SIMPSON THACHER

SECURITIES LAW ALERT

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This month's Alert reviews the most notable securities litigation decisions of 2013. From the Supreme Court, we discuss the Court's holdings in *Amgen Inc. v. Connecticut Retirement Plans & Trust Funds*, 133 S. Ct. 1184 (2013) (Ginsburg, J.); *Standard Fire Ins. Co. v. Knowles*, 133 S. Ct. 1345 (2013) (Breyer, J.); and *Gabelli v. SEC*, 133 S. Ct. 1216 (2013) (Roberts, C.J.). We also address a dozen of the most interesting circuit court decisions of 2013.

Looking ahead to 2014, we discuss the following securities litigation-related cases currently pending before the Court: *Halliburton Co. v. Erica P. John Fund* (No. 13-317), in which the Court will consider the fraud-on-the-market presumption of reliance set forth in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988); and the Stanford Ponzi scheme cases—*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)—in which the Court will address the "in connection with" requirement of the Securities Litigation Uniform Standards Act ("SLUSA").

On December 13, 2013, the Court granted certiorari in two cases of interest to securities litigators. In *Fifth Third Bancorp v. Dudenhoeffer* (No. 12-751), the Court will consider whether ERISA plaintiffs must "plausibly allege … that the fiduciaries of an employee stock ownership plan ('ESOP') … abused their discretion by remaining invested in employer stock, in order to overcome the presumption that [the fiduciaries'] decision to invest in employer stock was reasonable." In *Loughrin v. United States* (No. 13-316), the Court will consider whether, in a federal bank fraud case brought under 18 U.S.C. § 1344, "the Government must prove that the defendant intended to defraud a bank and expose it to risk of loss." We will discuss both cases in the January 2014 edition of the Alert.

We wish you and yours the happiest of holidays, and a wonderful new year.

SUPREME COURT DECISIONS OF 2013

In 2013, the Supreme Court issued three decisions in the securities litigation sphere: *Amgen*, 133 S. Ct. 1184, which held that plaintiffs do not have to prove materiality to obtain class certification in fraud-on-the-market cases brought under Section 10(b) and

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Rule 10b-5; *Standard Fire*, 133 S. Ct. 1345, which held that a plaintiff in a proposed class action cannot avoid removal under the Class Action Fairness Act of 2005 ("CAFA") by stipulating to damages of less than $5 million; and *Gabelli*, 133 S. Ct. 1216, which held that Section 2462's limitations period for government penalty actions (including SEC enforcement actions) begins to run in fraud cases when the allegedly fraudulent conduct occurs, not when it is discovered. We discuss each of these cases in turn below.

Amgen Inc. v. Connecticut Retirement Plans & Trust Funds: The Supreme Court Holds That Plaintiffs Do Not Have to Prove Materiality to Obtain Class Certification in Fraud-on-the-Market Cases

On February 27, 2013, the Supreme Court considered "whether district courts must require plaintiffs to prove, and must allow defendants to present evidence rebutting, the element of materiality before certifying a class action under § 10(b) and Rule 10b-5" under the fraud-on-the-market theory set forth in *Basic*, 485 U.S. 224.[1] *Amgen*, 133 S. Ct. 1184. Justice Ginsburg, writing for a 6-3 majority, held that "plaintiffs are not required to prove materiality at the class-certification stage." The Court further ruled that the question of materiality "is properly addressed at trial or in a ruling on a summary-judgment motion."

The *Amgen* Court Focuses on Whether Proof of Materiality Is Essential to the Rule 23(b)(3) Analysis

The *Amgen* Court explained that the "key question" is "not whether materiality is an essential predicate of the fraud-on-the-market theory; indisputably it is." Rather, "the pivotal inquiry is whether proof of materiality is needed to ensure that the *questions* of law or fact common to the class will 'predominate over any questions affecting only individual members,'" as required for class certification under Rule 23(b)(3).

The Court determined that materiality is a common question for Rule 23(b)(3) purposes because "materiality is judged according to an objective standard" and "can be proved through evidence common to the class." "As to materiality," the Court explained that a securities fraud "class is entirely cohesive: It will prevail or fail in unison."

Moreover, the Court found "no risk whatever that a failure of proof on the common question of materiality [would] result in individual questions predominating" because such a failure "would end the case for one and for all." The Court determined that "even a definitive rebuttal on the issue of materiality would not undermine the predominance of questions common to the class."

1. Please see page 19 for a discussion of *Basic*'s fraud-on-the-market presumption.

The *Amgen* Court Addresses the Requirements of the Rule 23 Analysis

The *Amgen* Court explained that "Rule 23(b)(3) requires a showing that *questions* common to the class predominate, not that those questions will be answered, on the merits, in favor of the class."

The Court also emphasized that "Rule 23 grants courts no license to engage in free-ranging merits inquiries at the class certification stage." "Merits questions may be considered to the extent—but only to the extent—that they are relevant to determining whether the Rule 23 prerequisites for class certification are satisfied."

Four Justices in *Amgen* Question the Continued Viability of *Basic's* Fraud-on-the-Market Presumption

Four Justices in *Amgen* voiced reservations concerning the continued viability of *Basic*'s fraud-on-the-market presumption. Justice Alito, concurring, observed that "recent evidence suggests that the [fraud-on-the-market] presumption may rest on a faulty economic premise" and stated that "reconsideration of the *Basic* presumption may be appropriate." Justice Thomas, dissenting, joined by Justices Kennedy and Scalia, observed that "[t]he *Basic* decision itself is questionable" and noted that the *Basic* dissent's concerns with the economic theories underlying the fraud-on-the-market presumption "remain valid today."

Fifth Circuit Relies on *Amgen* to Hold That Defendants May Not Rebut the Fraud-on-the-Market Presumption of Reliance with Price Impact Evidence at the Class Certification Stage

On April 30, 2013, the Fifth Circuit considered the question of "whether a defendant should be permitted to show the absence of price impact at the class certification stage … to establish that common issues among class members do not predominate" in a fraud-on-the-market case. *Erica P. John Fund, Inc. v. Halliburton Co.*, 718 F.3d 423 (5th Cir. 2013) (Davis, J.). Relying on *Amgen*, the Fifth Circuit held that "price impact fraud-on-the-market rebuttal evidence should not be considered at class certification."

The Fifth Circuit found that under *Amgen*, "the 'pivotal inquiry' when determining whether to consider a matter at [the] class certification [stage] is whether resolution of the matter" is necessary to "ensure that the *questions* of law or fact common to the class will 'predominate over any questions affecting only individual [class] members'" as required under Rule 23(b)(3). Applying this first *Amgen* consideration, the Fifth Circuit concluded that "price impact fraud-on-the-market rebuttal evidence should not be addressed at class certification" because price impact is "an objective inquiry" that "inherently applies to everyone in the class."

The Fifth Circuit explained that the "second inquiry suggested by *Amgen* is whether there is any risk that a later failure of proof on the common question of price impact will result in individual questions predominating." If a defendant could

"successfully show that the price did not drop when the truth was revealed, then no plaintiff could establish loss causation," an essential element of a claim under Section 10(b) and Rule 10b-5. The Fifth Circuit found that this "second *Amgen* consideration also leads to the conclusion that price impact fraud-on-the-market rebuttal evidence should not be addressed at class certification."

Based on its determination that "price impact evidence does not bear on … common question predominance," the Fifth Circuit held that price impact is "appropriately considered only on the merits after the class has been certified." Halliburton petitioned the Court for certiorari of the Fifth Circuit's decision. On November 15, 2013, the Court granted Halliburton's petition. Please see pages 19 to 20 below for a discussion of the questions presented and the issues raised in *Halliburton Co. v. Erica P. John Fund* (No. 13-317).

