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This month's Alert discusses the oral argument before the Supreme Court in the Stanford Ponzi scheme cases. At issue is 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").

We also address a Ninth Circuit decision declining to apply a "novel" loss causation standard when securities are traded in inefficient markets, and a Tenth Circuit opinion applying the test set forth in *Reves v. Ernst & Young*, 494 U.S. 56 (1990) for determining whether a loan instrument qualifies as a "security" for purposes of the federal securities laws.

In addition, we cover a Southern District of Texas decision declining to dismiss English common law claims brought by purchasers of BP shares on the London Stock Exchange in connection with the Deepwater Horizon explosion. The court had previously dismissed Section 10(b) claims brought by the same plaintiffs based on the Supreme Court's ruling in *Morrison v. Nat'l Australia Bank Ltd.*, 130 S. Ct. 2869 (2010).

Finally, we discuss two decisions from the Delaware Chancery Court: one dismissing on statute of limitations grounds a shareholder action against Sirius XM Satellite Radio's directors concerning Liberty Media Corporation's 2009 capital infusion; and another dismissing a shareholder action against the directors of BioClinica, Inc. in connection with the March 2013 acquisition of BioClinica by JLL Partners.

Supreme Court Hears Oral Argument in the Stanford Ponzi Scheme Cases Concerning the Scope of SLUSA's "in Connection with" Requirement

On October 7, 2013, the first day of its new term, the Supreme Court heard oral argument in three related cases arising out of R. Allen Stanford's multi-billion dollar Ponzi scheme: *Chadbourne & Parke LLP v. Troice* (No. 12-79); *Proskauer Rose LLP v. Troice* (No. 12-88); and *Willis of Colorado Inc. v. Troice* (No. 12-86).[1]

1 The cases were consolidated for purposes of the oral argument.

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The question presented in each case concerns the scope of SLUSA's "in connection with" requirement for the preclusion of state law-based securities fraud class actions.[2]

Circuit Courts Differ in Their Interpretations of SLUSA's "in Connection with" Requirement

In 1995, Congress enacted the Private Securities Litigation Reform Act ("PSLRA"). Among other reforms, the PSLRA imposed heightened pleading requirements for Section 10(b) claims. To circumvent the PSLRA's restrictions, plaintiffs soon began filing state law-based securities fraud class actions, often in state court. Congress responded by enacting SLUSA.

SLUSA precludes class actions brought under state law alleging "a misrepresentation or omission of a material fact *in connection with* the purchase or sale of a covered security." 15 U.S.C. § 78bb(f)(1) (emphasis added). A "covered security" is a security that is listed, or authorized for listing, on a national exchange or issued by a federally registered investment company. 15 U.S.C. § 77r(b).

In *Merrill Lynch, Pierce, Fenner & 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.[3] 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.).[4] "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."

The Second Circuit has held that "SLUSA's 'in connection with' standard is met where … plaintiff's claims 'necessarily allege,' 'necessarily involve,' or 'rest on' the purchase or sale of [covered] securities." *Romano v. Kazacos*, 609 F.3d 512 (2d Cir. 2010). The Sixth Circuit has found SLUSA's "modest" "in connection with" requirement satisfied where the plaintiff's allegations do not "merely 'coincide' with [covered] securities transactions" but "depend on them." *Segal v. Fifth Third Bank, N.A.*, 581 F.3d 305 (6th Cir. 2009). The Ninth Circuit has ruled that SLUSA's "in connection with" requirement is met if "the fraud and the stock sale coincide or are more than tangentially related." *Madden v. Cowen & Co.*, 576 F.3d 957 (9th Cir. 2009). The Fifth Circuit recently adopted the Ninth Circuit's test in the Stanford Ponzi scheme cases. *Roland*, 675 F.3d 503. Finally, the Eleventh Circuit has held that SLUSA's "in connection with" requirement is met where the plaintiff 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." *Instituto De Prevision Militar v. Merrill Lynch*, 546 F.3d 1340 (11th Cir. 2008).

2 *Chadbourne & Parke LLP v. Troice* ("whether SLUSA precludes a state-law class action alleging a scheme of fraud that involves misrepresentations about transactions in SLUSA-covered securities"); *Willis of Colorado Inc. v. Troice* ("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* (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").

3 Section 10(b) prohibits, *inter alia*, the use of "any manipulative or deceptive device" "*in connection with* the purchase or sale of any security registered on a national securities exchange." 15 U.S.C. § 78j(b) (emphasis added). Rule 10b-5 similarly prohibits, *inter alia*, the use of "any device, scheme, or artifice to defraud" or the making of material misrepresentations or omissions "*in connection with* the purchase or sale of any security." 17 CFR § 240.10b-5 (emphasis added).

4 The three Stanford Ponzi scheme-related cases before the Supreme Court arise from the *Roland* consolidated appeal in the Fifth Circuit.

The Stanford Ponzi Scheme Class Actions

In 2009, the SEC brought suit against the Stanford Group Company, as well as a number of other Stanford corporate entities, including the Stanford International Bank ("SIB"), for "allegedly perpetrating a massive Ponzi scheme." *Roland*, 675 F.3d 503. 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, however, "SIB [allegedly] 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."

Investors in SIB CDs subsequently brought state law-based class action suits 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. These suits were consolidated in the Northern District of Texas. Defendants moved to dismiss the actions on SLUSA grounds.

On August 31, 2010, the Northern District of Texas held that SLUSA precluded the Stanford Ponzi scheme-related actions. Applying the Eleventh Circuit's test for SLUSA's "in connection with" requirement, the district court found that plaintiffs "had alleged two distinct factual bases connecting the fraud to transactions in covered securities." First, the court found that plaintiffs' purchases of SIB CDs were "'induced' by the misrepresentation that SIB invested in a portfolio including SLUSA-covered securities." Second, the district court found that plaintiffs' allegations "reasonably impl[ied] that the Stanford scheme coincided with and depended upon … [p]laintiffs' sale of SLUSA-covered securities to finance SIB CD purchases" insofar as the scheme "target[ed] recent retirees who were urged to" roll over their retirement account funds into IRAs "fully invested" in Stanford CDs. Plaintiffs appealed.

