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The Bankruptcy Examiner's Report in Lehman Bros. – Who Knew What, And When?

By Patrick A. Klingman, Esquire

On March 11, 2010, the examiner appointed by the Bankruptcy Court for the Southern District of New York, which is overseeing the liquidation of Lehman Brothers Holdings, Inc., the largest bankruptcy in U.S. history, filed his report (the "Report"). At over 2,000 pages (the table of contents alone is 45 pages), and based upon a year-long review of over 10 million pages and interviews with over 100 witnesses, it is a massive effort (for which the examiner and his firm, Chicago-based Jenner & Block, reportedly earned almost $40 million in fees) and, according to the presiding U.S. Bankruptcy Judge, James M. Peck, it reads like a "best seller."

The Bankruptcy Code allows bankruptcy courts to appoint an independent examiner to investigate matters related to the debtor's estate, "including an investigation of any allegations of fraud, dishonesty, or gross mismanagement ..." 11 U.S.C. § 1104(c). As described by one court, a bankruptcy examiner's investigation "is supposed to be a 'fishing expedition,' as exploratory and groping as appears proper to the Examiner." *In re Ionosphere, Inc.*, 156 B.R. 414, 432 (S.D.N.Y.1993). The benefit of appointing an independent examiner is that they will act as an objective nonadversarial party who will

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Claims Against Madoff Feeder Fund Dismissed In Substantial Part, *SEC v. Cohmad Sec. Corp.*, No. 09 Civ. 5680, 2010 WL 363844 (S.D.N.Y. Feb. 2, 2010)

By Natalie Finkelman Bennett, Esquire and Paul Rettinger, Esquire

In one of the first significant decisions rendered in litigation arising out of Bernard Madoff's epic Ponzi scheme, the U.S. District Court for the Southern District of New York dismissed securities fraud claims brought by the Securities and Exchange Commission ("SEC") against Cohmad Securities Corporation ("Cohmad"), a tiny so-called "feeder fund" and certain of its officers. In its complaint, the SEC asserted that Madoff paid fees to Cohmad for referring investors to Bernard L. Madoff Investment Securities, LLC ("BMIS"), and that Cohmad derived a majority of its revenues from these referral fees (over $98 million from 1996 to 2008), while concealing the scheme through false regulatory filings. The SEC did not allege that the Defendants knew of or recklessly disregarded Madoff's fraud, rather, that the Defendants "helped mislead investors into believing that Madoff

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Is A Trend Arising In Mortgage-Related Securities Cases?

By Douglas P. Dehler, Esquire and Rose F. Luzon, Esquire

In the aftermath of recent events giving rise to the financial and mortgage crisis, a number of class actions have been filed by and on behalf of investors in mortgage-related securities. In recent months, federal courts have issued noteworthy decisions in these cases, which allege securities fraud claims against mortgage lenders, mortgage insurers, and investment managers. A review of these decisions is worthwhile, as they may lay the groundwork for the prosecution of successful mortgage-related securities class actions in the future.

***In re Thornburg Mortgage, Inc. Securities Litigation*, No. Civ. 07-0815 JB/WDS, 2010 WL 445047 (D.N.M. Jan. 27, 2010)**