Standard Fire Ins. Co. v. Knowles: The Supreme Court Holds That a Plaintiff in a Proposed Class Action Cannot Avoid Removal under CAFA by Stipulating to Total Class Damages of Less Than $5 Million

Under the Class Action Fairness Act of 2005 ("CAFA"), district courts have "original jurisdiction" over certain civil class actions "in which the matter in controversy exceeds the sum or value of $5,000,000." 28 U.S.C. § 1332(d)(2). CAFA further provides that "the claims of the individual class members shall be aggregated to determine whether the matter in controversy exceeds the sum or value of $5,000,000." 28 U.S.C. § 1332(d)(6).

On March 19, 2013, the Supreme Court considered the effect of a precertification stipulation that a plaintiff "and the class he seeks to represent … will

not seek damages that exceed $5 million in total." *Standard Fire*, 133 S. Ct. 1345. The Court unanimously held that such a stipulation "does not resolve the amount-in-controversy question" for CAFA purposes because "a plaintiff who files a proposed class action cannot legally bind members of the proposed class before the class is certified."

The Court acknowledged that "federal courts permit individual plaintiffs, who are the masters of their complaints, to avoid removal to federal court, and to obtain a remand to state court, by stipulating to amounts at issue that fall below the federal jurisdictional requirement." However, the Court explained that "the key characteristic about those stipulations is that they are legally binding on all plaintiffs." The Court pointed out that this "essential feature [was] missing here," as the plaintiff could "not speak for those he purport[ed] to represent" and therefore "lacked the authority to concede the amount-in-controversy issue for the absent class members."

One issue that has arisen post-*Standard Fire* is the applicable burden of proof for defendants seeking removal where plaintiffs have pled an amount in controversy of less than $5 million. In *Rodriguez v. AT&T Mobility Services LLC*, 728 F.3d 975 (9th Cir. 2013) (Clifton, J.), the Ninth Circuit ruled that defendants

seeking removal under CAFA need only "demonstrate, by a preponderance of evidence, that the aggregate amount in controversy exceeds the jurisdictional minimum." The Ninth Circuit determined that *Standard Fire* had "effectively overruled" its prior decision in *Lowdermilk v. U.S. Bank National Association*, 479 F.3d 994 (9th Cir. 2007), which required defendants to "prove with legal certainty that CAFA's jurisdictional amount [had been] met." *Lowdermilk*, 479 F.3d 994.

The Ninth Circuit explained that "*Lowdermilk* [had] adopted the legal certainty standard to reinforce plaintiff's prerogative, as master of the complaint, to avoid federal jurisdiction by forgoing a portion of the recovery on behalf of the putative class." *AT&T Mobility Svcs.*, 728 F.3d 975. However, "[t]hat choice has been taken away by *Standard Fire*," which "instructs courts to look beyond the complaint to determine whether the putative class action meets the jurisdictional requirements." The Ninth Circuit concluded that "the reasoning behind *Lowdermilk*'s imposition of the legal certainty standard is clearly irreconcilable with *Standard Fire*."

Another question that has come up is whether *Standard Fire* permits plaintiffs to evade CAFA's requirements by bringing multiple class actions, each with less than 100 plaintiffs, asserting parallel claims in connection with the same underlying facts. In *Scimone v. Carnival Corp.*, 720 F.3d 876 (11th Cir. 2013) (Marcus, J.), defendants urged the court to read *Standard Fire* as "stating a broad rule that CAFA does not allow plaintiffs to structure their lawsuits to avoid CAFA jurisdiction." The Eleventh Circuit rejected defendants' contention as an effort to "stretch[ ] the Supreme Court's analysis far past its breaking point." The court held that *Standard Fire* could not "be read to suggest that all sections of CAFA strip plaintiffs of their traditional roles as masters of their complaint."

In *Romo v. Teva Pharmaceuticals USA, Inc.*, 731 F.3d 918 (9th Cir. 2013) (Rawlinson, J.), the Ninth Circuit considered whether plaintiffs' request to coordinate multiple class actions, each with less than 100 plaintiffs, was tantamount to a proposal to try the cases jointly for purposes of CAFA's mass action provision.[2] The Ninth Circuit found that "plaintiffs' petition for coordination stopped far short of proposing a joint trial." Citing *Standard Fire*, which "reiterat[ed] in the CAFA context that plaintiffs are the 'masters of their complaints,'" the Ninth Circuit explained that "the plaintiff is, and should be, in control of selection of the litigation forum."

Judge Gould, dissenting from the majority opinion in *Teva Pharmaceuticals*, acknowledged that *Standard Fire* does not preclude plaintiffs from bringing multiple actions, each with less than a hundred plaintiffs. "If plaintiffs are masters of their complaints and can plead in a way to avoid federal jurisdiction, they remain free to 'game' the system to some degree, including by joining less than one hundred plaintiffs in many suits in state court, so long as those cases are separate." However, Judge Gould found that when plaintiffs here sought "to coordinate their cases for reasons that only a joint trial could address, they implicitly proposed a joint trial, bringing their cases within CAFA's mass action provision."

Gabelli v. SEC: The Supreme Court Holds That Section 2462's Limitations Period for Government Penalty Actions Begins to Run in Fraud Cases When the Allegedly Fraudulent Conduct Occurs

Section 2462 of Title 28 provides that a federal government action "for the enforcement of any civil fine, penalty, or forfeiture" must be "commenced within five years from the date when the claim first

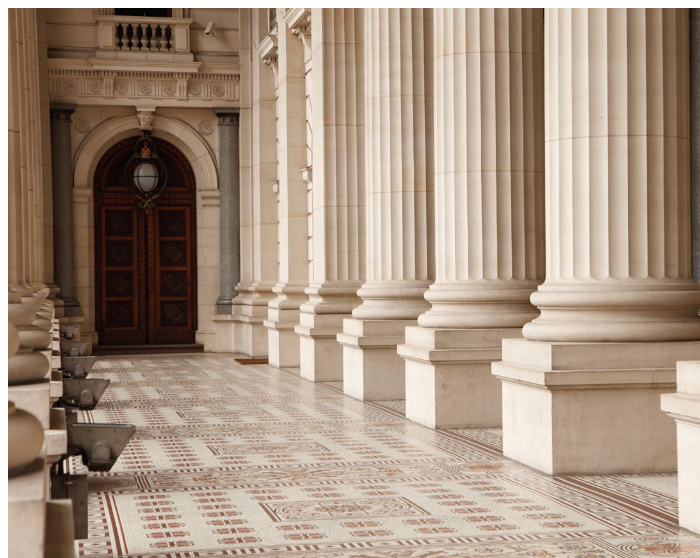
2. CAFA defines a "mass action" as "any civil action … in which monetary relief claims of 100 or more persons are proposed to be tried jointly on the ground that the plaintiffs' claims involve common questions of law or fact." 28 U.S.C. § 1332(d)(11)(B)(i).

accrued" unless "otherwise provided by" Congress. 28 U.S.C. § 2462. In *Gabelli*, 133 S. Ct. 1216, the Supreme Court considered "whether the five-year clock begins to tick" in fraud cases "when the fraud is complete or when the fraud is discovered."

Chief Justice Roberts, writing for a unanimous Court, held that "a claim based on fraud accrues—and the five-year clock begins to tick—when a defendant's allegedly fraudulent conduct occurs." The Court reasoned that "[t]his reading sets a fixed date when exposure to the specified Government enforcement efforts ends" and advances "the basic policies of all limitations provisions: repose, elimination of stale claims, and certainty about a plaintiff's opportunity for recovery and a defendant's potential liabilities." Moreover, the Court found no "textual, historical, or equitable reasons to graft a discovery rule onto the statute of limitations of § 2462."