In a March 19, 2012 decision, the Fifth Circuit reversed the district court's decision and held that SLUSA did not preclude plaintiffs' claims. The Fifth Circuit rejected the Eleventh Circuit's test for SLUSA's "in connection with" requirement as "too stringent a standard." Instead, the court adopted the Ninth Circuit's test as set forth in *Madden*, 576 F.3d 957. The *Madden* court held that misrepresentations are made 'in connection with' the purchase and sale of covered securities for SLUSA purposes if "the fraud and the stock sale coincide or are more than tangentially related."

Applying the Ninth Circuit's test, the Fifth Circuit found alleged misrepresentations that the SIB CDs were backed by "covered securities" to be "merely tangentially related to the 'heart,' 'crux,' or 'gravamen' of the defendants' fraud." *Roland*, 675 F.3d 503. The Fifth Circuit emphasized that the SIB CDs were "not mere 'ghost entities' or 'cursory pass-through vehicles' to invest in covered securities." Rather, "[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 Fifth Circuit also found "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."

Three different sets of defendants separately petitioned for certiorari of the Fifth Circuit's decision. On January 18, 2013, the Court granted all three petitions.

Petitioners Argue the Fifth Circuit's Test Has No Basis in SLUSA's Statutory Text

In their merits brief to the Supreme Court, petitioners contended that the Stanford Ponzi scheme-related "class action is precluded [under SLUSA] because it alleges material misrepresentations about SIB's purchases of covered securities." Brief for Petitioner Chadbourne & Parke LLP, *Chadbourne & Parke LLP v. Troice*, 2013 WL 1883206 (May 3, 2013). "The complaint repeatedly alleges that plaintiffs were induced to purchase SIB CDs based in part on the Stanford entities' false representation that the CDs were safe and liquid because they were backed by past and future purchases of covered securities."

Petitioners argued that the Fifth Circuit's "tangentially related" test for applying SLUSA's "in connection with" requirement is "wrong for several reasons." First, SLUSA's "[p]reclusion [p]rovision is not limited to misrepresentations that are the 'heart,' 'crux,' or 'gravamen' of the alleged fraud." Petitioners pointed out that "[n]o such terms appear in the text of the provision." "Rather, the provision applies so long as the complaint 'allege[s] … *a* misrepresentation … of a material fact in connection with the purchase or sale of a covered security.'" Second, the Fifth Circuit's test allows an "end-run" around "the strictures of the PSLRA." "[A]ll a plaintiff alleging securities fraud would need to do to evade SLUSA (and thus the PSLRA) is add *more* allegations to the complaint unrelated to securities fraud, and try to convince the reviewing court that the additional allegations are the 'crux' of the fraud while the others are not." Finally, petitioners contended that "the Fifth Circuit's standard is too subjective" and "would depend entirely on each individual court's subjective view of the 'heart,' 'crux,' or gravamen' of an alleged fraud."

Petitioners also challenged as "irrelevant" and "wrong" the Fifth Circuit's focus on the fact that "plaintiffs were not promised either a direct ownership stake in covered securities or returns that tracked the performance of SIB's purported securities portfolio." Petitioners emphasized that SLUSA's statutory language "does not require that the misrepresentations concern the plaintiffs' own purchase of securities, or purchases on the plaintiffs' behalf."

United States Submits an Amicus Brief in Support of Petitioners' View

In an amicus brief supporting petitioners' position, the United States argued that a "broad reading" of SLUSA is "essential" to "further Congress's objective of preventing the use of state-law class actions to circumvent the restrictions imposed by the PSLRA." Brief for the United States as Amicus Curiae Supporting Petitioners, *Chadbourne & Parke LLP v. Troice*, 2013 WL 1947418 (May 10, 2013). Here, the United States explained that SLUSA's requirements were met because "SIB [had] falsely represented that its assets were invested in the types of securities that are typically listed on a regulated national exchange." The United States contended that "[t]he fact that the purported securities transactions did not actually occur does not render SLUSA inapplicable."

Like the petitioners, the United States posited that "[n]othing in SLUSA's text" supports the Fifth Circuit's "tangentially related" test. "Rather," SLUSA "unambiguously encompasses all state-law covered class actions in which the plaintiff alleges a material misrepresentation having the requisite connection to a transaction in covered securities." The United States argued that even if SLUSA preclusion "depended on the centrality of particular misrepresentations to an overall fraudulent scheme, respondents' suits would be precluded" because "only the securities-related misrepresentations purported to explain *how* SIB could deliver the promised above-market returns."

Respondents Counter That Petitioners' Interpretation Would Require a "Radical Expansion" of SLUSA

Respondents contended that SLUSA does not preclude their claims because they "allege fraud in connection with the sale of the SIB certificates of deposit, which were not covered securities and which did not convey any interest in any covered security." Brief of Respondents, *Chadbourne & Parke LLP v. Troice*, 2013 WL 3817000 (Jul. 18, 2013). Respondents pointed out that "SIB's misrepresentation was not about any 'purchase or sale.'"

According to respondents, "[t]he securities laws apply only to misrepresentations that 'coincide' with securities transactions, not misstatements 'about' securities ownership." "The securities laws do not apply to the sale of a non-covered asset when the seller misrepresents its intent to buy covered securities in which no other party will hold any interest." Respondents argued that "[o]n petitioners' reading, every false statement about securities ownership—whether in a credit application, a job interview, or anywhere else—potentially constitutes securities fraud."

Justices Question Whether SLUSA Applies to Cases Where There Has Been No Purchase or Sale of Covered Securities

During oral argument on October 7, 2013, petitioners' counsel stated that "[t]he simplest, narrowest way to decide this case is to say that when there is a misrepresentation and a false promise to purchase covered securities for the benefit of the plaintiffs, then the 'in connection with' standard is" met. Counsel for the United States, as amicus curiae, "[a]gree[d] with [this] narrow formulation."

