SIMPSON THACHER

SECURITIES LAW ALERT

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This month's edition addresses three Second Circuit opinions: one affirming dismissal of a securities fraud action against Porsche Automobil Holding SE based on the Supreme Court's decision in *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247 (2010); another holding that the whistleblower antiretaliation provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act does not apply extraterritorially; and a third defining the term "customer" for purposes of the right to arbitrate disputes under the Financial Industry Regulatory Authority ("FINRA") Code.

We also discuss a Ninth Circuit decision holding that the announcement of an investigation, standing alone, is insufficient to establish loss causation. In addition, we address a Tenth Circuit opinion affirming dismissal of a securities fraud action against Chesapeake Energy Corporation on the grounds that the company had no obligation to disclose changes to its hedging strategy. Finally, we discuss an Eleventh Circuit opinion vacating and remanding a class certification order in a securities fraud action against Regions Financial Corporation for consideration of price impact evidence in light of the Supreme Court's decision in *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398 (2014).

Second Circuit Affirms Dismissal of Securities Fraud Action against Porsche on *Morrison* Grounds

On August 15, 2014, the Second Circuit relied on the Supreme Court's decision in *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247 (2010),[1] to affirm dismissal of a securities fraud action brought against Porsche Automobil Holding SE, a German corporation, and two of the company's former executives.[2] *Parkcentral Global Hub Ltd. v. Porsche Automobile Holdings SE (Porsche II)*, 2014 WL 3973877 (2d Cir. Aug. 15, 2014) (per curiam). The case concerned securities-based swap agreements allegedly executed in the United States but pegged to the stock price of Volkswagen AG ("VW"), a German corporation whose shares trade on the German stock exchange. Notably, the Second Circuit held that "in the case of securities not listed on domestic exchanges, a domestic transaction is necessary but not necessarily sufficient to make § 10(b) applicable."

1. Please click here to read the Firm's June 2010 memo on the *Morrison* decision.

2. Simpson Thacher represents Porsche's former CFO in this action.

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Background

In 2008, more than thirty international hedge funds entered into swap agreements "to bet that VW stock would decline in value." Plaintiffs' positions in these "swap agreements were roughly economically equivalent to short positions in VW stock, in that they would gain to the extent VW stock declined in value and would lose to the extent it rose." Although a number of the plaintiff funds are organized under the laws of foreign jurisdictions, all of the funds have U.S.-based investment managers. Moreover, the swap agreements were allegedly negotiated and executed in large part in the United States.

At the time plaintiffs entered into these agreements, Porsche was VW's largest shareholder. Plaintiffs alleged that Porsche and two of its executives (collectively, "defendants") "made various fraudulent statements and took various manipulative actions to deny and conceal Porsche's intention to take over VW." Defendants' "statements were [allegedly] made primarily in Germany, but were also [allegedly] accessible in the United States and were [allegedly] repeated [in the United States] by … defendants." Plaintiffs claimed that "they [had] relied on defendants' fraudulent denial of Porsche's intention to take over VW in making their swap agreements." In October 2008, Porsche disclosed its intent to take over VW. Following Porsche's announcement, "the price of VW shares rose dramatically, causing [ ] plaintiffs to suffer large losses."

Plaintiffs subsequently brought suit under § 10(b) and Rule 10b-5 in the Southern District of New York. While the case was pending, the Supreme Court handed down its decision in *Morrison*, 561 U.S. 247. The *Morrison* Court held that § 10(b) only governs "transactions in securities listed on domestic exchanges, and domestic transactions in other securities." Defendants subsequently moved to dismiss the complaint on *Morrison* grounds, arguing that § 10(b) did not reach the swap agreements because they referenced foreign-traded securities.

On December 30, 2010, the Southern District of New York granted defendants' motion to dismiss. *Elliott Associates v. Porsche Automobil Holding SE (Porsche I)*, 759 F. Supp. 2d 469 (S.D.N.Y. 2010) (Baer, J.).[3] The court found that the swap agreements at issue "were the functional equivalent of trading the underlying VW shares on a German exchange." The court therefore concluded that the "swap agreements [were] essentially 'transactions conducted upon foreign exchanges and markets,' and not 'domestic transactions' that merit[ed] the protection of § 10(b)." The court explained that it was "loathe to create a rule that would make foreign issuers with little relationship to the U.S. subject to suits here simply because a private party in this country entered into a derivatives contract that references the foreign issuer's stock."

Plaintiffs appealed, arguing that "under *Morrison*, § 10(b) reaches transactions in securities-based swap agreements within the territorial United States." *Porsche II*, 2014 WL 3973877.

3. Please click here to read our discussion of the district court's decision in the January 2011 edition of the Alert.

Second Circuit Holds That § 10(b) Does Not Govern All Domestic Transactions in Securities Not Listed on a Domestic Exchange

The Second Circuit explained that "under *Morrison*, a domestic transaction in a security (or a transaction in a domestically listed security) … [is] a *necessary* element of a domestic § 10(b) claim." However, the Second Circuit found that the key question here was whether "a domestic transaction in a security is not only necessary but also sufficient to justify the application of § 10(b) to otherwise foreign facts." Following a "careful consideration of *Morrison*'s words and arguments," the Second Circuit concluded that "a domestic securities transaction (or a transaction in a domestically listed security) … is not alone sufficient to state a properly domestic claim under" § 10(b).

The Second Circuit "reach[ed] this conclusion for several reasons." First, the Second Circuit found it significant that the Supreme Court "never said that an application of § 10(b) *will* be deemed domestic *whenever*" a domestic securities transaction or a transaction in a domestically listed security "is present" (emphasis in original). Rather, "[t]he language the Court used was consistent with the description of necessary elements rather than sufficient conditions."