Post-*Gabelli* courts have rejected plaintiffs' efforts to limit the *Gabelli* Court's holding to SEC enforcement actions or securities cases. In *New Jersey v. RRI Energy Mid-Atlantic Power Holdings, LLC*, 2013 WL 1285456 (E.D. Pa. Mar. 28, 2013) (Gardner, J.), the Eastern District of Pennsylvania found that the *Gabelli* Court "made clear that the limitations period provided by 28 U.S.C. § 2462 'is not specific to the Investment Advisers Act, or even to securities law.'" Rather, the Supreme Court held that "§ 2462 provided a general statute of limitations which 'governs many penalty provisions throughout the U.S. Code.'" The *RRI* court emphasized that "[n]othing in the *Gabelli* decision indicated that it was analyzing § 2462 as applied to the SEC specifically." Similarly, in *U.S. Commodity Futures Trading Commission v. Reisinger*, 2013 WL 3791691 (N.D. Ill. July 18, 2013) (Gottschall, J.), the Northern District of Illinois found no indication in *Gabelli* "that the same reasoning does not apply to the efforts of other federal agencies, including the [Commodity Futures Trading Commission], to bring claims for civil penalties." The *Reisinger* court explained that "the Court's analysis focused on the proper reading of § 2462 itself."

In *U.S. v. Midwest Generation, LLC*, 720 F.3d 644 (7th Cir. 2013) (Easterbrook, J.), the Seventh Circuit relied on *Gabelli* in considering whether Section 2462's statute of limitations had run on a claim under the Clean Air Act. The court explained that "*Gabelli* tells us not to read statutes in a way that would abolish effective time constraints on litigation."



A number of courts have found that *Gabelli* limits the application of the discovery rule to other federal statutes of limitations. In *Kost v. Hunt*, 2013 WL 6048921 (D. Minn. Nov. 15, 2013) (Ericksen, J.), the District of Minnesota found that *Gabelli* "should be read as seriously undermining, if not rendering obsolete, earlier statements by the lower courts that the discovery rule operates as a default" when interpreting federal statutes of limitations. The *Kost* court relied on *Gabelli* to hold that the discovery rule does not apply to the statute of limitations set forth in 28 U.S.C. § 1658(a) with respect to claims under the federal Driver's Privacy Protection Act. *See also Singleton v. Clash*, 2013 WL 3285096 (S.D.N.Y. July 1, 2013) (Koeltl, J.) (applying *Gabelli* to find that "Congress did not provide for a discovery rule under Section 2255, and none should be implied").

NOTEWORTHY CIRCUIT COURT DECISIONS OF 2013

First Circuit Holds That a Corrective Disclosure Need Not Mirror the Original Alleged Misrepresentation for Loss Causation Purposes

On May 24, 2013, the First Circuit held that in order to allege loss causation, plaintiffs do not have to identify a corrective disclosure that is "a 'mirror-image' disclosure—a direct admission that a previous statement [was] untrue." *Mass. Ret. Sys. v. CVS Caremark Corp.*, 716 F.3d 229 (1st Cir. 2013) (Howard, J.). While a "corrective disclosure must relate to the same subject matter as the alleged misrepresentation," the First Circuit found that "a defendant's failure to admit to making a misrepresentation, or his denial that a misrepresentation was made, does not necessarily preclude loss causation." The court explained that the "appropriate inquiry" is whether the purported corrective disclosure "plausibly revealed to the market" that an earlier statement was untrue.

The First Circuit further held that "[w]hen a plaintiff alleges corrective disclosures that are not straightforward admissions of a defendant's previous misrepresentations, it is appropriate to look for indications of the market's contemporaneous response" when determining whether the statements constituted corrective disclosures for loss causation purposes. In the case before it, the court found that the district court should have considered analyst reports when determining whether plaintiffs had adequately alleged loss causation. The First Circuit explained that "[t]o preclude a plaintiff from relying on analyst reports that expose the limitations of a defendant's statements could permit the defendant to 'defeat liability by refusing to admit the falsity of its prior misstatements.'"

Second Circuit Holds Plaintiffs Must Allege a Misrepresentation to State a Market Manipulation Claim Under Section 10(b)

On May 7, 2013, the Second Circuit held that in order to state any claim for damages under Section 10(b), including a market manipulation claim, plaintiffs must allege that defendants made a misrepresentation upon which plaintiffs relied. *Fezzani v. Bear, Stearns & Co. Inc.*, 716 F.3d 18 (2d. Cir. 2013) (Winter, J.) (*Fezzani II*).

The case concerned an alleged "pump and dump" scheme by A.R. Baron, a now defunct broker-dealer. To recover their losses, Baron's investors brought Section 10(b) and Rule 10b-5 claims against various defendants, including Issac R. Dweck, allegedly one of Baron's principal investors. Plaintiffs claimed that Dweck had "provided Baron with short-term cash infusions and financing for specific deals, and [had] allowed Baron to park certain securities on particular occasions in his accounts at other broker-dealers." Dweck's assistance allegedly created an "illusion of trading activity" in the securities Baron sold.

Plaintiffs did not allege that Dweck himself made any representations concerning the market

for Baron's securities; rather, plaintiffs asserted that Dweck's conduct constituted market manipulation in violation of Section 10(b) and Rule 10b-5. Notably, plaintiffs sought recovery from Dweck for all losses they suffered as a result of Baron's scheme, not simply "discrete claims related to the prices paid for the particular securities parked by Dweck at times they were trading." In September 2008, the Southern District of New York dismissed plaintiffs' market manipulation claims against Dweck based on plaintiffs' failure to plead "reliance upon Dweck's alleged fraudulent behavior." *Fezzani v. Bear, Stearns & Co., Inc.*, 592 F. Supp. 2d 410 (S.D.N.Y. 2008) (Crotty, J.).

On appeal, the Second Circuit explained that its "difficulty with regard to Dweck's liability under Section 10(b)" stemmed from "the lack of an allegation that Dweck was involved in any communication with any of the appellants." *Fezzani II*, 716 F. 3d 18. Although Dweck had allegedly "engaged in phony trading activity that created an 'impression' of 'value and liquidity' in securities being pedaled by Baron," there was "no allegation that any appellant was told of Dweck's artificial trading, or purchased such securities in specific reliance on such trading."

The Second Circuit turned to Supreme Court precedent to determine whether the allegations "sufficiently support[ed] a Section 10(b) claim" against Dweck "for damages by all the appellants for all the fraudulent sales of securities to them by Baron." Citing *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994) (Kennedy, J.), the Second Circuit explained that "Dweck may be liable in this matter only as a primary violator." The Second Circuit further found that under *Stoneridge Investment Partners, L.L.C. v. Scientific-Atlanta*, 552 U.S. 148 (2008) (Kennedy, J.), "a plaintiff must allege that the specific defendant was identified as making the pertinent misrepresentation(s)" in order "to prove a primary violation of Section 10(b)." In other words, "an allegation of acts facilitating or even indispensable to a fraud is not sufficient to state a claim if those acts were not the particular misrepresentations that deceived the investor."

"Applying these principles to the present claims," the Second Circuit found that plaintiffs "were required to allege acts by Dweck that amounted to more than knowingly participating in, or facilitating, Baron's fraud to state a claim under Section 10(b)." The Second Circuit explained that under its prior decision in *ATSI Communications, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87 (2d Cir. 2007) (Walker, J.), "manipulation violates Section 10(b) when an artificial or phony price of a security is communicated to persons who, in reliance upon a misrepresentation that the price was set by market forces, purchase the securities." In view of *Stoneridge and Janus*, the Second Circuit determined that "only the person who communicates the misrepresentation is liable in private actions under Section 10(b)." The Second Circuit therefore held that the complaint "fail[ed] to state a Section 10(b) *private claim for damages* against Dweck."

