ability to manage the risk of catastrophic safety failures in its most dangerous operations."

The defendants moved to dismiss "all new alleged misrepresentations and all alleged misrepresentations previously dismissed in the February 13th [o]rders."

The Court Finds the Complaint Adequately Alleges that BP's CEO Made Material Misrepresentations with Scienter Regarding the Scope and Implementation of OMS

BP's CEO Anthony Hayward "assumed a very active role [in] promoting BP's safety reform efforts" and "spoke frequently on the topic of OMS generally." The plaintiffs alleged that Hayward had "falsely represented the scope of OMS by suggesting that OMS was a 'single framework' applied to 'every site' when in fact it applied only to rigs fully-owned by BP."

The defendants responded that OMS did in fact "apply to and govern contractor-owned sites by establishing a floor under which [a] contractor's safety management systems were not allowed to fall." The defendants argued that "even though OMS distinguished in its application between owned and non-owned sites, the end result was intended to be consistent—supporting Hayward's representation that OMS was a 'comprehensive' framework applied across 'every' BP site." Moreover, the defendants pointed out that "Hayward's public statements mirrored statements found in the OMS Framework and in internal [BP] reports."

The court found that the defendants had "identified serious flaws in [the] [p]laintiffs' scienter allegations." Nevertheless, the court determined that the plaintiffs had met their burden to present "an inference of scienter *at least* as compelling as any inference that scienter was lacking." The court explained that "Hayward did not make one or two stray comments about the scope of OMS." Rather, he "repeatedly emphasized its expansiveness in his most important presentations to investors." The court noted that "over time, Hayward's statements became more detailed and emphatic, and thus more likely to mislead given the reality of how OMS 'applied' in the case of contractor-owned project sites." "Therefore, the inference that he knew or should have realized that these later statements overstated—indeed, oversold—OMS is at least as strong as the alternative that he was oblivious to the inaccurate impression they created."

For similar reasons, the court also found that the complaint adequately alleged that Hayward had made material misrepresentations with scienter regarding "the impressive pace of [OMS's] implementation."

The Court Dismisses Claims Against the Head of BP's Exploration and Production Business Unit for Failure to Allege a Duty to Disclose

The plaintiffs alleged that Andrew Inglis, head of BP's Exploration and Production business unit, had also made misrepresentations regarding the scope of OMS." The court determined that the plaintiffs' allegations "fairly suggest that Inglis knew that the components of OMS would be implemented only on assets owned or controlled by BP." However, the court explained that the allegations "must [also] give rise to a strong inference that Inglis had an obvious duty to disclose the information, or that he intended to confuse the market by omitting it."

The plaintiffs "emphasize[d] the similar positions occupied by both Hayward and Inglis, suggesting that they should be held to the same standard." But the court found "an important distinction between the two men." While "both were undeniably high in the corporate hierarchy," the court explained that "only Hayward presented himself as the public face of BP's safety reform efforts" and "[o]nly Hayward spoke often and at length about the steps BP was

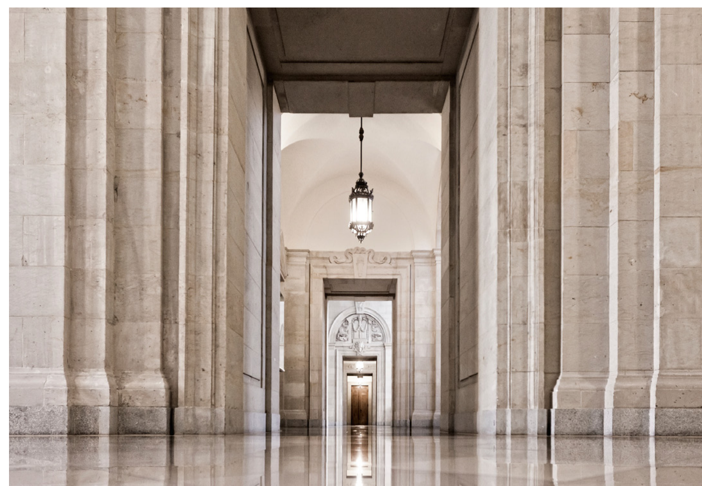
taking to improve its process safety record." Inglis, on the other hand, "delivered only two statements, two and a half years apart, neither of which reached the level of specificity and intensity of Hayward's later statements." The court held that the complaint did "not give rise to a strong inference that Inglis acted with the requisite state of mind."

The court also dismissed Section 20(a) claims against Inglis for failure to allege that he had "specific involvement in or control over someone else's actionable misrepresentation."