Counsel for the respondents, on the other hand, asked the Court to adopt the following rule: "a false promise to purchase securities for one's self in which no other person will have an interest is not a material misrepresentation in connection with the purchase or sale of covered securities" for SLUSA purposes.

A numbers of the Justices expressed skepticism at petitioners' position. Justice Kagan stated that "[i]n all of our cases, there's been something to say when somebody can ask the question: How has this

affected a potential purchaser or seller in the market for the relevant securities?" She emphasized that in this case, "there's nothing to say." Justice Scalia observed that he had "assumed that the purpose of the securities laws was to protect the purchasers and sellers of the covered securities." But here "[t]here is no purchaser … or seller of a covered security."

Justice Alito asked whether it matters for SLUSA preclusion if there was in fact a purchase or sale of securities. Petitioners' counsel cautioned against "draw[ing] a line that basically says, look, if you buy different securities than you were supposed to or you sell fewer than you were supposed to, that's covered, but if you're a Madoff and you go all the way and simply lie about the whole thing and there never were any securities purchases at all, … that's somehow better." Counsel for the United States echoed this view, stating that "a purported or intended purchase or sale is sufficient" for purposes of SLUSA preclusion.

Justice Scalia suggested that this view conflicted with SLUSA's statutory text:

> It can't be in connection with a purchase or sale that has never occurred. I mean, it could have read in connection with the purchase or sale, or the promised purchase or sale, or the contemplated purchase or sale, but it doesn't. It says 'in connection with the purchase or sale.' I don't know how you can make that stick to a situation where there has been no purchase or sale.

Counsel for the United States responded that SLUSA "also doesn't say the consummated purchase or sale." She argued that "the purported, intended, consummated [sale], all those things are swept up in the text."

Justice Kagan posited: "[S]uppose I think that the correct test" for purposes of SLUSA preclusion is whether the misrepresentation at issue "affect[ed] somebody's decision to buy or sell or hold covered securities. Can you satisfy that test?" Counsel for the United States responded that the fraud at issue here could have "a major effect on investor confidence … specifically with respect to covered securities."

Justice Kennedy observed that the case at hand is not "that much different" from a scenario in which a "broker says, 'Give me $100,000 and I will buy covered securities,' and then he just pockets it and … flees." Respondents' counsel argued that "[t]he critical difference" here is that the Stanford entities "did not give the plaintiffs any interest" in the covered securities and "the interest rate on the CDs was completely independent of the return on those covered securities." Respondents' counsel attempted to distinguish the Madoff cases on similar grounds. "Madoff engaged in securities fraud. He was selling air," respondents' counsel explained. But in this case "SIB sold only non-covered securities."

* * *

The Court is expected to issue a decision later this term which we will discuss in a future edition of the Alert.

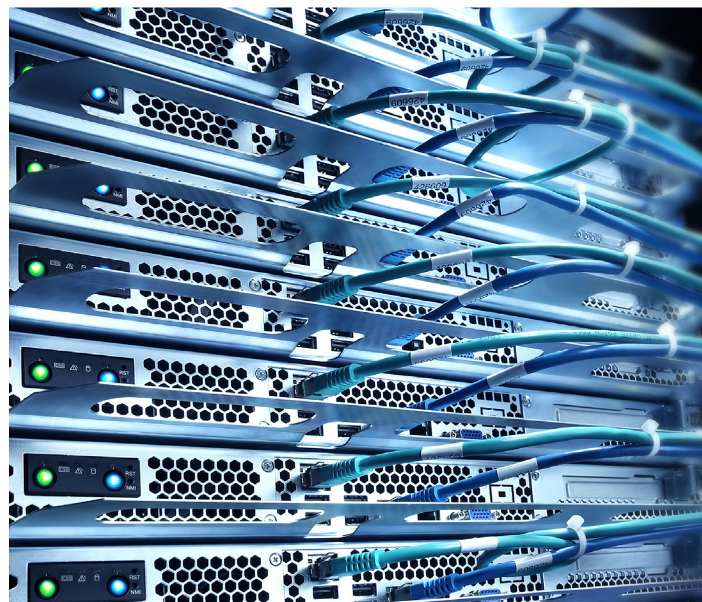
Ninth Circuit Declines To Apply a "Novel" Loss Causation Standard When Securities Are Traded in Inefficient Markets

On September 19, 2013, the Ninth Circuit affirmed summary judgment in favor of the City of Alameda in a securities fraud action alleging that the City had misrepresented the risks of certain municipal bonds. *Nuveen Municipal High Income Opportunity Fund v. City of Alameda*, 2013 WL 5273097 (9th Cir. Sept. 19, 2013) (McKeown, J.). The Ninth Circuit rejected plaintiffs' argument that "a novel standard [for loss causation] should apply" because the market for the municipal bonds at issue was inefficient.

Background

In 2004, the City of Alameda issued $33 million in Revenue Bond Anticipation Notes (the "Notes") to complete construction of a municipal telecommunications system. The Official Statement accompanying the Notes "set forth projections regarding the telecom system's viability and profitability" and discussed "certain risk factors," including "the risk of competition from other cable television and Internet service providers, chief among them Comcast." Nuveen Municipal High Income Opportunity Fund, the Nuveen Municipal Trust Fund for the Nuveen High Yield Municipal Bond Fund, and Pacific Specialty Insurance Company (collectively, "Nuveen") held approximately $20 million worth of the City of Alameda's Notes.

The City's telecommunications system "performed poorly" in the years that followed the Notes' issuance, both as a result of "fierce" competition from Comcast and the economic recession that began in 2007. Between January 31, 2005 and May 1, 2008, the Notes



were traded only eighteen times, at or near face value. In June 2008, the City sold its telecommunications system to Comcast for approximately $15 million, and paid all proceeds from the sale to the holders of the Notes. Nuveen received a little over $10 million, leaving it with a shortfall of close to $10 million.