Judge Lohier issued a lengthy dissent criticizing the majority for "superimpos[ing] the elements of a misrepresentation claim on a market manipulation claim." He found that the majority had "misread [ ]" both *Janus and Stoneridge* "to require a direct communication of false information to the plaintiffs in the context of a claim of market manipulation." Unlike the misrepresentation

claims at issue in *Janus* and *Stoneridge*, Judge Lohier explained that stock manipulation "necessarily and directly communicates false information through the market and goes beyond a false statement."

Second Circuit Holds *American Pipe* Tolling Does Not Apply to Section 13's Three-Year Statute of Repose

In *American Pipe & Construction Co. v. Utah*, 414 U.S. 538 (1974), the Supreme Court considered whether members of a proposed class could intervene in a class action that had been dismissed for failure to meet Rule 23's numerosity requirements where the applicable statute of limitations had run on the intervenors' claims. The Supreme Court held that plaintiffs could intervene because "the commencement of a class action suspends the applicable statute of limitations as to all asserted members of the class who would have been parties had the suit been permitted to continue as a class action." *American Pipe*, 414 U.S. 538.

On June 27, 2013, the Second Circuit held that "*American Pipe*'s tolling rule does not apply to the three-year statute of repose in Section 13" of the Securities Act of 1933, which governs claims under Sections 11 and 12 of the Securities Act. *Police and Fire Ret. Sys. of the City of Detroit v. IndyMac MBS, Inc.*, 721 F.3d 95 (2d Cir. 2013) (Cabranes, J.) (*IndyMac II*). The Second Circuit explained that "while statutes of limitations are 'often subject to tolling principles,' a statute of repose '*extinguishes* a plaintiff's cause of action after the passage of a fixed period of time, usually measured from one of the defendant's acts." "[I]n contrast to statutes of limitations," the Second Circuit found that statutes of repose 'create[ ] a substantive right in those protected to be free from liability after a legislatively-determined period of time.'" The court underscored that "a statute of repose is 'subject [only] to legislatively created exceptions.'" Accordingly, the Second Circuit determined that "*American Pipe*'s tolling rule … does not extend to the statute of repose in Section 13."

The Second Circuit further ruled that "neither Rule 24 nor the Rule 15(c) 'relation back' doctrine permits members of a putative class, who are not named parties, to intervene in [a] class action as named parties in order to revive claims that were dismissed from the class complaint for want of jurisdiction."

On November 22, 2013, the plaintiff in the *IndyMac* action filed a petition for certiorari, citing a circuit split on the question of whether *American Pipe* tolling applies to the Section 13 statute of repose. Petition for a Writ of Certiorari, *Public Employees' Ret. Sys. Of Mississippi v. IndyMac MBS, Inc.* (No. 13-640) (November 22, 2013). Plaintiff argued that "[t]he Second Circuit's holding creates a direct and acknowledged conflict with the Tenth Circuit's holding" in *Joseph v. Wiles*, 223 F.3d 1155 (10th Cir. 2000) "that *American Pipe* applies to the three-year period in § 13."

Post-*IndyMac* courts have declined to extend the Second Circuit's holding to statutes of limitations. In *Monroe County Employees Retirement System v. YPF Sociedad Anonima*, 2013 WL 5548833 (S.D.N.Y. Oct. 8, 2013) (Sheindlin, J.), the Southern District of New York found that *IndyMac* does not govern "the question of whether *American Pipe* tolls a *statute of limitations* such as the one in Section 11 where the initial plaintiff

lacked standing." And in *Sapirstein-Stone-Weiss Foundation v. Merkin*, 2013 WL 2495141 (S.D.N.Y. June 11, 2013) (Marrero, J.), the Southern District of New York found that "*IndyMac* has no bearing" on the question of whether *American Pipe* tolling applies to a statute of limitations for New York state law-based claims. The court explained that "unlike *IndyMac*, the present case does not involve a statute of repose and therefore there is no bar to equitable tolling pursuant to *American Pipe*."

Second Circuit Holds ERISA Fiduciaries Have No Duty to Seek Out Inside Information

On July 15, 2013, the Second Circuit affirmed dismissal of an ERISA action brought by participants in the Lehman Brothers Savings Plan based on the presumption of prudence set forth by the Third Circuit in *Moench v. Robertson*, 62 F.3d 553 (3d Cir. 1995).[3] *Rinehart v. Akers*, 722 F.3d 137 (2d Cir. 2013) (Wesley, J.). Notably, the Second Circuit held that ERISA "[f]iduciaries are under no obligation to either seek out or act upon inside information in the course of fulfilling their duties under ERISA."

The *Moench* presumption holds that "an [employee stock ownership plan] fiduciary who invests the assets in employer stock is entitled to a presumption that it acted consistently with ERISA by virtue of that decision." 62 F.3d 553. In an effort to overcome this presumption, plaintiffs in the Lehman action argued that defendants "had a duty to investigate whether Lehman was in a dire situation." Plaintiffs contended that "any reasonable investigation would have revealed material, nonpublic information sufficient to confirm that Lehman was on the verge of collapse." Rejecting plaintiffs' argument, the Second Circuit held that the duty of prudence under ERISA cannot "be construed to include an obligation to affirmatively seek out material, nonpublic information pertaining to plan investments." The Second Circuit observed that several other circuit courts had also reached the same conclusion.

The Second Circuit described the "quandary" that would be "bound to occur" if ERISA required plan fiduciaries to "conduct an investigation into the financial condition of a plan asset that extend[ed] to material, nonpublic information." If the fiduciaries uncovered inside information establishing that "continued investment [was] imprudent," then they would be able to "limit[ ] further investment in the improvident asset without breaching securities laws." However, fiduciaries would "not be able to comply with their duty of prudence by divesting the plan of its pre-existing investment without risking liability for insider trading." The Second Circuit explained that "[t]he prudent man does not commit insider trading."

Second Circuit Addresses the Materiality Standard for Section 11 Claims Based on Alleged Omissions

On July 22, 2013, the Second Circuit affirmed dismissal of Section 11 claims brought against ProShares Trust and ProShares Trust II ("ProShares") based on plaintiffs' failure to plead *material* omissions or misrepresentations in the prospectuses for ProShares exchange-traded funds ("ETFs"). *In re ProShares Trust Sec. Litig.*, 728 F.3d 96 (2d Cir. 2013) (Wesley, J.). The Second Circuit held that when evaluating materiality for purposes of a Section 11 claim, courts must read prospectuses with the assumption "that a reasonable investor can comprehend the basic meaning of plain-English disclosures."

The court explained that while materiality "will rarely be dispositive in a motion to dismiss" a Section 11 claim based on an alleged omission, "the

3. Simpson Thacher represents the members of the Lehman Employee Benefit Plans Committee in this action.

materiality hurdle remains a meaningful pleading obstacle." Dismissal of a Section 11 claim is warranted if an "alleged omission was 'so obviously unimportant to a reasonable investor' that reasonable minds would agree on that omission's unimportance."

The Second Circuit noted that "the Supreme Court has been 'careful not to set too low of a standard of materiality, for fear that management would bury the shareholders in an avalanche of trivial information.'" *ProShares*, 728 F.3d 96 (quoting *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309 (2011)). For materiality purposes, the Second Circuit stated that what matters is whether there is a "*substantial* likelihood" that disclosure of the omitted information "would have been viewed by the *reasonable* investor as having *significantly* altered the total mix of information already made available."