In this case, plaintiffs are investors who purchased Thornburg Mortgage, Inc. ("TMI") stock, allegedly at artificially inflated prices. TMI is a publicly-traded, residential mortgage lender with a multi-billion dollar asset portfolio, which includes mortgage-backed securities backed by "Alt-A collateral mortgage loans" - in short, higher-risk loans for borrowers who lack proof of income and other traditional loan guarantees. TMI's underwriters purchased TMI stock and subsequently sold it to other investors as part of TMI's public offerings. This class action lawsuit alleges that, in connection with these public offerings, TMI and its underwriters violated federal securities law by making false and misleading statements or omissions. The case was filed in the U.S. District Court for New Mexico. Defendant underwriters moved to dismiss the complaint, and the District Court granted their motion, declaring that the defendants' public offering documents did not contain material misstatements or omissions. Although plaintiffs alleged that false statements were made by underwriter defendants, the District Court closely scrutinized those allegations and documents attached to the complaint before concluding, as a matter of law, that defendants had not made any actionable false statements. For instance, the Court rejected plaintiffs' contention that the underwriter defendants made false and misleading statements in the offering documents by referencing TMI's 2006 financials, which plaintiffs alleged were false. In rejecting plaintiffs' claim, the Court cited a letter from TMI's auditors, which was attached to the complaint as an exhibit. In that letter, TMI's auditors "blessed" the 2006 financials, in the Court's view. Accordingly, even though plaintiffs alleged that defendants' public disclosures were false and misleading because they referenced false financials, the Court rejected plaintiffs' allegations, as matter of law, in light of the letter from TMI's auditor. Similarly, the Court rejected plaintiffs' allegation that the public offering documents improperly failed to disclose the cross-default provisions in TMI's short-term borrowing contracts, as well as the adverse impact that the Alt-A and subprime mortgage crises were having on TMI. In so ruling, the Court stated that defendants had no duty to disclose the cross-default provisions specifically because they were not "unique." The Court also found that defendants did not mislead investors by referencing TMI's "high quality" assets because they had not represented that TMI dealt "exclusively" in such assets. Plaintiffs have not appealed the Court's decision. On February 5, 2010, plaintiffs filed a motion to clarify whether they may replead their complaint to cure the factually deficient allegations. A decision on this motion is currently pending.

***Fulton County Employees' Retirement System v. MGIC Investment Corp.*, No. 08-C-0458, 2010 WL 601364 (E.D.Wis. Feb. 18, 2010)**

Plaintiffs, institutional investors who purchased MGIC Investment Corporation ("MGIC") stock, filed a class action alleging that MGIC and individual executives of MGIC and Credit-Based Asset Servicing and Securitization ("C-BASS") committed securities fraud in violation of the Securities Exchange Act of 1934 and SEC Rule 10b-5. MGIC is in the business of insuring residential home mortgages, including subprime mortgages. C-BASS, an MGIC affiliate, specializes in purchasing subprime residential mortgages and packaging them into mortgage-based securities. The complaint alleges that defendants made false and misleading statements intended to mask the adverse impact of the subprime crisis on the defendants' business, including statements that MGIC's underwriting practices were "superior" despite allegedly being lax, and that the business was "problem-free" despite the increasing number of claims on defaulted mortgages. Plaintiffs also alleged that defendants failed to disclose that C-BASS was subject to multi-million dollar margin calls, but did not have the liquidity to satisfy the calls. Defendants filed a motion to dismiss, which the U.S. District Court for the Eastern District of Wisconsin granted. The Court held that, as a matter of law, none of the alleged improper statements were misleading and/or material. Specifically, the Court found that statements regarding MGIC's underwriting practices were so vague that no reasonable investor would have deemed them important and, even if deemed material, the complaint failed to allege sufficient facts giving rise to a

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Foreign Investors' Standing Faces New Challenges