Second, the court found that "a rule making the statute applicable whenever the plaintiff's suit is predicated on a domestic transaction, regardless of the foreignness of the facts constituting the defendant's alleged violation, would seriously undermine *Morrison*'s insistence that § 10(b) has no extraterritorial application." The Second Circuit explained that "[s]uch a rule would inevitably place § 10(b) in conflict with the regulatory laws of other nations" because "[i]t would require courts to apply the statute to wholly foreign activity … solely because a plaintiff in the United States made a domestic transaction, even if the foreign defendants were completely unaware" of that transaction.

Second Circuit Finds § 10(b) Does Not Reach Plaintiffs' Claims

Turning to the case at hand, the Second Circuit found that plaintiffs' claims were "so predominantly foreign as to be impermissibly extraterritorial."[4] The Second Circuit explained that "[t]he complaints concern statements made primarily in Germany with respect to stock in a German company traded only on exchanges in Europe." Essentially, plaintiffs were attempting "to hale … European participants in the market for German stocks into U.S. courts and subject them to U.S. securities laws" merely "by virtue of an agreement independent from the reference securities." The Second Circuit reasoned that "the application of § 10(b) to the defendants would so

4. In view of its finding that plaintiffs' claims were clearly extraterritorial in nature, the Second Circuit determined that it was unnecessary to apply the test it had previously articulated in *Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60 (2d Cir. 2012) for determining when a securities transaction is "domestic" for *Morrison* purposes. The *Absolute Activist* court held that in order for a transaction to qualify as "domestic" under *Morrison*, "the parties [must] incur irrevocable liability to carry out the transaction within the United States or … title [to the securities must be] passed within the United States." Please click here to read our discussion of the *Absolute Activist* decision in the March 2012 edition of the Alert.

obviously implicate the incompatibility of U.S. and foreign laws that Congress could not have intended it *sub silentio*."

Nevertheless, the Second Circuit found that plaintiffs "might conceivably be able to draft amended complaints that would invoke a domestic application of § 10(b)," and therefore remanded the case to "allow the district court to entertain a motion to amend the complaints."

Second Circuit Emphasizes the Need for a Fact-Specific Analysis as to Whether the Application of § 10(b) Comports with *Morrison* in Any Given Case

The Second Circuit cautioned that its conclusion in the case at hand could not "of course, be perfunctorily applied to other cases based on the perceived similarity of a few facts." The court explained that it did "not purport to proffer a test that [would] reliably determine whether a particular invocation of § 10(b) [should] be deemed appropriately domestic or impermissibly extraterritorial." Rather, the Second Circuit emphasized that "courts must carefully make their way with careful attention to the facts of each case and to combinations of facts that have proved determinative in prior cases, so as eventually to develop a reasonable and consistent governing body of law on this elusive question."

In a Concurring Opinion, Judge Leval States That *Morrison* Does Not Require a Bright-Line, Single-Factor Rule for Determining Whether § 10(b) Applies

Judge Leval issued a concurring opinion in which he expressed his view that *Morrison* does not

"command[ ] that only bright-line, single-factor rules may be employed to determine when an invocation of § 10(b) would be impermissibly extraterritorial." He explained that the "[u]se of a bright-line, or single-factor, test" for determining the reach of § 10(b) "would lead to seriously undesirable results, likely to be incompatible with the main objectives of the *Morrison* opinion." Such a test would "almost certainly be either under-inclusive, failing to protect the domestic securities markets" or "over-inclusive, compelling applications of § 10(b) to foreign conduct far more appropriately covered by foreign law, and thus contradicting the main thrust of *Morrison*." Moreover, Judge Leval predicted that "a bright-line rule would perversely offer safe harbors for fraud," since "unscrupulous securities dealers [could] design their transactions with their victims so as to stay on the side of the line that is outside the reach of the statute."

Judge Leval therefore concluded that *Morrison* does not "prohibit[ ] the use of a flexible, multi-factor test to ensure that § 10(b) not be applied extraterritorially."

Second Circuit Holds Dodd-Frank Act's Whistleblower Antiretaliation Provision Does Not Apply Extraterritorially

On August 14, 2014, the Second Circuit considered whether the whistleblower antiretaliation provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act, codified at 15 U.S.C. § 78u-6(h)(1)(A),[5] "protects a foreign worker employed abroad by a foreign corporation where all events related to the disclosures occurred abroad." *Liu Meng-Lin v. Siemens AG*, 2014 WL 3953672 (2d Cir. Aug. 14, 2014) (Lynch, J.). Applying the presumption against extraterritoriality established in *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247 (2010), the Second Circuit held that the Dodd-Frank Act whistleblower antiretaliation provision "does not apply extraterritorially."

Background

At issue before the Second Circuit were claims brought by a Taiwanese citizen who had been employed as a compliance officer by a Chinese subsidiary of Siemens AG, a German corporation with shares listed on the New York Stock Exchange. Not long after plaintiff internally reported alleged violations of the Foreign Corrupt Practices Act, Siemens terminated his employment.

Plaintiff then brought suit in the Southern District of New York, alleging that Siemens had violated the Dodd-Frank Act whistleblower antiretaliation provision. Notably, plaintiff did not "plead that any of the events related to his firing—the allegedly corrupt conduct, [his] discovery of that conduct, [his] efforts to address the corrupt conduct through [Siemens'] internal protocols, or his subsequent mistreatment by Siemens—occurred within the territorial jurisdiction of the United States."