The Second Circuit explained that "[i]n evaluating a prospectus," a court must "read it as a whole." After reviewing "the prospectus cover-to-cover," a court should "consider whether the disclosures and representations, 'taken together and in context, would have misled a reasonable investor.'" The Second Circuit emphasized that prospectuses need not address reasonable investors "as if they were children in kindergarten." Applying this standard to the case before it, the Second Circuit found that the ProShares "prospectuses adequately warned the reasonable investor of the allegedly omitted risks."

In a decision issued on November 1, 2013, the Southern District of New York applied the *ProShares* materiality standard to claims brought under Section 10(b) and Rule 10b-5. *In re Bank of America AIG Disclosure Sec. Litig.*, 2013 WL 5878814 (S.D.N.Y. Nov. 1, 2013) (Koeltl, J.). The court found that "no reasonable investor could have read [Bank of America's] extensive risk disclosures … without understanding that indeterminate potential losses … could later materialize." Citing *ProShares*, the court found that "defendants had no duty to say more."

Second Circuit Holds *Morrison*'s Limits on the Extraterritorial Application of Section 10(b) Apply to Criminal Securities Fraud Actions

In a decision issued on August 30, 2013, the Second Circuit considered "a question left open after the Supreme Court's decision" in *Morrison v. National Australia Bank Ltd.*, 130 S. Ct. 2869 (2010): "whether *criminal* liability under Section 10(b) of the Securities Exchange Act of 1934 … extends to conduct in connection with an extraterritorial purchase or sale of securities." *United States v. Vilar*, 729 F.3d 62 (2d Cir. 2013) (Cabranes, J.). The Second Circuit held that "Section 10(b) and its implementing regulation, Rule 10b-5, do not apply to extraterritorial conduct, regardless of whether liability is sought criminally or civilly."

The Second Circuit concluded that "*Morrison*'s holding applies equally to criminal actions brought under Section 10(b) … for two reasons." First, the Second Circuit determined that "the presumption against extraterritoriality applies to criminal statutes." Second, the court found that "the presumption

against extraterritoriality applies to Section 10(b)." The Second Circuit explained that "[t]he presumption against extraterritoriality is a method of interpreting a statute" rather than "a rule to be applied to the specific facts of each case." Either a statute "applies extraterritorially or it does not." In this case, the court observed that "[t]he Supreme Court has already interpreted Section 10(b)" and has held "in unmistakable terms" that Section 10(b) does not apply extraterritorially.

Second Circuit Affirms Dismissal of State Law Claims Against Madoff's Bankers on SLUSA Grounds

The Securities Litigation Uniform Standards Act of 1998 ("SLUSA") precludes certain state law-based class actions "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).

On September 16, 2013, the Second Circuit held that SLUSA precluded state law claims brought by investors in foreign "feeder funds" for Bernard L. Madoff Investment Securities ("Madoff Securities") against JPMorgan Chase & Co. and the Bank of New York Mellon ("BNY"), the banks which held Madoff Securities' accounts. *In re Herald*, 730 F.3d 112 (2d Cir. 2013) (Rakoff, J.). The court reasoned that plaintiffs' claims were "integrally tied" to "Madoff Securities' Ponzi scheme, which indisputably engaged in purported investments in covered securities" under SLUSA.

As an initial matter, the Second Circuit determined that Madoff Securities' failure to "actually execute[ ] [its] pretended securities trades" did not take the case "outside the ambit of SLUSA." The Second Circuit next found that the district court had correctly based its SLUSA analysis on "Madoff's 'downstream' transactions in covered securities" rather than plaintiffs' "purchase of 'uncovered' interests in the foreign feeder funds." The court explained that "on the very face of plaintiffs' complaints, the liability of JPMorgan and BNY is predicated not on these banks' relationship with plaintiffs or their investments in the feeder funds but on the banks' relationship with, and alleged assistance to, Madoff Securities' Ponzi scheme." Because "plaintiffs' allegations with respect to BNY and JPMorgan relate directly to Madoff's purported transactions in covered securities," the Second Circuit noted that it was "appropriate … to look to Madoff's purported transactions as the relevant transaction in covered securities for SLUSA's purposes."

The Second Circuit found that SLUSA precluded plaintiffs' claims against JPMorgan and BNY even though plaintiffs did not "style their claims … as securities fraud claims." The court explained that "plaintiffs cannot avoid SLUSA 'merely by consciously omitting references to securities or to the federal securities law.'" Here, plaintiffs alleged that JPMorgan and BNY "knew of the fraud, failed to disclose the fraud, and helped the fraud succeed—in essence, that JPMorgan and BNY were complicit[ ] in Madoff's fraud." The Second Circuit held that "[t]hese allegations [were] more than sufficient to satisfy SLUSA's requirement that the complaint allege a 'misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security.'"

Third Circuit Considers the Weight That Should Be Given to Confidential Witness Allegations

In a decision issued on November 15, 2013, the Third Circuit considered the weight that should be given to confidential witness allegations. The court explained that "[w]here plaintiffs rely on confidential personal sources but also on other facts," plaintiffs

"need not name their sources as long as the latter facts provide an adequate basis for believing that the defendants' statements were false." *Rahman v. Kid Brands, Inc.*, 736 F.3d 237 (3d Cir. 2013) (Greenberg, J.). The court noted that "there is no requirement that [confidential witnesses] be named, provided they are described in the complaint with sufficient particularity to support the probability that a person in the position occupied by the source would possess the information alleged."

"[W]hen dealing with confidential witnesses," the Third Circuit stated that "courts should assess the 'detail provided by the confidential sources, the sources' basis of knowledge, the reliability of the sources, the corroborative nature of other facts alleged, including from other sources, the coherence and plausibility of the allegations, and similar indicia.'" "If, after that assessment, 'anonymous source allegations are found wanting with respect to these criteria … [courts] must discount them steeply.'" The Third Circuit explained that "such a discount is consistent with" the Supreme Court's decision in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007), which holds "that omissions and ambiguities count against inferring scienter under the [Private Securities Litigation Reform Act's] particularity requirements." *Rahman*, 736 F.3d 237.

Fifth Circuit Finds the Dodd-Frank Act Whistleblower Protection Provision Creates a Private Right of Action Only for Individuals Who Report Possible Securities Violations to the SEC

On July 17, 2013, the Fifth Circuit held that the whistleblower protection provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act") "creates a private cause of action only for individuals who provide information relating to a violation of the securities laws to the SEC." *Asadi v. G.E. Energy (USA), LLC*, 720 F.3d 620 (5th Cir. 2013) (Elrod, J.). In so holding, the Fifth Circuit rejected recent court decisions finding that the Dodd-Frank Act's whistleblower protections extend to individuals who report internally, as well as the SEC's implementing regulation adopting a broader definition of "whistleblower."

The Fifth Circuit "start[ed] and end[ed]" its analysis "with the text of the relevant statute," which defines the term "whistleblower" as "any individual who provides … information relating to a violation of the securities laws *to the Commission*." 15 U.S.C. § 78u-6(a)(6) (emphasis added). The court found that "[t]his definition, standing alone, expressly and unambiguously requires that an individual provide information to the SEC to qualify as a 'whistleblower'" under the Dodd-Frank Act.

The Fifth Circuit acknowledged that its ruling conflicted with recent district court decisions holding that the statute "extends to protect certain individuals who do not make disclosures to the SEC." Moreover, the Fifth Circuit recognized that under the SEC's implementing regulation, an individual can qualify as a "whistleblower" "even though he never reports any information to the SEC." *Asadi*,

720 F.3d 620 (citing 17 C.F.R. § 240.21F-2(b)(1)). Nonetheless, the Fifth Circuit held that the "plain language and structure" of the Dodd-Frank Act establish "only one category of whistleblowers: individuals who provide information relating to a securities law violation to the SEC."