The Court Finds the Plaintiffs Failed to Allege Scienter as to Various Unattributed Corporate Statements

The plaintiffs alleged that several unattributed corporate statements regarding the scope and rollout of OMS, as well as BP's oil spill response capabilities generally, were "so egregious that they establish[ed] a 'strong inference' of scienter on their own, without needing to be tied to any specific individuals." The court found that none of the statements at issue was "so egregiously false as to meet" the standard set forth in *Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 513 F.3d 702 (7th Cir. 2008) for corporate scienter.[5]

The plaintiffs also relied in part on the Fifth Circuit's holding in *Southland Sec. Corp. v. INSpire Ins. Solutions, Inc.*, 365 F.3d 353 (5th Cir. 2004) to argue that "they may establish scienter by linking the documents at issue to particular individuals with scienter."[6] The court acknowledged that "the *Southland* standard appears fairly broad" and is "accommodating of some uncertainty and ambiguity in [the] [p]laintiffs' allegations." *BP III*. However, the court explained that "many allegedly 'fraudulent' corporate statements are the product of a 'series of acts' taken pursuant to a 'hierarchical and differentiated corporate structure,' none of which was both (1) done with scienter and (2) imputable to the company." The court cautioned that "allowing [p]laintiffs too much latitude in showing a connection between a particular statement and a particular individual would greatly increase the chance of BP being held liable for a statement that no responsible executive understood or believed to be misleading or inaccurate."



Approaching the question with "this delicate balance in mind," the court held that the plaintiffs had adequately pleaded scienter with respect to one unattributed statement regarding the scope of OMS by alleging that "Hayward [had] made or issued the statement; ordered or approved its making or issuance; or furnished information or language for inclusion therein." The court dismissed claims as to the remaining unattributed corporate statements at issue.

5. The *Tellabs* court stated that "it is possible to draw a strong inference of corporate scienter without being able to name the individuals who concocted and disseminated the fraud" in exceptional cases. "Suppose General Motors announced that it had sold one million SUVs in 2006, and the actual number was zero." In that example, the court explained that "[t]here would be a strong inference of corporate scienter, since so dramatic an announcement would have been approved by corporate officials sufficiently knowledgeable about the company to know that the announcement was false."

6. The *Southland* court held that "corporate documents that have no stated author or statements within documents not attributed to any individual may be charged to one or more corporate officers provided specific factual allegations link the individual to the statement at issue."

The Delaware Supreme Court Finds Allegations of a Board's Failure to Adopt a Tax-Deductible Section 162(m) Plan for Executive Compensation Insufficient to State a Corporate Waste Claim

On January 14, 2013, the Delaware Supreme Court "consider[ed] whether a derivative complaint challenging a corporate board's decision to pay certain executive bonuses without adopting a [Section 162(m)] plan that could make those bonuses tax deductible states a claim for waste." *Freedman v. Adams*, 58 A.3d 414 (Del. 2013) (Berger, J.). The Delaware Supreme Court affirmed the Chancery Court's finding that the complaint failed to state a waste claim, explaining that "[t]he decision to sacrifice some tax savings in order to retain flexibility in compensation decisions is a classic exercise of business judgment."

Background

In 2008, a stockholder of XTO Energy Inc. brought a derivative suit alleging that XTO's board had "committed waste by failing to adopt a plan" pursuant to Section 162(m) of the Internal Revenue Code that "could have made its bonus payments tax deductible." The plaintiff contended that XTO "would have saved approximately $40 million" over a three-year period if it had paid bonuses to its executive officers pursuant to a Section 162(m) plan.

Not long after the plaintiff filed suit, XTO's board approved a Section 162(m) plan. However, the company never had the opportunity to make use of the plan because XTO merged with and into a subsidiary of ExxonMobil Corporation on June 25, 2010.

Following the merger, the plaintiff agreed to dismiss her complaint as moot, but subsequently

sought $1 million in attorneys' fees on the grounds that her complaint had "benefitted the company by causing XTO to adopt a Section 162(m) plan." The Chancery Court denied the plaintiff's motion for attorneys' fees, "finding that the complaint was not meritorious when filed because it [did] not adequately allege that demand on the board would have been futile." The plaintiff appealed.

The Delaware Supreme Court Finds the Board's Decision to Be a "Classic Exercise of Business Judgment"

On appeal, the Delaware Supreme Court explained that "[a] valid waste claim would deprive the board of the protection of the business judgment rule, and excuse demand." In order to "state a claim for waste," a plaintiff must "allege, with particularity, that the board authorized action that no reasonable person would consider fair." The Delaware Supreme Court noted that under the "onerous standard for waste" set forth in *In re the Walt Disney Co. Derivative Litig.*, 906 A.2d 27 (Del. 2006), "[a] claim of waste will arise only in the rare, unconscionable case where directors irrationally squander or give away corporate assets."