Siemens moved to dismiss plaintiff's complaint, alleging, *inter alia*, that the Dodd-Frank Act's whistleblower antiretaliation provision does not apply extraterritorially. The district court granted Siemen's motion to dismiss; plaintiff appealed.

Second Circuit Holds That Listing Securities on a U.S. Exchange Does Not Subject a Company to the Dodd Frank Act Whistleblower Antiretaliation Provision

The Second Circuit first considered whether "the facts alleged in [plaintiff's] complaint state a domestic application of the antiretaliation provision of the Dodd-Frank Act." The court found it unnecessary to "define the precise boundary between domestic and extraterritorial application of [the whistleblower antiretaliation] provision" because it determined that the instant case was "extraterritorial by any reasonable definition." The court explained that "the whistleblower, his employer, and the other entities involved in the alleged wrongdoing [were] all foreigners based abroad, and the whistleblowing, the alleged corrupt activity, and the retaliation all occurred abroad."

Plaintiff nevertheless contended that Siemens had "voluntarily subjected itself to—and undertook to comply with—United States securities laws," including the Dodd-Frank Act whistleblower antiretaliation

5. The Dodd-Frank Act whistleblower antiretaliation provision provides in relevant part as follows:

> No employer may discharge … or in any other manner discriminate against, a whistleblower in the terms and conditions of employment because of any lawful act done by the whistleblower … in making disclosures that are required or protected under the Sarbanes-Oxley Act of 2002 … , this chapter, … and any other law, rule, or regulation subject to the jurisdiction of the [SEC].

15 U.S.C. § 78u-6(h)(1)(A).

provision, because "Siemens [had] voluntarily elected to have a class of its securities publicly listed on the New York Stock Exchange." The Second Circuit found this argument "unavailing" in view of the Supreme Court's decision in *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247 (2010).[6] There, the Supreme Court held that investors who had purchased shares of National Australia Bank (the "Bank") on a foreign stock exchange could not bring § 10(b) claims against the Bank, even though the Bank had listed American Depositary Receipts on the New York Stock Exchange.

The Second Circuit determined that *Morrison* "decisively refutes [plaintiff's] contention that the United States securities laws apply extraterritorially to the actions abroad of any company that has issued United States-listed securities." *Liu Meng-Lin*, 2014 WL 3953672. The court explained that "where a plaintiff can point only to the fact that a defendant has listed securities on a U.S. exchange, and the complaint alleges no further meaningful relationship between the harm and those domestically listed securities, the listing of securities alone is the sort of 'fleeting' connection that 'cannot overcome the presumption against extraterritoriality'" (quoting *Morrison*, 561 U.S. 247).

Second Circuit Applies *Morrison* to Hold That the Dodd-Frank Act Whistleblower Antiretaliation Provision Does Not Apply Extraterritorially

The Second Circuit next considered whether "the [Dodd Frank Act whistleblower] antiretaliation provision is intended to apply extraterritorially." Quoting *Morrison*, 561 U.S. 247, the court emphasized the "longstanding principle of American law that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States." The Second Circuit explained that it has previously "read *Morrison* to 'wholeheartedly embrace[ ] application of the presumption against extraterritoriality'" absent "a 'clear' and 'affirmative indication' that a statute applies to conduct occurring outside the territorial jurisdiction of the United States." Here, the Second Circuit found "absolutely nothing in the text … or in the legislative history" of the Dodd-Frank Act whistleblower antiretaliation provision suggesting that Congress intended the provision "to regulate the relationships between foreign employers and their foreign employees working outside the United States."

The Second Circuit rejected plaintiff's various arguments in support of his claim that the provision has "extraterritorial reach." First, the court found baseless plaintiff's "contention that the antiretaliation provision 'contains very broad language that includes all employees,'" including foreign employees. The court explained that "[t]he plain text of the statute contains no hint that the antiretaliation provision is meant to apply extraterritorially, but rather simply indicates that '[n]o employer' may retaliate against a whistleblower." The Second Circuit explained

6. Please click here to read the Firm's June 2010 memo on the *Morrison* decision.

that this "is precisely the sort of 'generic' language that the Supreme Court has expressly stated is insufficient to overcome the presumption against extraterritorial application" (citing *Kiobel v. Royal Dutch Petroleum Co.*, 133 S. Ct. 1659 (2013)).

Plaintiff also "point[ed] to other sections of the Dodd-Frank Act that do have some extraterritorial application to argue, in effect by association, that the antiretaliation provision also should be read to have extraterritorial reach." The Second Circuit found that plaintiff's "argument inverts the ordinary canons of statutory interpretation." The court explained that "it would be 'superfluous' for a statute to note that a particular provision applies extraterritorially if the entire statute had extraterritorial reach" (quoting *Morrison*, 561 U.S. 247).

Finally, plaintiff argued that "the SEC regulations which define the eligibility for a whistleblower bounty suggest that the agency conceives of the bounty as having international reach."[7] The Second Circuit found it "far from clear that an agency's assertion that a statute has extraterritorial effect, unmoored from any plausible statutory basis for rebutting the presumption against extraterritoriality, should be given deference." Moreover, even assuming that the SEC "regulations clearly apply the bounty program to whistleblowers located abroad," the Second Circuit determined that it "would not follow that Congress intended the antiretaliation provision to apply similarly."

Finding none of plaintiff's arguments "sufficiently germane or cogent to overcome the presumption against extraterritoriality," the Second Circuit affirmed dismissal of plaintiff's whistleblower retaliation claim.