On October 16, 2013, the District of Massachusetts "respectfully disagree[d]" with the Fifth Circuit's holding and "instead adopt[ed] the SEC's interpretation" of the Dodd-Frank Act whistleblower protection provision. *Ellington v. Giacoumakis*, 2013 WL 5631046 (D. Mass. Oct. 16, 2013) (Stearns, J.). The court found the "SEC's construction … more persuasive," and explained that it was "apparent" from the Dodd Frank Act's statutory text that Congress "intended that an employee terminated for reporting Sarbanes-Oxley violations to a supervisor or an outside compliance officer and ultimately to the SEC, have a private right of action."

Similarly, on October 25, 2013, the Southern District of New York declined to follow the Fifth Circuit's approach. *Rosenblum v. Thomson Reuters (Markets) LLC*, 2013 WL 5780775 (S.D.N.Y. Oct. 25, 2013) (Scheindlin, J.). Finding the statute "ambiguous," the court determined that it was "appropriate to consider the SEC's interpretation," which "does not require a report to the SEC in order to obtain whistleblower protection" under the Dodd-Frank Act.

Sixth Circuit Rules Plaintiffs Need Not Plead Defendant's Knowledge of Falsity to State a Section 11 Claim Based on an Alleged Misstatement of Opinion or Belief

On May 23, 2013, the Sixth Circuit held that Section 11 of the Securities Act "does not require a plaintiff to plead a defendant's state of mind" even if the Section 11 claim is based on a statement of opinion or belief. *Indiana State Dist. Council of Laborers & HOD Carriers Pension & Welfare Fund v. Omnicare, Inc.*, 719 F.3d 498 (6th Cir. 2013) (Cole, J.). Unlike Section 10(b) and Rule 10b-5, which "require a plaintiff to prove scienter," the Sixth Circuit emphasized that "§ 11 is a strict liability statute." "[O]nce a false statement has been made" in a registration statement, the court found that "a defendant's knowledge is not relevant to a strict liability claim" under Section 11. The Sixth Circuit held that a complaint asserting a Section 11 claim "may survive a motion to dismiss without pleading knowledge of falsity."

Notably, the Sixth Circuit declined to follow the Second Circuit's decision in *Fait v. Regions Fin. Corp.*, 655 F.3d 105 (2d Cir. 2011) and the Ninth Circuit's decision in *Rubke v. Capitol Bancorp Ltd.*, 551 F.3d 1156 (9th Cir. 2009). In *Fait*, the Second Circuit held that "when a plaintiff asserts a claim under [S]ection 11 … based upon a belief or opinion alleged to have been communicated by a defendant, liability lies only to the extent that the statement was both objectively false and disbelieved by the defendant at the time it was expressed." 655 F.3d 105. Similarly, in *Rubke*, the Ninth Circuit held that statements of opinion "can give rise to a claim under [S]ection 11 only if the complaint alleges with particularity that the statements were both objectively and subjectively false or misleading."

551 F.3d 1156. Both the Second and Ninth Circuits relied on the Supreme Court's ruling in *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083 (1991) in reaching their decisions. In the Sixth Circuit's view, "[t]he Second and Ninth Circuits ha[d] read more into *Virginia Bankshares* than the language of the opinion allows and ha[d] stretched to extend [a] § 14(a) case into a § 11 context."

Ninth Circuit Finds *Moench* Presumption of Prudence Does Not Apply where an ESOP Plan Permits But Does Not "Require or Encourage" Fiduciaries to Invest in Company Stock

Under the presumption of prudence set forth by the Third Circuit in *Moench v. Robertson*, 62 F.3d 553 (3d Cir. 1995), "an [employee stock ownership plan] fiduciary who invests the assets in employer stock is entitled to a presumption that it acted consistently with ERISA by virtue of that decision." *Moench*, 62 F.3d 553. In *Quan v. Computer Sciences Corp.*, 623 F.3d 870 (9th Cir. 2010), the Ninth Circuit found that the *Moench* presumption of prudence only applies "when plan terms require or encourage the fiduciary to invest primarily in employer stock."

In a decision issued on October 23, 2013, the Ninth Circuit held that the *Moench* presumption of prudence did not apply where the Amgen Retirement and Savings Plan and the Retirement and Savings Plan for Amgen Manufacturing, Limited (together, the "Plans") "specifically refer[red] to a Company Stock Fund as a permissible investment." *Harris v. Amgen, Inc.*, 2013 WL 5737307 (9th Cir. Oct. 23, 2013) (Fletcher, J.). The Ninth Circuit explained that "an explicit statement that plan fiduciaries *may* offer a Company Stock Fund as an investment to participants does not tell us that they were encouraged to do so within the meaning of the presumption of prudence."

The Ninth Circuit found that in *Taveras v. UBS AG*, 708 F.3d 436 (2d Cir. 2013), the Second Circuit had "concluded that almost identical plan language [did] not give rise to the presumption of prudence." The Second Circuit stated:

> If the presumption of prudence was triggered in every instance where the EIAP plan document, as here, simply (1) named and defined the employer's stock in the plan document's terms, and (2) allowed for the employer stock to be offered by the plan's fiduciaries on a discretionary basis to plan participants, then we are hard pressed to imagine that there exists *any* EIAP that merely offered the option to participants to invest in their employer's stock whose fiduciaries would not be entitled to the presumption of prudence.

Taveras, 708 F.3d 436.

Finding that the Amgen "defendants were neither required nor encouraged by the terms of the Plans to invest in Amgen stock," the Ninth Circuit held that they were "not entitled to a presumption of prudence." *Amgen*, 2013 WL 5737307.

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

Section 11 of the Securities Act "provides a cause of action to any person who buys a security issued under a materially false or misleading registration statement." *In re Century Aluminum Co. Sec. Litig.*, 729 F.3d 1104 (9th Cir. 2013) (Watford, J.). To bring a Section 11 claim, "[p]laintiffs need not have purchased shares in the offering made under the misleading registration statement; those who purchased shares

in the aftermarket have standing to sue provided they can trace their shares back to the relevant offering."

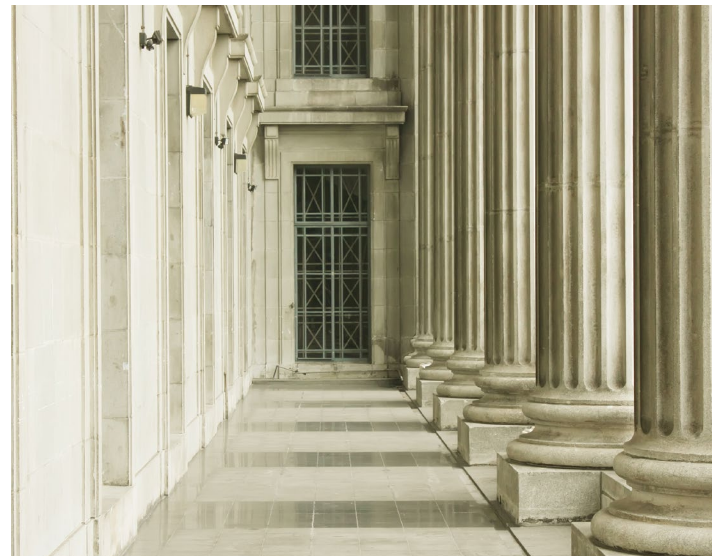
The "'tracing' requirement generally poses no obstacle" where "all of a company's shares have been issued in a single offering under the same registration statement." But in cases where "a company has issued shares under more than one registration statement, the plaintiff must prove that her shares were issued under the allegedly false or misleading registration statement, rather than some other registration statement."