By James E. Miller, Esquire and Karen M. Leser-Grenon, Esquire

Foreign investors' ability to bring securities fraud actions recently has been challenged in the courts. The Securities Exchange Act of 1934 does not specify as to whether its provisions apply to fraud relating to the trade of foreign securities. In litigation involving foreign investors, New York courts have developed two tests, the conduct test and the effect test, to determine whether jurisdiction can be conferred in fraud cases involving foreign investors. Under the 'conduct test,' the alleged fraudulent conduct must be conceived and executed in the United States. Under the 'effects test,' jurisdiction may be conferred whenever a predominantly foreign transaction has substantial effects within the United States. Foreign plaintiffs have a more difficult time alleging a substantial effect on U.S. investors and markets than do domestic plaintiffs. However, if the foreign plaintiffs can show that the harm inflicted on the foreign plaintiff actually caused the harm to the U.S. investors or markets due to the relationship between the foreign plaintiff and the U.S. investors, jurisdiction may be conferred. For example, jurisdiction has been found under the effects test where plaintiff's parent company, which holds 50% of its shares in the U.S., financed the foreign trading and actually experienced the relevant loss. *Itoba Ltd. v. Lep Group PLC*, 54 F.3d 118 at 124 (D. Conn. 1995). In *Copeland v. Fortis, Fortis Bank S.A./N.V., Fortis NV, Herman Verwilst, Jean-Paul Votron, Maurice Lippens, Gilbert Mittler, and Filip Dierckx,* No. 08-cv-9060, 2010 WL 569865 (S.D.N.Y. Feb. 18, 2010), plaintiffs were foreign and domestic investors of Fortis securities, which alleged that defendants concealed and misrepresented material information about Fortis' true financial condition. Specifically, plaintiffs alleged that defendants misrepresented the actual value of their collateralized debt obligations, the extent to which their assets were held as risky sub-prime mortgage-backed securities and the extent to which their decision to acquire ABN AMRO Holdings NV had compromised Fortis' solvency. Fortis' stock drastically declined during the class period as news of its true financial condition became public and following the bailout of Fortis by the governments of Belgium, Netherlands and Luxembourg. Defendants sought to dismiss the complaint for lack of subject matter jurisdiction and the Court agreed with defendants and dismissed the complaint. Under the conduct test, the Court concluded that jurisdiction was not conferred because the complaint did not allege that any of the fraudulent conduct was conceived or executed in the U.S. Indeed, most of the decision-making regarding the alleged fraudulent transactions took place from Brussels. Under the effects test, the Court acknowledged that Fortis' alleged fraud had some effect upon U.S. investors and the U.S. securities market, but, under the allegations in *Fortis*, the Court could not determine that the effect was substantial. The complaint did not allege that any foreign purchasers had a relationship to the U.S. such that U.S. investors were harmed by the losses suffered by the foreign purchasers.

In *Terra Securities ASA Konkursbo, et al. v. Citigroup, Inc., et al.*, No. 09-cv-7058, 2010 WL 546970 (S.D.N.Y. Feb. 17, 2010), a Norwegian securities firm and several Norwegian municipalities sued Citigroup, Inc. and several of its domestic and European subsidiaries for securities fraud. Plaintiffs alleged that defendants fraudulently misrepresented the investment risks involved in fund-linked notes. The defendants moved to dismiss the complaint, alleging that the Court lacked subject matter jurisdiction over defendants. The Court disagreed and found that jurisdiction had been conferred in this case. Pursuant to the 'conduct test,' the court found that because the conduct that directly caused investors harm occurred in New York, jurisdiction had been conferred. The plaintiffs had alleged that the marketing strategy, which allegedly contained misrepresentations, was devised in New York. Further, the Court found that the plaintiffs pled sufficient facts alleging that defendants' New York conduct was an essential aspect of the alleged fraud.

District Court Re-Defines Class Definition While Certifying Class in AIG Securities Litigation, *In re American International Group, Inc. Securities Litigation,* No. 04 Civ. 8141 (DAB), 2010 WL 646720 (S.D.N.Y. Feb. 22, 2010)

By Jayne A. Goldstein, Esquire and Rose F. Luzon, Esquire

In a highly-anticipated decision involving AIG, the U.S. District Court for the Southern District of New York declared that the securities fraud class action pending against AIG should be certified and proceed with some modifications to the class definition that excluded certain defendants and claims.

In this case, the lead plaintiffs are three Ohio public pension funds. They filed a putative securities fraud class action against defendants, AIG, its former Chairman and CEO Maurice Greenberg, its outside auditors Pricewaterhouse Coopers LLP ("PwC"), and numerous other corporate and individual

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Recent Developments In Mutual Fund Fee Litigation

By James E. Miller, Esquire and Karen M. Leser-Grenon, Esquire

Courts have been paying strict attention to disclosure obligations for mutual funds in recent months and there have been a number of extremely important legal developments in this field.