7. Plaintiff cited 17 C.F.R. § 240.21F-8(c)(2), which provides in relevant part as follows: "you are not eligible [for an award] if: … You are … a member, officer, or employee of a foreign government, any political subdivision, department, agency, or instrumentality of a foreign government, or any other foreign financial regulatory authority."

Second Circuit Defines Who Constitutes a "Customer" for Purposes of the FINRA Code

On August 1, 2014, the Second Circuit defined the term "customer" for purposes of the right to arbitration under Rule 12200 of the Financial Industry Regulatory Authority ("FINRA") Code. *Citigroup Global Markets Inc. v. Abbar (Citigroup II)*, 2014 WL 3765867 (2d Cir. Aug. 1, 2014) (Jacobs, J.). The court ruled that a "customer" is "one who, while not a broker or dealer, either (1) purchases a good or service from a FINRA member, or (2) has an account with a FINRA member."

Background

The case before the Second Circuit stemmed from an attempt by Saudi businessman Ghazi Abbar to bring a FINRA arbitration against Citigroup Global Markets Inc. ("Citi NY"). Abbar managed the Abbar family trusts, which invested in reference funds owned by Citigroup Global Markets Ltd. ("Citi UK"). While Abbar's investment agreements were with Citi UK and all fees in connection with the transactions were paid to Citi UK, employees of Citi NY "helped structure and manage the … transactions." Abbar ultimately "lost his entire investment" in the Citi UK funds. In 2011, Abbar commenced FINRA arbitration proceedings against Citi NY, a FINRA member.

Citi NY brought suit in the Southern District of New York to enjoin Abbar's FINRA arbitration. Under the FINRA Code, FINRA members must submit to arbitration if "[a]rbitration under the Code is either: (1) [r]equired by a written agreement; or (2) [r]equested by the customer." FINRA Rule 12200. Citi NY argued that because it "had no written arbitration agreement with Abbar, the FINRA rules mandate arbitration only if Abbar is a 'customer' of City NY." City NY contended that Abbar was only a "customer" of Citi UK,

not a "customer" of Citi NY.

The Southern District of New York explained that resolving the question of whether or not Abbar was a "customer" of Citi NY "was seen to require examining and evaluating the substance, nature, and frequency of each interaction and task performed by the various persons who dealt with" Abbar at Citi NY. *Citigroup Global Markets, Inc. v. Abbar (Citigroup I)*, 943 F. Supp. 2d 404 (S.D.N.Y. 2013) (Stanton, J.). Following two years of motion practice and a nine-day trial, the court determined that "the planning, structuring, and other services performed by [Citi NY] in New York were ancillary and collateral to [the] central core transactions" by Citi UK.

The Southern District of New York ultimately rested its decision on the following definition of "customer:" "the investor is the customer of the party with which he has an account and consummates the transaction." The court reasoned that "[t]he entity in which the investor has his account, and from whom the investor purchases his desired product, defines the legal and business locus of his status as a customer, and is the core of the relationship as a customer" for FINRA purposes. Based on this definition, the court held that Abbar was not a "customer" of Citi NY under the FINRA Code. Abbar appealed.

Second Circuit Addresses the "Precise Boundaries of the FINRA Meaning of 'Customer'"

At the outset of its analysis, the Second Circuit rejected Abbar's claim that it must "resolve any ambiguity" with respect to the FINRA Code's definition of "customer" "in favor of arbitration." *Citigroup II*, 2014 WL 3765867. The court explained that "[b]ecause the parties here are disputing the existence of an obligation to arbitrate, not the scope of an arbitration clause, the general presumption in favor of arbitration does not apply." The Second Circuit stated that "the word 'customer' must 'be construed in a manner consistent with the reasonable expectations of FINRA members'" (quoting *Wachovia Bank, National Association v. VCG Special Opportunities Master Fund, Ltd.*, 661 F.3d 164 (2d Cir. 2011)).

The Second Circuit found that the "sprawling litigation" that took place in the instant action was inconsistent with "the express goals of arbitration to yield economical and swift outcomes." The court determined that "[a] simple, predictable, and suitably broad definition of 'customer' [was] therefore necessary." Defining the "precise boundaries of the FINRA meaning of 'customer'" for the first time, the Second Circuit held that "a 'customer' under FINRA Rule 12200 is one who, while not a broker or dealer, either (1) purchases a good or service from a FINRA member, or (2) has an account with a FINRA member."

The Second Circuit explained that "[b]y agreeing to accept 'a fee for its services' or by selling securities to an entity, a FINRA member understands that it may be compelled to arbitrate if a dispute arises with that entity." The court further stated that "[a]n account holder has a reasonable expectation to be treated as a customer, whether or not goods or services are purchased directly from the FINRA member." The court clarified that "even if the FINRA member executes all securities transactions through an affiliate or provides services without fee, the account-holder can compel arbitration under Rule 12200."

The Second Circuit observed that "[i]n most cases, this definition of 'customer' can be readily applied to undisputed facts." The court noted that "[t]he only relevant inquiry in assessing the existence of a customer relationship is whether an account was opened or a purchase made; parties and courts need not wonder whether myriad facts will 'coalesce into a functional concept of the customer relationship'" (quoting *Citigroup I*, 943 F. Supp. 2d 404).

Here, "Abbar never held an account with the FINRA member [Citi NY] and … never purchased any goods or services from it." The Second Circuit therefore affirmed the district court's holding that Abbar was not a City NY "customer" for FINRA purposes, and thus had no right to a FINRA arbitration against City NY.

Ninth Circuit Finds the Announcement of an Internal Investigation, Standing Alone, Insufficient to Establish Loss Causation

On August 7, 2014, the Ninth Circuit affirmed dismissal of a securities fraud action against Immersion Corporation on loss causation grounds.