Nuveen brought Section 10(b) claims against the City claiming that "the Official Statement contained inflated and unrealistic projections that materially overstated the telecom system's anticipated performance." Nuveen contended that "these misrepresentations induced Nuveen to purchase the Notes and caused Nuveen to suffer economic losses when the system was sold." In 2011, the Northern District of California granted the City of Alameda's motion for summary judgment, finding that Nuveen had failed to "present[ ] any evidence of a causal relationship between the allegedly unrealistic projections in 2004 and the sale of the [telecommunications system] for less than the par value of the Notes in 2008." *In re Nuveen Funds/City of Alameda Sec. Litig.*, 2011 WL 1842819 (N.D. Cal. May 16, 2011) (Illston, J.). Nuveen appealed.

Ninth Circuit Finds "No Support in the Law" for Applying a Different Loss Causation Standard When Securities Are Traded in Inefficient Markets

On appeal, Nuveen contended that "a novel standard [for loss causation] should apply" where, as here, "the Notes were traded only sporadically" and "the market was inefficient." *Nuveen Municipal High Income Opportunity Fund*, 2013 WL 5273097. Nuveen argued that "the loss causation requirement is satisfied" in such cases if a plaintiff can establish that the securities "would not have been issued 'but for' the [defendant']s fraudulent misrepresentations."

The Ninth Circuit found "no support in the law" for Nuveen's claim that a different loss causation standard should apply when securities are traded in an inefficient market. The court emphasized that "[t]he loss causation element is a fixture of federal law and applies to all [Rule] 10b-5 claims, whether involving securities traded in an efficient or inefficient market." Moreover, the court pointed out that the loss causation requirement codified in the Private Securities Litigation Reform Act ("PSLRA") "applies to 'any private action' and does not carve out a different or special standard depending on the type of market in which securities are traded."

Ninth Circuit Rejects Nuveen's "But For" Loss Causation Argument

Nuveen contended that it had satisfied the loss causation requirement by establishing that "the Notes could never have been sold *but for* the City's fraud." Finding Nuveen's argument meritless, the Ninth Circuit explained that it has "consistently rejected" such "but for" loss causation theories because they "'render[ ] the concept of loss causation meaningless by collapsing it into transaction causation.'" The court underscored that "[t]he two elements of causation—transaction causation and loss causation—are distinct." Transaction causation, or reliance, "refers to the causal link between the defendant's misconduct and the plaintiff's decision to buy or sell securities." Loss causation, on the other hand, requires a plaintiff to "show 'proximate' or 'legal' cause."

"Typically, 'to satisfy the loss causation requirement, the plaintiff must show that the revelation of [a] misrepresentation or omission was a substantial factor in causing a decline in the security's price, thus creating an actual economic loss for the plaintiff.'" Alternatively, under the "'materialization of the risk' approach" recognized in several circuits, a plaintiff can establish loss causation by showing that the "misstatements and omissions concealed the … risk … that materialized and played some part in diminishing the [security's] market value." This approach allows a plaintiff to "satisfy loss causation by showing that 'the defendant misrepresented or omitted the *very facts* that were a substantial factor in causing the plaintiff's economic loss.'"

"To show loss causation" in this case, the Ninth Circuit found that Nuveen had to "demonstrate a causal connection between the alleged misrepresented risks in the Official Statement and the economic loss Nuveen suffered." The court determined that "[t]his critical link [was] missing" because "Nuveen's loss result[ed] from the decline in value of the Notes, as reflected in the sale price" of the City's telecom system. "Had Comcast purchased the system for the par value of the Notes, $33 million, Nuveen would not have suffered any economic loss at all."

The Ninth Circuit "reject[ed] Nuveen's suggestion that the 2008 sale price reflect[ed] the reduction in value attributable to the alleged 2004 fraud." The court observed that Nuveen's argument "fail[ed] to recognize that devaluation of collateral may be influenced by … a tangle of factors that affect refinancing and sale." While "the City's allegedly inflated projections were not in fact met," the court explained that "it does not follow from the proposition that the Official Statement downplayed

certain risks that those particular risks were substantially responsible for the economic loss Nuveen suffered."

Quoting *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005), the Ninth Circuit observed that "a security's 'lower price may reflect, not the earlier misrepresentation, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events.'" The Ninth Circuit found "the need to reliably distinguish among the tangle of factors affecting a security's price … no less urgent in inefficient markets." Because Nuveen had "presented no evidence" establishing that the City's alleged misrepresentations "were a substantial factor in causing its loss," the Ninth Circuit affirmed the district court's grant of summary judgment in favor of the City of Alameda.

Tenth Circuit Applies *Reves* Test for Determining Whether a Loan Instrument Qualifies as a "Security" for Purposes of the Federal Securities Laws

On October 4, 2013, the Tenth Circuit held that the District of Utah had correctly determined that loan instruments sold by Novus Technologies qualified as "securities" for purposes of the federal securities laws under the test set forth in *Reves v. Ernst & Young*, 494 U.S. 56 (1990). *SEC v. Thompson*, 2013 WL 5498133 (10th Cir. Oct. 4, 2013) (Ebel, J.). Notably, the Tenth Circuit ruled that the question of whether an instrument constitutes a "security" is a matter of law rather than fact in civil cases.

Background

In 2007, the SEC filed suit against Ralph W. Thompson, Jr. "in connection with an alleged Ponzi scheme Thompson ran through his company, Novus Technologies." Novus had issued unsecured promissory notes to investors, and then used the funds from those "loans" to invest in various Ponzi schemes. The promissory note expressly reflected the parties' understanding that Novus would be "using the proceeds from the Note for further investments." Moreover, the note "stated on its face that it was not a security." While Thompson initially offered the promissory notes only to family and friends, he eventually broadened his reach and even touted the notes at shopping mall seminars. Novus ultimately made a total of 138 "loans" to approximately 60 noteholders.

In October 2010, the District of Utah granted the SEC's motion for summary judgment on the question of whether the notes constituted "securities" for purposes of the federal securities laws. The district court held that the notes qualified as "securities" under *Reves*, and also constituted "investment contracts" under *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946). Thompson appealed, claiming that the district court had "ignored genuine disputes of material fact on the issue of whether the Novus instruments were securities" and contending that "he was entitled to have a jury make that determination."