The Supreme Court on March 30, 2010 issued *Jones v. Harris Associates L.P.*, --- S.Ct. ----, 2010 WL 1189560 (U.S. March 30, 2010), a widely anticipated decision, that is essentially a split-decision from both sides' perspectives. In the *Jones* case, owners of shares in mutual funds brought action against an investment advisor under the Investment Company Act of 1940, alleging that the advisor's compensation was too high. The Supreme Court essentially reiterated the prior standard for holding an advisor liable, stating that to face liability under the Investment Company Act of 1940 for breach of fiduciary duty with respect to the receipt of compensation for services, an investment advisor for a mutual fund must charge a fee that, under all of the circumstances, is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's length bargaining. Although the decision is helpful since it clearly enunciates a standard, it obviously creates a high burden for mutual fund participants to meet to establish a breach of fiduciary duty -- especially in an industry where excessive fees often appear to rule the day and, therefore, may be difficult to challenge under an "arm's length bargaining" standard where many (but certainly not all) mutual funds appear to be paying systemically high (and arguably excessive) fees to investment advisors -- many of whom have close relationships to the mutual funds for which they perform services. It will be interesting to see if *Jones* leads to greater (or less) mutual fund litigation involving allegations of excessive fees.

In an interesting disclosure case, in *Operating Local 649 Annuity Trust Fund v. Smith Barney Fund Management, LLC*, 595 F.3d 86, 95 (C.A.2 N.Y.2010), Smith Barney categorized fees that it ultimately pocketed as "other fees," rather than disclosing them as management fees. The Second Circuit reversed the District Court's ruling with respect to whether a mischaracterization of fees paid to a transfer agent of Smith Barney was a false material

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Refusal To Certify Halliburton Securities Class Action On Loss Causation Grounds Affirmed By Fifth Circuit, *The Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, 2010 WL 481407 (C.A.5 (Tex.) February 12, 2010)

By Jayne A. Goldstein, Esquire and Laurie Rubinow, Esquire

The Archdiocese of Milwaukee Supporting Fund, Inc. prosecuted this putative securities fraud class action as lead plaintiff against Halliburton Company ("Halliburton") and David Lesar, the Chief Operating Officer and then Chief Executive Officer during the class period ("defendants"), alleging violations of sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and SECRule 10 (b)-5. The district court denied the plaintiff's motion for class certification under Fifth Circuit law on loss causation and plaintiff appealed that order. On February 12, 2010, the Fifth Circuit Court of Appeals found no abuse of discretion by the district court and affirmed the denial of class certification.

This case was a private securities fraud-on-the-market case in which plaintiff claimed that Halliburton made false statements about three critical areas of its business and that, when Halliburton issued subsequent disclosures correcting the false statements and the market declined following the negative news, investors lost money. Plaintiff filed a motion for class certification and the district court denied plaintiff's motion on the basis that the plaintiff failed to prove loss causation, *i.e.* that the corrected truth of the former falsehoods actually caused the stock price to fall and resulted in the losses suffered by the putative class. The plaintiff filed an appeal of the district court's denial of class certification, and the appellate court reviewed the district court's certification decision for an abuse of discretion, and also reviewed de novo the legal standards employed by the district court.

In its appeal, the plaintiff contended that the district court applied an erroneous standard for loss causation and required it to prove more than is required under law. The appellate court reviewed the district court's order and the evidence and found

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Litigation Proceeds Against Apollo Group, Inc. – Section 20 Pleading Standards Clarified

By James C. Shah, Esquire and Nathan Zipperian, Esquire

In *Teamsters Local 617 Pension and Welfare Funds v. Apollo Group., Inc*, 2010 WL 6533440 (D.Ariz. Feb, 22, 2010), the United States District Court recently reinstated certain control person liability claims against various officers and directors of Apollo Group, Inc. ("Apollo") that had been asserted under Section 20(a) ("Section 20") of the Securities Exchange Act of 1934 ("Act"). In so doing, the Court clarified several important issues relating to pleading requirements applicable to Section 20 claims.