Loos v. Immersion Corp., 2014 WL 3866084 (9th Cir. Aug. 7, 2014) (Rice, J.). The court held that "the announcement of an investigation, standing alone, is insufficient to establish loss causation." The Ninth Circuit further ruled that "disappointing financial results [are] insufficient to establish loss causation as a matter of law."

Background

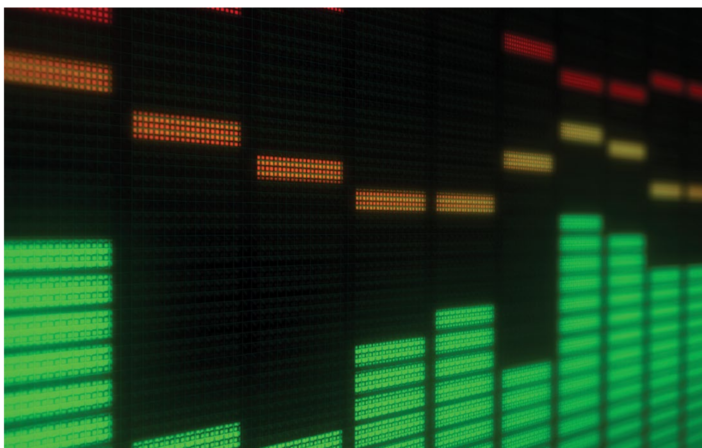
Immersion Corporation is a publicly traded technology company. After going public in 1999, the company did not turn a profit until the fourth quarter of 2006. In 2007, Immersion reported that it had four back-to-back profitable quarters. From 2008 onwards, however, Immersion reported net losses each quarter. In press releases accompanying the company's financial results, Immersion "attempted to focus investors' attention on revenue growth." For example, Immersion reported a net loss of $4.3 million for the third quarter of 2008, but underscored in a press release that the company had earned more than $10 million in quarterly revenue for the first time ever.

On July 1, 2009, Immersion revealed that there may be a problem with its reported revenue figures. The company issued a press release stating that its Audit Committee had commenced "an internal investigation into certain previous revenue transactions" and explained that the Committee had "not yet determined the impact, if any, to Immersion's historical financial statements." The press release cautioned that "[a]s a result of this investigation, Immersion may discover information that could raise issues with respect to its previously-reported financial information, which could be material." Following the announcement, Immersion's stock price dropped more than 20%.

In August 2009, Immersion informed investors that they should no longer rely upon the company's prior financial statements in light of irregularities with "certain revenue transactions." Several months later, in February 2010, Immersion restated its earnings for

2006, 2007, 2008, and the first quarter of 2009.

Plaintiffs subsequently brought suit under § 10(b) and Rule 10b-5 against Immersion and several of its executives. Their "overarching theory of liability [was] that Immersion [had] 'cooked the books' in response to mounting pressure from investors to become profitable." Plaintiffs claimed that "Immersion [had] systematically recognized medical sales revenue earlier than permitted under GAAP in order to mislead investors into believing that the company was on the cusp of finally achieving sustained profitability."



Plaintiffs contended that "Immersion's fraudulent accounting was revealed to the market through a series of 'partial disclosures' consisting of (1) disappointing earnings results for 1Q08, 2Q08, 4Q08 and 1Q09; and (2) the subsequent announcement of an internal investigation into prior revenue transactions." According to plaintiffs' theory of loss causation, "Immersion's disappointing financial results signaled that the company lacked the 'growth drivers and profitability' that it had previously claimed, and that the subsequent announcement of an investigation into prior revenue transactions confirmed that Immersion had fraudulently overstated its historical revenues." Plaintiffs argued that "Immersion's July 1, 2009 announcement of an internal investigation completed the revelation of the fraud to the market and removed all inflation from the company's stock price."

In December 2011, the Northern District of California dismissed the complaint. The court held, *inter alia*, that plaintiffs had failed to adequately allege loss causation. Plaintiffs appealed.

Ninth Circuit Holds That the Announcement of an Investigation Does Not Reveal Fraudulent Practices to the Market for Loss Causation Purposes

The Ninth Circuit stated in order to plead loss causation, a "plaintiff need only allege that the decline in the defendant's stock price was proximately caused by a revelation of fraudulent activity rather than by changing market conditions, changing investor expectations, or other unrelated factors." The complaint "must plausibly allege that the defendant's fraud was '*revealed* to the market and *caused* the resulting losses'" (quoting *Metzler Investment GMBH v. Cortinthian Colleges, Inc.*, 540 F.3d 1049 (9th Cir. 2008)).

With respect to plaintiff's effort to establish loss causation by pointing to Immersion's July 1, 2009 announcement of an internal investigation into its earlier revenue transactions, the Ninth Circuit explained that it had "never squarely addressed whether the disclosure of an internal investigation can satisfy the loss causation element of a § 10(b) and Rule 10b-5 claim." The court acknowledged that "the announcement of an investigation [could] *potentially* be relevant to a securities fraud plaintiff's theory of loss causation." However, the Ninth Circuit held that "the announcement of an investigation, without more, is insufficient to establish loss causation."

The Ninth Circuit found persuasive the Eleventh Circuit's reasoning in *Meyer v. Greene*, 710 F.3d 1189 (11th Cir. 2013) (Wilson, J.). There, the Eleventh Circuit held that "the commencement of an SEC investigation, without more, is insufficient to constitute a

corrective disclosure for purposes of § 10(b)." The court explained that while "stock prices may fall upon the announcement of an SEC investigation, … that is because the investigation can be seen to portend an added *risk* of future corrective action." The Eleventh Circuit found that this "does not mean that the investigations, in and of themselves, reveal to the market that a company's previous statements were false or fraudulent."