The "Family Resemblance" Test for Determining Whether a Note Qualifies as a "Security"

In *Reves v. Ernst & Young*, the Supreme Court held that a "note is presumed to be a security." 494 U.S. 56. The Court ruled that this "presumption may be rebutted only by a showing that the note bears a strong resemblance" to the categories of loan instruments enumerated by the Second Circuit in *Exchange Nat'l Bank of Chicago v. Touche Ross & Co.*, 544 F.2d 1126 (2d Cir. 1976). Those categories include:

> The note delivered in consumer financing, the note secured by a mortgage on a home, the short-term note secured by a lien on a small business or some of its assets, the note evidencing a 'character' loan to a bank customer, short-term notes secured by an assignment of accounts receivable, or a note which simply formalizes an open-account debt incurred in the ordinary course of business (particularly if, as in the case of the customer of a broker, it is collateralized) [, and] … notes evidencing loans by commercial banks for current operations.

Exchange Nat'l, 544 F.2d 1126.

To evaluate whether an instrument "bears a strong resemblance" to any of the aforementioned categories of notes, the *Reves* Court instructed courts to consider its "family resemblance" factors: (1) "the motivations that would prompt a reasonable seller and buyer to enter into [the transaction]"; (2) "the 'plan of distribution' of the instrument," including an assessment of whether "there is common trading" of the instrument "for speculation or investment"; (3) "the reasonable expectations of the investing public"; and (4) "whether some factor such as the existence of another regulatory scheme significantly reduces the risk of the investment, thereby rendering application of the Securities Acts unnecessary."

The *Reves* Court further ruled that if application of these four factors "leads to the conclusion that an instrument is not sufficiently similar to an item on the list," the court must then determine "whether another category should be added … by examining the same factors."

Whether an Instrument Qualifies as a "Security" Is a Question of Law, Tenth Circuit Holds

At the outset of its analysis, the Tenth Circuit held that "in the context of a civil case where the 'security' status of a 'note' is disputed, the ultimate determination of whether the note is a security is one of law." The court explained that "resolution of factual disputes will be necessary only in those rare instances where the reviewing court is unable to make a proper balancing of the [*Reves*] family-resemblance factors without resolving those factual disputes."

The Tenth Circuit further determined that "at the summary judgment stage," the evidentiary burden is on the "non-movant who argues that a note is *not* a security." The court stated that "the non-movant's evidence

that notes *are not* securities … must create a material amount of persuasion above equipoise … sufficient to overcome the presumption that all notes are securities."

Tenth Circuit Finds Novus Loan Instruments Constitute "Securities" Under the *Reves* Test

Applying the *Reves* test, the Tenth Circuit found that Thompson could not "meet his burden to rebut the presumption that Novus's [notes] were securities."

Motivations of the Parties

The court "first examine[d] the motivations that would prompt a reasonable buyer and seller of the [notes] to enter into the transaction." Under *Reves,* "[i]f the seller's purpose is to raise money for the general use of a business enterprise or to finance substantial investments and the buyer is interested primarily in the profit the note is expected to generate, the instrument is likely to be a 'security.'" *Reves,* 494 U.S. 56. But "if the note is exchanged to facilitate the purchase and sale of a minor asset or consumer good, to correct for the seller's cash-flow difficulties, or to advance some other commercial or consumer purpose, … the note is less sensibly described as a 'security.'"

The Tenth Circuit held that "[t]his factor clearly favors a finding that the [notes] were securities." *Thompson*, 2013 WL 5498133. The court found it significant that the note stated on its face the parties' understanding that Novus would be "using the proceeds from the Note for further investment." Moreover, the court determined that "the attractive interest rate the [notes] guaranteed provide[d] strong evidence that holders were 'interested primarily in the profit the note [was] expected to generate.'"

Plan of Distribution

The court then considered the second *Reves* factor: whether there was "common trading for speculation or investment" in the notes. *Reves*, 494 U.S. 56. The Tenth Circuit explained that "the sale of the notes on an exchange is not necessary to establish the requisite common trading." *Thompson*, 2013 WL 5498133. Rather, "all that is necessary to establish this element" under *Reves* is "the offer and sale of instruments to a 'broad segment of the public.'" The Tenth Circuit noted that "an 'evident interest in widening the scope of distribution,' combined with the 'broad availability of the notes' can tip this factor 'strongly in favor' of classifying the note as a security."

In the case at hand, the court found that Thompson had initially offered the Novus notes to family and friends but later "sought to expand … distribution to anyone interested who had $100,000 to invest—even if that meant unsophisticated investors obtaining the money by liquidating home equity."

The Tenth Circuit determined that "the plan of distribution" for the Novus notes bore "no similarity to the typical plan of distribution in the non-security instruments on the Second Circuit's list" in *Exchange Nat'l*. "[I]n those distribution plans, the party receiving the infusion of cash will often transact with only one 'lender'; and the 'lender,' ordinarily a bank or some other lending institution, will infuse cash into myriad 'borrowers' as part of its ordinary course of business." Here, however, "Novus's scheme

… involved one 'borrower' and myriad 'lenders,' which resemble[d] far more closely the activity of a company selling its own stock on an exchange." The Tenth Circuit held that the second *Reves* factor also "strongly cut[ ] toward finding that the [Novus notes] were 'securities.'"

Reasonable Perceptions of the Investing Public

Pursuant to *Reves*' third factor, the Tenth Circuit next examined "'the reasonable expectations of the investing public'" and whether the notes were "reasonably viewed by purchasers as investments." The court found that this factor was "a closer call" because the Novus notes "expressly stated that '[Novus] [was] not offering a security as defined by the Securities and Exchange Commission." Moreover, the notes had "features not ordinarily associated with securities, such as acceleration conditions." On the other hand, there were certain "'countervailing factors' that would lead a reasonable person to question Novus's characterization of the [notes] as non-securities."

The Tenth Circuit explained that it "need not spend too long on this element" because it is a "'one-way ratchet,' allowing 'notes that would not be deemed securities under a balancing of the other three factors nonetheless to be treated as securities if the public ha[d] been led to believe they are,' but not allowing 'notes which under the other factors would be deemed securities to escape the reach of regulatory laws.'" Nevertheless, the court "conclude[d] that this *Reves* factor lean[ed], at least slightly, toward characterizing the Novus [notes] as securities."