The litigation asserts that publicly traded shares of Apollo, which is a provider of on-line education services, dropped significantly following the disclosure of information to the market that the company had engaged in the practice of backdating stock options between 2000 and 2004. As a result of the practice, which provided undisclosed windfall bonuses to its executives and certain employees, Apollo was required to restate its financial statements for the five-year period. In its decision, the Court acknowledged that it had erred when it previously dismissed Section 20 claims, having incorrectly held that control person liability claims must be predicated on the individual defendants having individually violated Section 10(b) of the Act. In reconsidering and reversing its previous ruling, the Court specifically noted that an individual defendant can be liable under Section 20 so long as she exercises actual power or control over a primary violator. In concluding that the plaintiff had sufficiently alleged such control, the Court held that allegations of wrongdoing under Section 20 need only satisfy the general notice pleading requirement under Fed.R.Civ.P 8(a), rather than the more stringent pleading requirements under Fed R.CivP. 9(b) and the Private Securities Litigation Reform Act of 1995 ("PLSRA"). The Court, noting a split of authority on this issue within the Ninth Circuit, persuasively explained that notice pleading was sufficient because fraud and scienter are not essential elements of Section 20 claims. The Court supported its reasoning by analyzing the legislative history of the PLSRA, which makes clear that the heightened pleading standard is only meant to apply to securities fraud claims. In addition to clarifying the standard applicable to claims asserted under Section 20, the Court also made it very clear that a plaintiff is not required to allege "actual participation" by a control person to state a cause of action. Rather, the burden is on the defendant to show that she acted in good faith and did not directly or indirectly induce the violations.

In sum, the decision clarifies important pleading standards applicable to Section 20 claims and appropriately rejected defendant's arguments that plaintiffs have a heightened pleading burden in connection with asserting Section 20 "control person" claims.

Complaint Against Hardinge Dismissed With Prejudice – Not Only Do You Not Get What You Want, Sometimes You Don't Get What You Need

By Scott R. Shepherd, Esquire and Patrick A. Klingman, Esquire

In a recent decision, *In re Hardinge, Inc. Sec. Litig.*, No. 08-CV-6490, 2010 WL 447397 (W.D.N.Y. Feb. 2, 2010), the U.S. District Court for the Western District of New York dismissed securities fraud claims against Elmira-based Hardinge, Inc. ("Hardinge"), a global manufacturer and distributor of precision machine tools, primarily because it found no materially misleading statements. The decision reveals the tension between a publicly-traded company's duty to disclose information and the concept of materiality.

A fundamental element of a securities fraud claim is a material misstatement or omission. Whether an omitted fact is actionable depends on whether the corporation had a duty to disclose the information. *In re Time Warner Sec. Litig.*, 9 F.3d 259, 267 (2d Cir.1993); *see Basic Inc. v. Levinson*, 485 U.S. 224, 239 n.17 (1988) ("Silence, absent a duty to disclose, is not misleading" under the federal securities laws). Courts have identified three circumstances in which such a duty may arise: (1) when SEC rules require disclosure; (2) when an insider trades on the basis of non-public information (also known as the "disclose or abstain" rule); and (3) where disclosure is necessary to make prior statements not misleading. *See, e.g., Vladimir v. Bioenvision Inc.*, 606 F.Supp.2d 473, 485 (S.D.N.Y. 2009); *Glazer v. Formica Corp.*, 964 F.2d 149, 156-157 (2d Cir. 1992).