On April 17, 2013, the Ninth Circuit addressed the question of what plaintiffs must plead in order to satisfy the tracing requirement in cases where "a company has issued shares in multiple offerings under more than one registration statement." *Century Aluminum*, 729 F.3d 1104. The court explained that plaintiffs may "satisfy this requirement in one of two ways." "First, plaintiffs could prove that they purchased their shares directly in the secondary offering itself," which "would obviously eliminate any questions about the lineage of plaintiffs' shares."

Alternatively, "plaintiffs could prove that their shares, although purchased in the aftermarket, can be traced back to the secondary offering." The Ninth Circuit observed that "tracing shares in this fashion is 'often impossible,' because 'most trading is done through brokers who neither know nor care whether they are getting newly registered or old shares.'" While the tracing requirement is "difficult to meet in some circumstances," the Ninth Circuit emphasized that it is "the condition Congress has imposed for granting access to the 'relaxed liability requirements' § 11 affords."

In the case before it, plaintiffs contended that it was "enough for them to allege, without more, that they [had] 'purchased Century Aluminum common stock directly traceable to the Company's Secondary Offering.'" But the Ninth Circuit found that "a greater level of factual specificity" is "needed before a court can reasonably infer that shares purchased in the aftermarket are traceable to a particular offering." The court explained that "experience and common sense tell us that when a company has offered shares under more than one registration statement, aftermarket purchasers usually will *not* be able to trace their shares back to a particular offering." Therefore, "plaintiffs had to allege facts from which [the court could] reasonably infer that their situation is different."

The Ninth Circuit found plaintiffs' allegations "consistent with their shares having come from either" the secondary offering or the pool of previously issued shares. Because plaintiffs' allegations did "not tend to exclude the possibility that their shares came from the pool of previously issued shares," the Ninth Circuit held that the complaint did "not give rise to a reasonable inference that plaintiffs' shares [were] traceable to the secondary offering." The court therefore affirmed dismissal of plaintiffs' Section 11 claims.



On July 10, 2013, the Central District of California relied on the Ninth Circuit's decision in *Century Aluminum* to dismiss certain Section 11 claims where plaintiffs had not "alleged sufficient facts" showing that the shares at issue were "traceable" to the secondary offering. *Feyko v. Yuhe Intern., Inc.*, 2013 WL 3467067 (C.D. Cal. July 10, 2013) (Pregerson, J.).

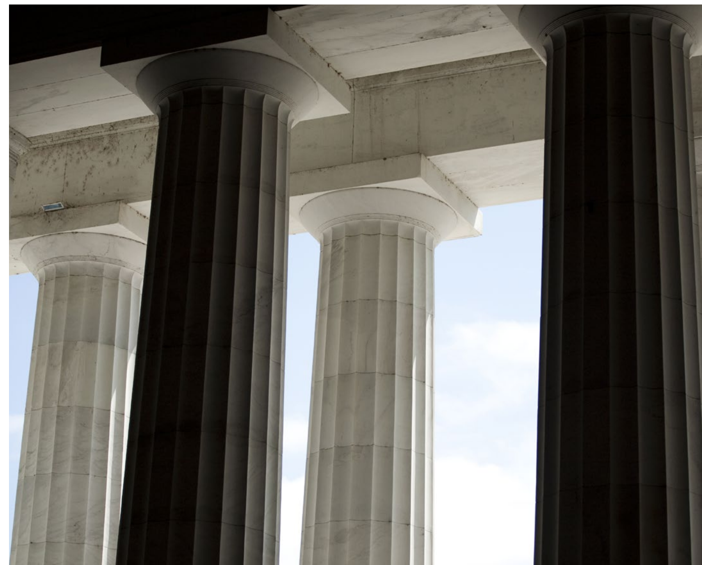
CASES TO WATCH IN 2014

2014 promises to be an extraordinarily interesting year for developments in securities litigation. In the Stanford Ponzi scheme cases, the Court is poised to rule on the scope of SLUSA's "in connection with" requirement. The Court's ruling will impact the extent to which plaintiffs can evade the requirements of the federal securities laws by bringing state law-based securities-related class actions.

In addition, the Court will consider *Basic*'s fraud-on-the-market presumption of reliance, which enables Section 10(b) plaintiffs to meet Rule 23(b)(3)'s predominance requirement for class certification in misrepresentation cases. The Court's decision will likely have far-reaching consequences for Section 10(b) misrepresentation cases.

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

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). In *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71 (2006), the Supreme Court stated 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.[4] 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."

Since *Dabit*, "[e]ach 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." *Roland v. Green*, 675 F.3d 503 (5th Cir. 2012) (Prado, J.). 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 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*,

4. 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).

546 F.3d 1340 (11th Cir. 2008).

In a decision issued on March 19, 2012, the Fifth Circuit followed the Ninth Circuit's approach in holding 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*." *Roland*, 675 F.3d 503. The Fifth Circuit considered whether SLUSA precluded state-law based class action suits brought in connection with R. Allen Stanford's multi-billion dollar 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." 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."

Applying the Ninth Circuit's test for SLUSA's "in connection with" requirement, the Fifth Circuit determined that SLUSA did not preclude plaintiffs' claims. 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."

On January 18, 2013, the Court granted three separate petitions for certiorari to review the Fifth Circuit's decision. *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). 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.[5]

On October 7, 2013, the Court heard consolidated oral argument in the three cases. Petitioners' counsel contended 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 Respondents, on the other hand, asked the

5. *Chadbourne & Parke LLP v. Troice* ("[w]hether 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").

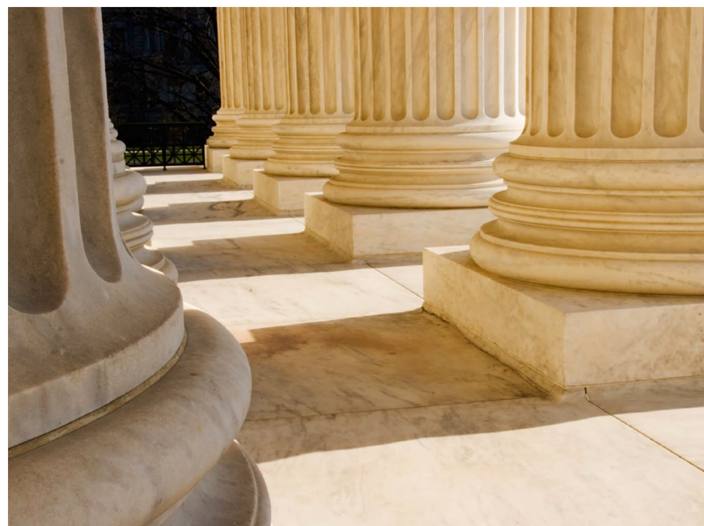
Court to adopt the following rule: "a false promise to purchase securities for one's self in which no other person will have an interest is not a material misrepresentation in connection with the purchase or sale of covered securities" for SLUSA purposes.

The Court is expected to issue a decision in the Stanford Ponzi scheme cases early next year.

Supreme Court to Consider the Fraud-on-the-Market Presumption of Reliance Adopted in *Basic Inc v. Levinson*

In *Basic*, 485 U.S. 224, the Supreme Court found that "[r]equiring proof of individualized reliance" on an alleged misrepresentation "from each member of the proposed plaintiff class" in cases brought under Section 10(b) and Rule 10b-5 "effectively would" prevent securities fraud plaintiffs "from proceeding with a class action, since individual issues" of reliance would "overwhelm[ ] the common ones." The *Basic* Court therefore held that courts may "apply a presumption of reliance supported by the fraud-on-the-market theory," which rests on the "premise that the market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations." The *Basic* Court further ruled that "[a]ny showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price, will be sufficient to rebut the presumption of reliance."