The Ninth Circuit "agree[d] with the Eleventh Circuit's reasoning." *Loos*, 2014 WL 3866084. Like the Eleventh Circuit, the Ninth Circuit determined that "[t]he announcement of an investigation does not 'reveal' fraudulent practices to the market." The court explained that "at the moment the investigation is announced, the market cannot possibly know what the investigation will ultimately reveal." Although "the disclosure of an investigation is … an ominous event," the Ninth Circuit underscored that the announcement of an investigation "simply puts investors on notice of a *potential* future disclosure of fraudulent conduct." The court found that "any decline in a corporation's share price following the announcement of an investigation can only be attributed to market speculation about whether fraud has occurred." The Ninth Circuit held that "[t]his type of speculation cannot form the basis of a viable loss causation theory."

Ninth Circuit Finds Disappointing Earnings Results Insufficient to Establish Loss Causation

The Ninth Circuit further determined that "the allegations regarding Immersion's disappointing financial results were insufficient to establish loss causation as a matter of law." Concurring with the district court's determination, the Ninth Circuit explained that its "precedent requires a securities fraud plaintiff to allege that the market 'learned of and reacted to th[e] fraud, as opposed to merely reacting to reports of the defendant's poor financial health generally'" (quoting *Metzler Investment GMBH*, 540 F.3d 1049).

The Ninth Circuit distinguished its earlier decision in *In re Daou Systems, Inc.*, 411 F.3d 1006 (9th Cir. 2005). There, "the defendant's earnings statement revealed more than $10 million in unbilled receivables," which the Ninth Circuit found "sufficiently suggestive of accounting fraud to survive a motion to dismiss." *Loos*, 2014 WL 3866084. Here, however, the Ninth Circuit determined that "Immersion's 1Q08, 2Q08, 4Q08 and 1Q09 results [did] not reveal any information from which revenue accounting fraud might reasonably be inferred."

The Ninth Circuit therefore affirmed the dismissal of plaintiffs' complaint.

Tenth Circuit Affirms Dismissal of Securities Fraud Action against Chesapeake Energy Corporation, Finding No Obligation to Disclose Changes to the Company's Hedging Strategy

On August 8, 2014, the Tenth Circuit affirmed dismissal of a securities fraud action against Chesapeake Energy Corporation in connection with the company's alleged failure to disclose changes to its hedging strategy. *United Food & Commercial Workers Union Local 880 Pension Fund v. Chesapeake Energy Corp. (Chesapeake II)*, 2014 WL 3882570 (10th Cir. Aug. 8, 2014) (Hartz, J.). The court found that disclosure is not "required of any alteration in application of a hedging strategy that reportedly makes frequent adjustments in response to market conditions."

Background

Chesapeake Energy Corporation was one of the country's largest producers of natural gas. Three months after its initial public offering in July 2008, the price of natural gas fell about 45%. Chesapeake was particularly affected by the changes in market conditions: the company's stock plummeted by 70%.

Investors in Chesapeake stock subsequently brought claims under §§ 11, 12(a)(2), and 15 of the Securities Act of 1933 against Chesapeake and its investment bankers in the Western District of Oklahoma. Plaintiffs contended, *inter alia*, that "Chesapeake should have disclosed … that it had expanded a risky gas-price hedging strategy that made it vulnerable to a fall in natural-gas prices." Specifically, plaintiffs asserted that "Chesapeake [had] violated securities laws when its Registration Statement did not disclose that it had entered into more knockout swaps and raised the knockout prices after it filed the May [2008] 10-Q." Compared to ordinary swap agreements, "[k]nockout swap agreements provided less protection from falling prices … because they did not limit Chesapeake's risk if the price of natural gas fell" below a set knockout price. In 2008, "when natural-gas prices fell dramatically," Chesapeake's knockout swaps allegedly caused losses of more than $500 million.

On March 29, 2013, the district court granted summary judgment in Chesapeake's favor. The court found that "the Offering materials disclosed in detail the risks associated with Chesapeake's hedging strategy." *United Food & Commercial Workers Union v. Chesapeake Energy Corp.*, 2013 WL 4494384 (W.D. Okla. Mar. 29, 2013). Plaintiffs appealed.

Tenth Circuit Finds Chesapeake Provided Adequate Disclosures Regarding Its Hedging Strategy, Including Its Use of Knockout Swap Agreements

On appeal, the Tenth Circuit held that plaintiffs had "failed to support [their] claim that Chesapeake [had] changed its knockout hedging *strategy* in the second quarter of 2008." *Chesapeake II*, 2014 WL 3882570 (emphasis in original). The court found that Chesapeake's "Registration Statement included general information about Chesapeake's hedging strategy." Moreover, "the offering materials signaled that Chesapeake's hedging commitments and the value of its hedging contracts changed substantially over time." For example, Chesapeake's most recent annual report expressly stated that "[c]ommodity markets are volatile" and the company's "hedging activities are dynamic."