In order for a duty to disclose to attach the information at issue also must be material. "For an undisclosed fact to be material, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available." *Castellano v. Young & Rubicam, Inc.*, 257 F.3d 171, 180 (2d Cir. 2001). Facts considered material are those that "affect the probable future of the company and [that] may affect the desire of investors to buy, sell, or hold the company's securities." *Id.* at 180. Because materiality is considered a "mixed question of law and fact," courts generally "will not dismiss a securities fraud complaint at the pleading stage ...,

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Shareholder Claims of Federal Securities Fraud Survive CEO's Motion to Dismiss *Burritt v. NutraCea*, No. CV-09-00406, 2010 WL 668806 (D. Ariz. Feb. 25, 2010)

By Laurie Rubinow, Esquire and Nathan Zipperian, Esquire

Plaintiffs, shareholders of a public corporation that produced stabilized rice bran to sell as a nutritional supplement, brought suit against the corporation, NutraCea, its former Chief Executive Officer, Bradley Edson, and its former Chief Financial Officer, Todd Crow ("defendants"), for violations of Section 10(b) of the Securities Exchange Act of 1934, SEC Rule 10b-5 and Section 20(a) of the Exchange Act, as well as for violations of the Arizona Securities Act in the United States District Court for the District of Arizona. NutraCea filed for bankruptcy in November 2009 and, as a result, the claims against it were dismissed without prejudice. Defendants, Edson and Crow, moved to dismiss the complaint and, on February 25, 2010, the Court granted only Crow's motion as to the Section 10(b) and Rule 10b-5 claim, but denied the defendants' motions in all other respects.

The gravamen of plaintiffs' complaint was that defendants misled investors concerning four corporate transactions completed between December 2006 and March 2008 by attesting to the correctness of NutraCea's public financial statements, which improperly recognized over $9.6 million in revenue from the transactions. Plaintiffs alleged that defendants knew, or were deliberately reckless in not knowing, that NutraCea improperly recognized revenue from four "sale" transactions in violation of Generally Accepted Accounting Principles ("GAAP"), as well as the company's stated revenue recognition principles. The defendants challenged plaintiffs' Section 10(b) and Rule 10b-5 claims on the elements of scienter, reliance and loss causation. The Court reviewed the plaintiffs' allegations and found that, while none was sufficient to support a strong inference of scienter against either defendant, in reviewing the allegations in their totality, plaintiffs' specific allegations against Edson, in combination with the general allegations against him, created a strong inference of scienter which was cogent and at least as compelling as an inference that Edson was merely reckless or negligent. In addition, with regard to the element of reliance, the Court determined that, at the pleading stage, plaintiffs need only allege an efficient market, and the Court concluded that plaintiffs adequately alleged an efficient market given NutraCea's weekly trade volume and the market's immediate response to the public information. Lastly, the Court concluded that plaintiffs' loss causation theory was sufficient to survive the defendants' motion to dismiss because the plaintiffs offered sufficient detail to give Edson ample notice of their loss causation theory and provided some assurance that the theory had a basis in fact. Consequently, the Court denied defendant Edson's motion to dismiss with regard to the Section 10(b) and Rule 10b-5 claims.

With respect to defendant Crow, however, the Court stated that the scienter analysis produced a contrary result: not only did plaintiffs fail to assert particular allegations about Crow's knowledge of the transactions and about his motive to commit securities fraud, the Court concluded that, even in combination with the general allegations concerning the accounting violations, the nature of the transactions and Crow's position at the company did not present a strong inference of scienter. For these reasons, the Court granted Crow's motion to dismiss on the plaintiffs' Section 10(b) and Rule 10b-5 claims.

In response to the defendants' motion to dismiss plaintiffs' Section 20(a) claims, the Court found that a well-pled Section 10(b) and Rule 10b-5 claim against a corporate officer is sufficient to state a primary violation against the corporation entity itself, and since the plaintiffs adequately pled NutraCea as a controlled primary violator with defendants as control persons, the Court denied defendants' motion to dismiss these claims.

Lastly, the Court denied the defendants' motion to dismiss the Arizona state law securities claim because it concluded that the Arizona statute broadly authorized liability against any person who potentially "induced" a securities purchase by disseminating false information into the marketplace. The Court further found that, although plaintiffs had not explicitly alleged inducement in their complaint, the allegations gave defendants fair notice of their inducement theory and that these allegations would support a claim under Arizona law.