Existence of Alternate Regulatory Scheme

The Tenth Circuit then turned to the fourth *Reves* factor, which considers whether "some factor such as the existence of another regulatory scheme significantly reduces the risk of the instrument, thereby rendering application of the Securities Acts unnecessary." The court explained that this factor "cuts toward characterizing the instrument as a security" if "the instrument 'would [otherwise] escape federal regulation entirely.'"

Thompson contended that the "Novus [note]holders were adequately protected" by the Utah State Securities Division ("USSD"). However, he "offer[ed] no argument or authority as to the nature of the USSD's state-enforcement mechanisms, how those coexist or interact with the federal Securities Acts, or how those might have protected out-of-state holders of Novus [notes]." Finding this argument to "run[ ] counter to *Reves*'s clear emphasis on federal regulation," the Tenth Circuit determined that "*Reves*'s fourth factor weighs heavily in favor of the presumption that the Novus [notes] were securities."

Based on its analysis of *Reves*' four factors, the Tenth Circuit found that the Novus notes bore "little resemblance to the categories of non-securities instruments on the Second Circuit's judicially crafted list" in *Exchange Nat'l*. The court determined that this "same analysis … counsel[ed] against adding a new category of non-security to the Second Circuit's list." The Tenth Circuit concluded that the Novus notes were securities under the *Reves* test.

Southern District of Texas Declines to Dismiss Deepwater Explosion-Related English Common Law Claims Brought by Purchasers of BP Shares on a Foreign Exchange

On September 30, 2013, the Southern District of Texas denied defendants' motion to dismiss English common law claims brought by purchasers of BP p.l.c. shares on the London Stock Exchange in securities fraud actions arising out of the April 2010 Deepwater Horizon explosion in the Gulf of Mexico. *Alameda Cty. Emp. Ret. Assoc. v. BP*, 2013 WL 5716880 (S.D. Tex. Oct.

30, 2013) (Ellison, J.). The court had previously held that the Supreme Court's decision in *Morrison v. Nat'l Australia Bank Ltd.*, 130 S. Ct. 2869 (2010) precluded Section 10(b) claims brought by the same plaintiffs because the BP securities at issue traded only on a foreign exchange. *In re BP p.l.c. Sec. Litig.*, 2012 WL 432611 (S.D. Tex. Feb. 13, 2012) (Ellison, J.).[5] The court's recent decision may allow plaintiffs to circumvent *Morrison* by bringing suit in U.S. federal courts in connection with securities purchased on foreign exchanges, and recasting Section 10(b) claims as foreign law-based common law claims.

Court Finds English Law Governs Plaintiffs' Common Law Claims

Barred from asserting Section 10(b) claims, purchasers of BP ordinary shares on the London Stock Exchange asserted state law claims as well as common law claims "for which four different states' laws" (Texas, California, Massachusetts, and Rhode Island) were "proffered as providing the substantive law." Defendants contended that the common law claims "should be decided under English law."

Although the court found no "strong … conflict in the proposed substantive laws as would ordinarily precipitate a choice-of-laws analysis," the Southern District of Texas explained that "failure to fix upon one jurisdiction's laws … is less than ideal." The court applied Texas's choice-of-law rules and determined that there were no "strong public policy grounds for displacing England as the jurisdiction with the most significant relationship to [p]laintiffs' claims." Accordingly, the court determined that "English law pertain[ed] to [p]laintiffs' claims."

5 Please click here to read our discussion of this decision in the February 2012 edition of the Alert.

Court Holds Forum Non Conveniens Does Not Require Dismissal of Plaintiffs' Common Law Claims

Defendants contended that the court should dismiss plaintiffs' common law claims under the doctrine of forum non conveniens. The court rejected defendants' argument, finding that defendants had failed to "surmount[ ] the high bar for disturbing [p]laintiffs' choice of forum." Viewing "the private and public interest factors … *in toto*," the court concluded that the Southern District of Texas was not "an inconvenient forum for [p]laintiffs' English law claims."

The court explained that "[i]t would be *in*efficient to send these claims to England" because "nearly the same issues will be adjudicated here" in securities fraud actions brought by purchasers of BP American Depositary Shares on the New York Stock Exchange. Moreover, the court emphasized the "unquestionably local" "nature of the controversy." The court noted that "[t]he majority of the misrepresentations alleged by [the] [p]laintiffs touch the adequacy of, and the attention paid to, the safety of BP's *U.S.* operations."

While the court acknowledged that "[t]he one public interest factor favoring dismissal is the need to apply foreign law," it found that "this factor alone cannot be determinative." The court reasoned that it "is certainly capable of applying English law, which shares so many strong similarities with U.S. law due to a common heritage." While the court granted defendants' motion to dismiss with respect to certain of plaintiffs' claims, it rejected defendants' arguments that the "English law claims" should be dismissed.

Delaware Chancery Court Dismisses Shareholder Suit Against Sirius XM's Directors as Time-Barred

On September 27, 2013, the Delaware Chancery Court dismissed as time-barred a shareholder suit brought in connection with Liberty Media Corporation's acquisition of control of Sirius XM Satellite Radio Inc. ("Sirius") pursuant to the terms of the February 2009 Investment Agreement governing Liberty Media's $530 million capital infusion in Sirius.[6] *In re Sirius XM S'holder Litig.*, 2013 WL 5411268 (Del. Ch. Sept. 27, 2013) (Strine, C.). The court found that plaintiffs were "not entitled to watch Sirius take over half a billion dollars in capital from Liberty Media, sit on the sidelines benefitting from the investment Liberty Media made in Sirius until after the statute of limitations [had] expire[d], and then belatedly seek to deprive Liberty Media of the benefits of the contract it received in exchange."