While Chesapeake did not specifically reference knockout swaps in its Registration Statement, the Tenth Circuit explained that "information about knockout swaps could be found in the SEC filings incorporated in the statement." The court found it significant that "almost all the change in Chesapeake's knockout-swap hedging was disclosed before the offering date in the May 8-K filed by Chesapeake with the SEC." Notably, the Tenth Circuit rejected plaintiffs'

contention that it would be "inappropriate to consider the May 8-K because it was not part of the offering materials." The court emphasized that "[a] 'reasonable investor' is neither an ostrich, hiding her head in the sand from relevant information, nor a child, unable to understand the facts and risks of investing" (quoting *Greenhouse v. MCG Capital Corp.*, 392 F.3d 650 (4th Cir. 2004)). In the case at hand, "the May 8-K was readily available on the SEC website, and a reasonable investor interested in Chesapeake's swap practices would know from prior 8-Ks that these disclosures provide the latest information on the subject." Since "the May 8-K supplied essentially all the information whose absence in the Registration Statement [was] the basis of [plaintiffs'] claim," the Tenth Circuit held that "[a]dditional disclosure would not have 'altered the total mix of information available' to investors" (quoting *Slater v. A.G. Edwards & Sons, Inc.*, 719 F.3d 1190 (10th Cir. 2013)).

Finally, the Tenth Circuit found that the authorities cited by plaintiffs did "not support [their] contention that Chesapeake's disclosures were misleading." Plaintiffs attempted to rely on *In re Lehman Brothers Securities & ERISA Litigation*, 799 F. Supp. 2d 258 (S.D.N.Y. 2011) "for the proposition that 'a statement regarding a company's hedging strategy obliges it to disclose when it alters or suspends that strategy.'" However, the Tenth Circuit found that the *Lehman* opinion could not "be read as saying that disclosure is required of any alteration in application of a hedging strategy that reportedly makes frequent adjustments in response to market conditions." Plaintiffs also cited *Caiola v. Citibank, N.A.*, 295 F.3d 312 (2d Cir. 2002) in support of their claim that "once [Chesapeake] chose to discuss its hedging strategy, it had a duty to be both accurate and complete." Finding that plaintiffs had "read[ ] too much into the court's statement," the Tenth Circuit found that *Caiola* does "not requir[e] disclosure of every detail of a hedging strategy."

The Tenth Circuit therefore affirmed dismissal of plaintiffs' claims.

Eleventh Circuit Vacates and Remands *Regions Financial* Class Certification Order for Consideration of Price Impact Evidence in Light of *Halliburton*

On August 6, 2014, the Eleventh Circuit vacated and remanded the Northern District of Alabama's class certification order in a securities fraud action against Regions Financial Corporation in order "to allow consideration of Regions's evidence of price impact" in accordance with the Supreme Court's recent decision in *Halliburton Co. v. Erica P. John Fund, Inc. (Halliburton II)*, 134 S. Ct. 2398 (2014).[8] *Local 703, I.B. of T. Grocery & Food Employees Welfare Fund v. Regions Financial Corp.*, 2014 WL 3844070 (11th Cir. Aug. 6, 2014) (Martin, J.).

Background

Plaintiffs brought suit under § 10(b) and Rule 10b-5 alleging that "Regions [had] made a series of misrepresentations beginning in 2008 … about the value of its assets and its financial stability." According to plaintiffs, the company's "failure to accurately represent the company's financial situation resulted in artificially high stock prices for Regions, and allowed it to avoid the precipitous decline of its stock price that would have resulted during the recession, absent the misleading disclosures."

On June 14, 2012, the Northern District of Alabama granted plaintiffs' motion for class certification. Regions appealed, contending that the district court had erred in certifying the class. Among other grounds, Regions argued that plaintiffs had failed to prove that common questions concerning reliance would predominate over individual ones. Regions

8. Please click here to read our discussion of the *Halliburton II* decision in the June/July 2014 edition of the Alert.

further asserted that it had provided sufficient evidence to rebut the presumption of classwide reliance. While the appeal was pending, the Supreme Court handed down its decision in *Halliburton II*, 134 S. Ct. 2398.

Eleventh Circuit Affirms District Court's Finding of Market Efficiency for Purposes of the *Basic* Presumption of Reliance

The Eleventh Circuit stated that in order "[t]o certify a class under Rule 23(b)(3)," a court "must find 'that the questions of law or fact common to class members predominate over any questions affecting only individual members'" (quoting FED. R. CIV. P. 23(b)(3)). The Eleventh Circuit observed that "[w]hether common questions of law or fact predominate in a securities fraud action often turns on the element of reliance" (quoting *Erica P. John Fund, Inc. v. Halliburton Co. (Halliburton I)*, 131 S. Ct. 2179 (2011)).[9] The court noted that the *Regions Financial* action was "no exception" to this general principle.

The Eleventh Circuit explained that in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), the Supreme Court established a presumption of classwide reliance based on the fraud on the market theory. However, the Eleventh Circuit emphasized that "the mere purchase of stocks at a price set by the market does not permit plaintiffs to take advantage of *Basic*'s rebuttable presumption of reliance." Rather, "'plaintiffs must prove certain things in order to invoke'" the *Basic* presumption, including "'that the stock traded in an efficient market'" (quoting *Halliburton I*, 131 S. Ct. 2179).

Here, Regions contended that "the evidence was insufficient to conclude that its stock traded on an efficient market." Regions raised three arguments in support of this claim. First, Regions asserted that "the [d]istrict [c]ourt should have, but failed to, apply the analytical framework for analyzing market efficiency set forth in *Cammer v. Bloom*, 711 F. Supp. 1264 (D.N.J. 1989)."[10] Second, Regions argued that the district court "should have required the plaintiffs to offer evidence that the misrepresentations caused an immediate change in the stock price." Finally, Regions took the position "that these analytical shortcomings contributed to the erroneous application of a *per se* rule that the market for every stock listed on a national exchange trades on an efficient market."