The plaintiff "contend[ed] that the [XTO] board's failure to adopt a Section 162(m) plan" met this high bar "because it amounted to a gift in the form of tax payments that were not required." However, the

Delaware Supreme Court found that the XTO board had "intentionally chose[n] not to implement a Section 162(m) plan" because of its belief that such a plan "would constrain the compensation committee in its determination of appropriate bonuses." Although the XTO board's decision to forego a Section 162(m) plan might in fact have been "a poor one," as the plaintiff alleged, the Delaware Supreme Court determined that the board's decision was neither "unconscionable" nor "irrational." Rather, it was a "classic exercise of business judgment." The Delaware Supreme Court therefore affirmed the Chancery Court's dismissal of the plaintiff's motion for attorneys' fees.

The Delaware Chancery Court Dismisses a Shareholder Class Action Against the Board of BJ's Wholesale Club in Connection with its Private Equity Buyout

On January 31, 2013, the Delaware Chancery Court dismissed a direct shareholder class action brought against the former directors (the "directors" or the "Board") of BJ's Wholesale Club, Inc. for alleged breaches of fiduciary duty in connection with the September 2011 buyout of BJ's (the "Buyout") by affiliates of Leonard Green & Partners, L.P. ("LGP") and funds advised by CVC Capital Partners (together, the "Buyout Group").[7] *In re BJ's Wholesale Club, Inc. S'holders Litig.*, 2013 WL 396202 (Del. Ch. Jan. 31, 2013) (Noble, V.C.). The court concluded that "the Board's decision to sell the [c]ompany at a 38% premium to its unaffected stock price and after a lengthy sales process was not 'so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith.'" The court also dismissed the plaintiffs' aiding and abetting breach of fiduciary duty claim against the Buyout Group.

Background as Alleged by the Plaintiffs

In July 2010, LGP publicly signaled its interest in BJ's. The following month, the Board "formed a special committee charged with evaluating potential strategic alternatives ('the Special Committee')." On February 3, 2011, BJ's "issued a press release announcing that the Board, based on the Special Committee's recommendation, had decided to explore strategic alternatives."

Not long afterwards, one of BJ's strategic competitors ("Party A") approached BJ's financial advisor, Morgan Stanley, about the possibility of acquiring BJ's. Because Party A "had no prior history of acquiring domestic companies," Morgan Stanley was "dismissive" of Party A's interest. The Board discussed Party A's interest at a meeting on March 7, 2011. The following day, "Morgan Stanley informed Party A that BJ's would not be comfortable sharing material, non-public information with a direct competitor at that stage." The Board did, however, provide a confidential offering memorandum to twenty-three private equity firms.

"In early April, Party A sent a letter to BJ's proposing, subject to certain conditions, to acquire it in an all-cash transaction at a purchase price in the range of $55 to $60 per share." At Party A's request, BJ's regulatory counsel conferred with Party A's regulatory counsel on April 15, 2011. Three days later, BJ's executives met with representatives from Party A. Following the meeting, BJ's "determined that it would not be in the best interests of the [c]ompany to pursue the expression of interest by Party A."

BJ's also received a proposal from a private equity firm ("Party B") for a hybrid transaction that valued

7. Simpson Thacher represents CVC in this action.

BJ's between $60 and $72 per share. Party B's proposal "called for BJ's to acquire Party B's warehouse club franchise." The Board "rejected this proposal two days after receiving it." On April 25, 2011, Party B submitted an all-cash proposal to buy BJ's at a price range from $50 to $53 per share, but the firm "never advanced to the final round of bidding." Moreover, "none of the other four private equity firms which had expressed some interest" after receiving BJ's confidential offering memorandum "ultimately submitted a bid."

On June 16, 2011, the Buyout Group submitted a joint proposal to acquire BJ's for $50 per share in an all-cash transaction. After back-and-forth negotiations, the Board ultimately accepted the Buyout Group's "best and final" offer of $51.25 per share. "That price represented a 6.6% premium to the $48.08 closing price of BJ's common stock on June 28, 2011, the day before BJ's publicly announced the Buyout." The Board "relied upon Morgan Stanley's fairness opinion" in accepting the Buyout Group's offer.