Background

In 2009, Sirius faced a serious financial crisis. The company's stock was trading at only $0.15 per share, and Sirius lacked the cash flow necessary to repay certain outstanding Convertible Notes. To remain solvent, Sirius obtained a $530 million capital infusion from Liberty Media that provided Sirius with the time it needed to develop new sources of revenue and expand its on-air talent. In exchange, "Liberty Media received, among other things, preferred stock in Sirius that was convertible into a 40 percent common equity interest" pursuant to an Investment Agreement between the two companies.

Sirius negotiated a standstill period that "limited Liberty Media's ability to take majority control of Sirius for three years." After the expiration of the standstill period, however, "the Investment Agreement specifically prevented the Sirius board from using a poison pill or any other charter or bylaw provision to interfere with Liberty Media's ability to purchase additional Sirius stock." Sirius publicly announced the Investment Agreement with Liberty Media and disclosed the terms of the capital infusion on February 17, 2009.

On March 6, 2012, the standstill period expired. Liberty Media announced its intention to acquire majority control of Sirius and began purchasing additional Sirius shares on the open market. Sirius shareholders subsequently brought the instant action alleging that Sirius's directors had breached their fiduciary duties by failing to block Liberty Media's initiative through the adoption of a poison pill. Plaintiffs "also alleged that Liberty Media had breached its fiduciary duties as a controlling stockholder by purchasing shares on the open market to acquire majority control of Sirius without paying a premium." Defendants moved to dismiss the complaint as untimely, among other grounds.

6 Simpson Thacher represents Sirius and certain of the director defendants in this action.

Chancery Court Finds Plaintiffs' Claims Against Sirius's Directors Accrued When the Capital Infusion Was Negotiated

Absent the application of a recognized tolling doctrine, "a plaintiff must file a claim for breach of fiduciary duty within three years of the conduct that gives rise to the claim." The Chancery Court explained that "[u]nder Delaware law, a plaintiff's cause of action accrues at the moment of the wrongful act—not when the harmful effects of the act are felt—even if the plaintiff is unaware of the wrong."

Here, the court found that "[t]he core of the plaintiffs' Complaint—the Anti-Takeover Provisions contained in the Investment Agreement—were agreed to and disclosed to the public in 2009." The court observed that "the board's inability to block Liberty Media's so-called 'creeping takeover' was merely the manifestation of the bargain struck between Sirius and Liberty Media in 2009." Since "reasonable Sirius stockholders were on full notice of the Investment Agreement's terms," the court held that there was "no excuse for the plaintiffs' failure to challenge the Anti-Takeover Provisions within the three-year statute of limitations."

The Chancery Court found the case at hand "similar to the circumstances in" *Hokanson v. Petty*, 2008 WL 5169633 (Del. Ch. Dec. 10, 2008). There, Exactech had provided Altiva Corporation with a capital infusion in 2003 in exchange for a buyout option allowing Exactech to buy all outstanding Altiva common shares during a set time period at a price based on a preset formula. When Exactech attempted to exercise the buyout option in 2007, four years after the capital infusion, plaintiffs brought suit contending that the price was too low. Plaintiffs attempted to avoid dismissal on statute of limitations grounds by challenging the board's failure to negotiate a higher share price at the time of Exactech's buyout, rather than at the time of the contract negotiations governing Exactech's capital infusion. Rejecting plaintiffs' claims, the court held that "[t]he material decisions about the [Exactech] transaction, including the price and transaction form" were made in 2003, when the capital infusion was negotiated, and could not be challenged four years later.

The Chancery Court determined that the Sirius XM plaintiffs, "like those in *Hokanson,*" could not "ignore the reality created by the Investment Agreement; that reality included the fact that the Sirius board was contractually precluded from blocking Liberty Media from acquiring more shares in the open market." *Sirius XM S'holder Litig.*, 2013 WL 5411268.

Chancery Court Deems Meritless Plaintiffs' "Duty of Fairness" Claim Against Liberty Media

Plaintiffs contended that "even if Liberty Media had specifically negotiated as a non-controlling stockholder" for the contractual right to obtain control over Sirius, Liberty Media nevertheless "owed a

broad duty of fairness" to Sirius's shareholders "that precluded it from buying additional shares in the marketplace except in a transaction that was approved as fair by the Sirius board of directors." In essence, plaintiffs claimed that "Liberty Media [had] breached its fiduciary duties as a controlling stockholder by not relinquishing the contractual right it had secured in 2009—before it was a stockholder of Sirius—to be able to acquire Sirius stock after the expiration of the standstill period without being impeded by the Sirius board."

The Chancery Court held that this claim could "not survive the defendants' motion to dismiss for two reasons." First, the court found the claim time-barred because it accrued in 2009, when the Investment Agreement providing Liberty Media with the right to obtain control over Sirius was negotiated and executed. Second, the court held that plaintiffs had "fail[ed] to state a cognizable claim" for breach of fiduciary duty against Liberty Media. Plaintiffs were "unable to point to anything Liberty Media did that involved control over Sirius's board or misuse of its resources in connection with those purchases," nor did plaintiffs claim that "Liberty Media was trying to effect a going-private transaction" or had "engaged in fraud in its purchase transactions." The Chancery Court ruled that Liberty Media's "mere exercise of its contractual right to purchase additional shares of Sirius stock on the open market to acquire a majority stake" "did not involve any use of fiduciary power by Liberty Media at all" and did "not constitute a breach of any duty."

The court granted defendants' motion to dismiss the complaint in its entirety.

Delaware Chancery Court Dismisses Shareholder Suit Against BioClinica's Directors

On October 16, 2013, the Delaware Chancery Court dismissed with prejudice a shareholder action brought against the directors of BioClinica, Inc. in connection with BioClinica's March 2013 acquisition by JLL Partners, BioCore Holdings and BC Acquisition Corp. (collectively, "JLL"). *In re BioClinica, Inc. S'holder Litig.*, 2013 WL 5631233 (Del. Ch. Oct. 16, 2013) (Glasscock, V.C.) (*BioClinica II*). The Chancery Court had previously denied plaintiffs' motion to expedite litigation to enjoin the merger. The court explained that "[w]here a complaint seeking to enjoin a merger on grounds of breach of fiduciary duty by the company's directors is insufficient to support a motion to expedite, the chances of the same allegations surviving a motion to dismiss are vanishingly small."