Eleventh Circuit Rejects Regions' Argument That District Courts Must Consider the *Cammer* Factors When Analyzing Market Efficiency

The Eleventh Circuit "reject[ed] Regions's suggestion that [it] adopt the *Cammer* factors as

9. Please click here to read our discussion of the *Halliburton I* decision in the June 2011 edition of the Alert.

10. In *Cammer*, 711 F. Supp. 1264, the District of New Jersey enumerated several factors (known as the "*Cammer* factors") that courts should consider when evaluating market efficiency for purposes of the *Basic* presumption. "The *Cammer* factors are: (1) high average trading volume during the class period; (2) a significant number of analysts following the stock; (3) numerous market makers who react quickly to, and trade based upon, new information about the company; (4) entitlement to file a Securities and Exchange Commission (SEC) Form S-3, which has minimum stock and trading requirements; and (5) empirical facts showing a cause and effect relationship between unexpected corporate events and an immediate response in the stock price." *Regions Financial*, 2014 WL 3844070.

the mandatory analytical framework for market efficiency inquiries." Instead, the Eleventh Circuit reaffirmed that district courts in its jurisdiction have "the flexibility to make the fact-intensive [market efficiency] inquiry on a case-by-case basis." The Eleventh Circuit explained that district courts in its jurisdiction already "have a good idea of what they should be looking for in determining market efficiency," and found "no reason to upset the balance."[11]

Eleventh Circuit Holds Plaintiffs Need Not Show Price Impact to Establish Market Efficiency

The Eleventh Circuit also rejected "Regions's argument that a finding of market efficiency always requires proof that the alleged misrepresentations had an immediate effect on the stock price." The court explained that the case at hand "presents a perfect example of why an inflexible requirement would run contrary to the market principles that motivated the decision in *Basic*." Here, plaintiffs alleged that Regions had made "confirmatory misrepresentations," which "'confirm' existing information about a stock, rather than release new and different information that might bring about a negative change in the stock's price." The misrepresentations at issue were allegedly "designed to prevent a more precipitous decline in the stock's price, not bring about any change to it." The Eleventh Circuit explained that "[r]equiring plaintiffs to present evidence that the alleged misrepresentations immediately moved the market price in these circumstances would thus place an evidentiary burden upon them which is, at best, elusive."

Eleventh Circuit Finds the District Court Did Not Apply a *Per Se* Presumption of Market Efficiency for National Exchange-Traded Stocks

On appeal, the Eleventh Circuit agreed with Regions that it would be improper for courts to apply "a *per se* rule of market efficiency for all stocks that trade on a national exchange, without regard for the particular characteristics of that stock." The Eleventh Circuit explained that "although trading on a national exchange may be relevant to the [efficiency] inquiry, [d]istrict [c]ourts should remain focused on the market for the particular stock" at issue. In the case at hand, however, the Eleventh Circuit found that the district court did not apply "a strict *per se* rule of market efficiency for all stocks trading on national exchanges."

The Eleventh Circuit "therefore affirm[ed] the [d]istrict [c]ourt's determination that the plaintiffs justified application of the *Basic* presumption."

11. The Eleventh Circuit explained that in its earlier decision in *FindWhat Investor Group v. FindWhat.com*, 658 F.3d 1282 (11th Cir. 2011), it had found that an efficient market is often marked by "high-volume trading activity facilitated by people who analyze information about the stock or who make trades based upon that information." The Eleventh Circuit noted that "[t]hese are factors [d]istrict [c]ourts … know to look for when analyzing the markets for securities of established companies like Regions." However, the Eleventh Circuit cautioned that the *FindWhat* factors are not prerequisites to a finding of market efficiency: "[s]tocks that trade on a smaller scale, or that are not widely followed, might trade on an efficient market." The Eleventh Circuit emphasized that "[i]t is up to the [d]istrict [c]ourts to consider the nature of the market on a case-by-case basis to decide whether the totality of the circumstances supports a finding of market efficiency."

Eleventh Circuit Vacates and Remands Class Certification Order for Consideration of Price Impact Evidence in Accordance with the Supreme Court's Decision in *Halliburton II*

The Eleventh Circuit explained that "[t]he *Basic* inquiry does not end once the presumption of class-wide reliance has been invoked." Citing the Supreme Court's decision in *Halliburton II*, 134 S. Ct. 2398, the Eleventh Circuit recognized that "defendants may introduce price impact evidence both to undermine the plaintiff's case for market efficiency and to rebut the *Basic* presumption once it has been established."

In the proceedings before the district court, Regions did "present[ ] evidence that its stock price did not change in the wake of any of the alleged misrepresentations." However, the district court "did not fully consider this evidence" because of "the state of the law before *Halliburton II*." The Eleventh Circuit vacated the class certification order and remanded the action in order for the district court "to undertake [a] review" of Regions's price impact evidence. The Eleventh Circuit explained that "the [d]istrict [c]ourt is in the best position to review all the facts and conduct the inquiry now required in the wake of *Halliburton II*."

Notably, the Eleventh Circuit cautioned that the district court's "work on remand will be limited in scope." The Eleventh Circuit pointed out that the *Halliburton II* Court "only said that defendants '*may* seek to defeat the *Basic* presumption' with evidence that the misrepresentations did not impact the price" (quoting *Halliburton II*, 134 S. Ct. 2179 (emphasis in original)). The court emphasized that "*Halliburton II* by no means holds that in every case in which such evidence is presented, the presumption will always be defeated." The Eleventh Circuit observed, for example, that confirmatory misrepresentations will not impact stock price because the market is already aware of the information underlying such misrepresentations.

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