On November 15, 2013, the Supreme Court granted certiorari in *Halliburton Co. v. Erica P. John Fund* (No. 13-317)[6] to consider whether it "should overrule or substantially modify" its holding in *Basic* "to the extent that it recognizes a presumption of classwide reliance derived from the fraud-on-the-market theory." The Court will also address the question of whether, at the class certification stage, a "defendant may rebut the presumption and prevent class certification by introducing evidence that the alleged misrepresentations did not distort the market price of its stock."



The parties have not yet submitted merits briefs in the *Halliburton* case. However, in its petition for certiorari, Halliburton contended that "*Basic*'s central economic premise—the efficient capital markets hypothesis—has been almost universally repudiated" by economists and academics. Petition for a Writ of Certiorari, *Halliburton Co. v. Erica P. John Fund, Inc.*, 2013 WL 4855972 (Sept. 9, 2013). Halliburton claims that even in "well-developed markets, stock prices do not efficiently incorporate all types of information at all times." Rather, a particular security "might trade efficiently some of the time, for some information types, but then trade inefficiently at other times, for other information types." Halliburton further argued that "*Basic*'s legal reasoning conflicts with this Court's insistence" in *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541 (2011) (Scalia, J.) and *Comcast Corp. v. Behrend*, 133 S. Ct. 1426 (2013) (Scalia, J.) "that class-action plaintiffs prove *in fact* that common issues predominate over individual ones." Petition for a Writ

6. Please see pages 3 to 4 above for a discussion of the Fifth Circuit's decision in *Erica P. John Fund, Inc. v. Halliburton Co.*, 718 F.3d 423 (5th Cir. 2013) (Davis, J.), which the Court will review in *Halliburton Co. v. Erica P. John Fund* (No. 13-317).

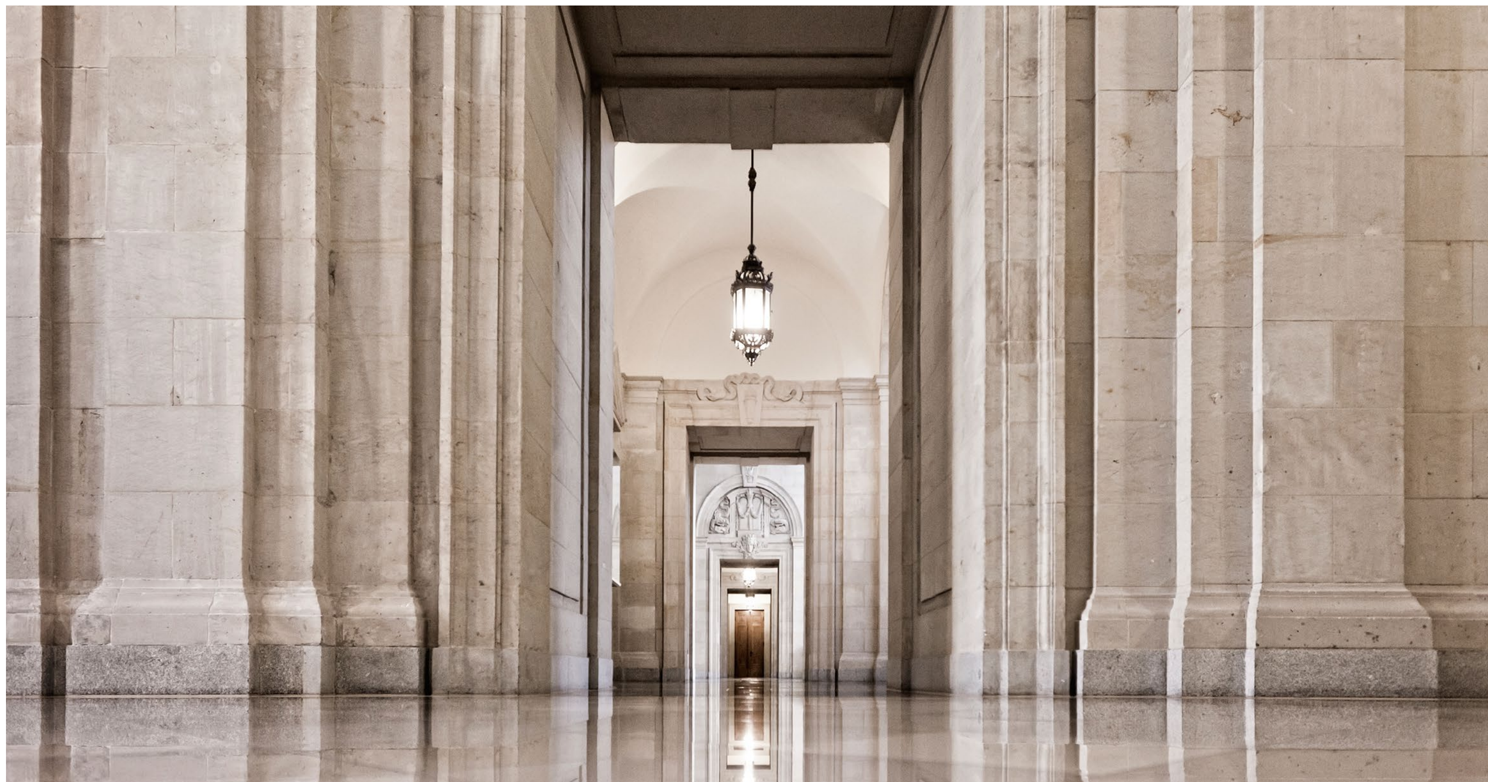
of Certiorari, 2013 WL 4855972.

Halliburton asserted that "the Court should overrule *Basic*" or, at a minimum, modify *Basic* "to require plaintiffs to prove price impact in order to invoke the presumption in the first instance." In Halliburton's view, "[i]t makes scant sense to certify enormous 'fraud-on-the-market' class actions based on disproven notions of general efficiency without inquiring whether the market was actually defrauded by the alleged misrepresentations."

A group of former SEC Commissioners and officials, as well as leading law professors (collectively, "Amici"), submitted an amicus brief stating that the Court should "require plaintiffs in Section 10(b) cases to prove actual reliance to obtain [money] damages" as relief. Brief of Former SEC Commissioners and Officials and Law Professors as Amici Curiae in Support of Petitioners, *Halliburton Co. v. Erica P. John Fund, Inc.*, 2013 WL 5652547 (Oct. 11, 2013). The Voice of the Defense Bar also submitted an amicus brief asking the Court to "make clear that a defendant can seek to rebut the presumption of reliance at any time—including at the class certification stage—with evidence that the alleged misrepresentations did not affect the stock price." Brief of DRI—The Voice of the Defense Bar as Amicus Curiae in Support of Petitioners, *Halliburton Co. v. Erica P. John Fund, Inc.*, 2013 WL 5652548 (Oct. 11, 2013).

Respondent the Erica P. John Fund has defended the *Basic* presumption, claiming that it has been "repeatedly endorsed" by the Supreme Court, Congress, the SEC, and the DOJ. Brief in Opposition, *Halliburton Co. v. Erica P. John Fund, Inc.*, 2013 WL 5652544 (Oct. 11, 2013). Quoting *Amgen*, 133 S. Ct. 1184, the Fund has contended that Congress has "rejected calls to undo the fraud-on-the-market presumption of classwide reliance endorsed in *Basic*."

The Supreme Court will hear oral argument in the *Halliburton* case on March 5, 2014; the Court is expected to issue a decision sometime during the first half of next year.



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Simpson Thacher "continues to occupy a prominent position in cases flowing from the aftermath of the financial crisis."

— CHAMBERS USA 2013

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