Background

In May 2012, BioClinica's board of directors decided to explore the possibility of selling the company. The board established a committee of independent directors (the "Committee"), and retained EP Securities LLC ("Excel") as its financial advisor. To avoid disclosing confidential information to BioClinica's competitors, the Committee initially instructed Excel to pursue private equity bidders rather than strategic bidders. In August 2012, after Excel informed the Committee that three private equity firms were potentially interested in acquiring BioClinica, the Committee asked Excel to broaden its search to include strategic acquirers.

On January 23, 2013, after Excel solicited twenty-one bidders, JLL—a private equity bidder—confirmed an offer to acquire BioClinica at a premium of more than 20%. The Committee recommended the

transaction to the Board, and Excel opined that the transaction was fair. The Merger Agreement was finalized on January 29, 2013 and contained certain deal-protection devices, including "a no-solicitation provision; a $6.5 million termination fee that included $2 million in expense reimbursement; information rights; and a topup option."

BioClinica's shareholders subsequently filed the instant action alleging that the company's directors had "breached their duties of care and loyalty in approving the transaction" and "their duties of disclosure to the stockholders by providing misleading disclosures." Plaintiffs also contended that JLL had aided and abetted the directors' breaches of fiduciary duty. On February 25, 2013, the Chancery Court denied plaintiffs' motion to expedite litigation of the action, finding none of plaintiffs' claims "colorable" and "sufficient to justify the substantial burden of expedited proceedings." *In re BioClinica, Inc. S'holder Litig.*, 2013 WL 673736 (Del. Ch. Feb. 25, 2013) (Glasscock, V.C.).

JLL's acquisition of BioClinica closed on March 13, 2013. Plaintiffs subsequently amended their complaint; defendants moved to dismiss plaintiffs' claims.

Chancery Court Finds Plaintiffs Failed to Allege Any Breach of the Duty of Loyalty

At the outset, the Chancery Court noted that "BioClinica's certificate of incorporation absolve[d] its directors from monetary damages arising out of breaches of the duty of care." *BioClinica II*, 2013 WL 5631233. Plaintiffs could therefore only recover damages if they "successfully assert[ed] a claim not entitled to exculpation, i.e., a breach of the duty of loyalty." Here, plaintiffs advanced "two bases on which the Board could be held liable for beaching its duty of loyalty in approving the Merger Agreement: the directors procured material benefits for themselves that were not shared by the other stockholders, and the directors did not act in good faith in approving the transaction." The Chancery Court determined that plaintiffs failed to allege facts sufficient "to adequately plead any breach of the Board's duty of loyalty to the BioClinica stockholders."

With respect to plaintiffs' contention that "the directors were interested due to vesting of stock options," the Chancery Court found this argument "frivolous" in light of Delaware precedent holding that "an interest in options vesting does not violate the duty of loyalty." As to plaintiffs' claim that

two of BioClinica's directors were interested in the transaction, the court found that plaintiffs did not allege that these directors "dominated or controlled the Board."

Turning to plaintiffs' bad faith claims, the court deemed "purely conclusory" plaintiffs' contention that "the Board [had] breached its duty of good faith by 'inflating' the capital expenditure estimates … used in Excel's fairness opinion." Since plaintiffs failed to provide "a story of *why* the directors would artificially inflate the capital expenditures," the court found "no basis to conclude that they [had] acted in bad faith."

With respect to plaintiffs' claim that "the directors [had] breached their *Revlon* duties by failing to conduct a reasonable sales process," the court emphasized the "important difference between a board's duty to maximize the value of a transaction as required by *Revlon*, and a board's duty to act in good faith throughout that process." Quoting the Delaware Supreme Court's decision in *Lyondell Chem. Co. v. Ryan*, 970 A.2d 235 (Del. 2009), the Chancery Court explained that "'if the directors failed to do all that they should have under the circumstances, they breached their duty of care.'" But "'[o]nly if they knowingly and completely failed to undertake their responsibilities would they breach their duty of loyalty.'" The Chancery Court underscored the "'vast difference between an inadequate or flawed effort to carry out fiduciary duties and a conscious disregard for those duties' amounting to bad faith."

Here, the Chancery Court concluded that "the Board did satisfy its *Revlon* duties by forming a committee of independent directors, engaging Excel's financial advising services, and retaining independent legal counsel." *BioClinica II*, 2013 WL 5631233. The court found plaintiffs' "assertion that JLL was a favored bidder … flatly contradicted by the facts." Moreover, the court determined that the deal-protection devices in the Merger Agreement "have been routinely upheld" by Delaware courts.

Chancery Court Finds Plaintiffs' Disclosure Allegations Insufficient to State a Bad Faith Claim

The court explained that "any disclosure claim that does not adequately allege a violation of the duty of good faith cannot survive the exculpation provision in BioClinica's certificate of incorporation." Moreover, the court noted that in order to qualify for compensatory relief, plaintiffs would have to demonstrate that the disclosures at issue would have changed the vote of "at least thirty-eight percent of the stockholders who voted in favor of the transaction," and that the stock value was greater than what BioClinica's stockholders "received in the tender offer." The court determined that "[s]uch allegations [were] absent here."

With respect to plaintiffs' claim that defendants "should have disclosed why they adjusted the capital expenditures upward," the Chancery Court found that "stockholders are entitled [only] to management's best estimates of future financials at the time of the merger." Management is under no obligation to "explain the basis for [its] estimates nor why [it] ha[s] adjusted [its] estimates." As to plaintiffs' contention that "the directors failed to disclose certain inputs used in Excel's fairness opinion," the court explained that "directors need only provide a 'fair summary of the substantive work performed'" by the board's financial advisors "when describing the inputs of a fairness opinion." Directors need not disclose "granular details concerning why individual inputs were selected or rejected."

The court concluded that plaintiffs had "failed to state a reasonably conceivable claim against the BioClinica directors" and "similarly failed to state a claim against JLL for aiding and abetting" the directors in the breach of their fiduciary duties. The court therefore dismissed plaintiffs' complaint in its entirety.

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