The day after the announcement of the Buyout, plaintiffs brought suit challenging the transaction. After the Board filed a proxy statement with the SEC, the plaintiffs moved for a preliminary injunction. The board twice supplemented the proxy statement with more information, "including the expressions of interest by Party A and Party B." The plaintiffs subsequently withdrew their motion for a preliminary injunction, and the transaction closed on September 30, 2011. The defendants later moved to dismiss the plaintiffs' complaint.

The Court Finds the Plaintiffs Failed to Challenge the Disinterestedness and Independence of a Majority of BJ's Directors

The Delaware Chancery Court explained at the outset that where "a corporation's certificate of incorporation contains an exculpatory provision authorized by *8 Del. C.* § 102(b)(7), which immunizes directors from damages arising from a breach of the duty of care, plaintiffs must 'plead sufficient facts to show that *a majority of the [b]oard of [d]irectors* breached the fiduciary duty of loyalty.'" The complaint must either show that "a majority of the [b]oard was not both disinterested and independent" or establish that the board failed to act in good faith.

The court determined that the plaintiffs "did not seriously challenge the disinterestedness and independence of the Board." There were no "allegations that six [of BJ's nine] directors were interested." Moreover, "[f]our of the six concededly disinterested directors were members of the Special Committee that ultimately recommended the transaction." The court noted the absence of "any well-pleaded allegations that the six disinterested directors were somehow dominated or controlled by the … allegedly interested directors. "

The Court Determines the Plaintiffs Failed to Allege that BJ's Directors Had Acted in Bad Faith During the Sale Process

The court found that the plaintiffs had failed to allege facts "support[ing] a reasonable inference that the Board [had] consciously disregarded its so-called *Revlon* duties" in the course of the sale process. To succeed on a bad faith claim, the plaintiffs therefore had to "allege that the decision to sell the [c]ompany was 'so far beyond the bounds of reasonable judgment

that it seems essentially inexplicable on any ground other than bad faith.'"

The plaintiffs advanced several arguments in support of their bad faith claim. First, the plaintiffs argued that the Board had "exhibited bad faith when it did not sufficiently explore expressions of interest from Party A and Party B."

With respect to Party A's interest, the court concluded that the directors "had no reason not to rely upon Morgan Stanley's advice that strategic buyers, including Party A, would not likely be interested or that their interest would not likely lead to a serious offer." The court was also not moved by the Board's alleged lack of interest in Party A's overtures, explaining that "[s]omething of a negative attitude toward a competitor is not unusual." As to the Board's "decision not to share confidential information with Party A, "the court determined that the Board "could reasonably have had concerns about sharing confidential business information with a competitor, especially where, as here, the seriousness of Party A's interest was in doubt."

The court also found baseless the plaintiffs' claim that the Board had "summarily reject[ed] Party A's offer without due consideration." The court instead determined that "the only reasonable inference that can be drawn from [the] facts is that the Board had legitimate concerns about the potential antitrust risks inherent in a transaction between two of the three largest players in the warehouse club industry."

With respect to Party B's offer, the court found that the Board "had no obligation under its *Revlon* duties to pursue [a] fundamentally different proposal" involving "the purchase of Party B's affiliate." The court determined that "the Board's rejection of this different proposal in only two days supports no inference that it [had] acted in bad faith."

The plaintiffs also alleged that "the [two] self-interested directors … [had] manipulated the sales process in favor of the Buyout Group." The court found this argument "belied by [the] year-long sales process, reasonable explanations for the Board's conduct with respect to Parties A and B, and the fact that the Buyout was ultimately approved by a majority of disinterested and independent directors."

The plaintiffs further contended that the Board had "acted in bad faith by agreeing to a combination of deal protection devices that collectively and unreasonably precluded a higher bid." The court held that "under Delaware law," similar deal protection measures have "routinely been upheld as reasonable, especially where, as here, the Board [had] negotiated a $175 million reverse termination fee and obtained a fiduciary out clause."

The Court Finds No Basis for the Plaintiffs' Aiding and Abetting Claim Against the Buyout Group

The plaintiffs alleged, *inter alia*, that "the Buyout Group [had] pressured the Board to accept a lower price and engage in a hasty sale." However, the court found "nothing in the Complaint suggest[ing] that [the] Buyout Group's actions were not otherwise hard-bargaining on the part of an arms'-length third-party bidder." The court held that the plaintiffs "fail[ed] to allege adequately that the Buyout Group [had] knowingly participated in a breach of fiduciary duty," and therefore dismissed the aiding and abetting claim.

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

With "a preeminent track record" in securities litigation, Simpson Thacher "remains at the forefront of litigation work."

— CHAMBERS USA 2012

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