Complaint Against Hardinge Dismissed With Prejudice – Not Only Do You Not Get What You Want, Sometimes You Don't Get What You Need

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unless reasonable minds could not differ on the importance of the omission." *Halperin v. eBanker USA.com, Inc.*, 295 F.3d 352, 357 (2d Cir.2002).

The complaint in *Hardinge* alleged, among other things, that public statements regarding the company's plans to transition from distributors to a direct sales force in Canada were misleading because they failed to mention the ongoing "restructuring" to a direct sales force in Germany and other areas, all of which would cause decreased market penetration and lower sales for the Company. *Hardinge*, 2010 WL 447397, at *2-*3. Indeed, after the end of the class period, Hardinge admitted that its poor financial results for the 2007 fiscal year were "self-inflicted" and attributable to the restructuring. *Id.* at *5.

After parsing through each of the public statements, the *Hardinge* court determined that they accurately conveyed the information the company intended to disclose and were not contradicted by the allegedly withheld information, which the court found was only "tangentially related to the subject matter of a statement," and which, therefore, imposed no duty to disclose. *Id.* at *9; *see In re Time Warner*, 9 F.3d at 267 ("A corporation is not required to disclose a fact merely because a reasonable investor would very much like to know that fact"); *In re Bristol Myers Squibb Co. Sec. Litig.*, 586 F.Supp.2d 148, 160 (S.D.N.Y 2008) ("The requirement to be complete and accurate does not mean that 'by revealing one fact ... one must reveal all others that, too, would be interesting ... but means only such others, if any, that are needed so that what was revealed would not be so incomplete as to mislead'").

Finding no misleading public statements and no materially omitted information, the *Hardinge* court then found that allegations of the defendants' scienter (*i.e.*, an intent to deceive, manipulate or defraud), which must support a "strong inference," were likewise insufficient. *Id.* at *14-*18.

Thus, a motive and opportunity to commit fraud, based upon the stock sales of one of Hardinge's officers, was not shown because nothing indicated that the sales were unusual or suspicious; indeed, on the day the officer disposed of his largest amount of shares, he actually acquired even more. *Id.* at *16. Similarly, allegations demonstrating "strong circumstantial evidence of conscious misbehavior or recklessness," such as "access to information contradicting public statements," were lacking – the desire to maintain a high stock price to maximize returns from a class period stock offering were too "generalized" and there was no specific showing of reports or other sources of information that were inconsistent with the public statements. *Id.* at *17-*18.

Ultimately, the *Hardinge* court concluded that the most plausible inference, based upon the facts alleged, was that the defendants "believed that they were under no obligation to [disclose the omitted facts], and that, from a business standpoint, there was no good reason to disclose the omitted information." *Id.* at *19. In other words, because the information was not material, the failure to disclose it could not form the basis of a securities fraud claim.

Recommended Reading

Circle of Greed: The Spectacular Rise and Fall of the Lawyer Who Brought Corporate America to Its Knees, by Patrick Dillon and Carl Cannon - by all accounts a fascinating read about a lawyer rightfully recognized for his genius that rose to the heights of his profession before suffering a very public downfall.

Fordlandia, by Greg Grandin - a very interesting book about Henry Ford's folly in the Amazon and the creation of a prefabricated industrial town established in the rainforest in 1928 for the purpose of securing a source of cultivated rubber for the automobile manufacturing operations.

Lords of Finance, by Liaquat Ahamed - an important book regarding central bankers and the disaster of the gold standard that led to the Great Depression.

Marx's General, by Tristam Hunter - an insightful study of Friedrich Engels, the industrialist who bankrolled the publication of *Das Kapital*. This is an impressive biography of a figure attempting to reconcile his contradictory roles as both capitalist and communist.

The First Tycoon, by T.J. Stiles - an excellent account of the risks and gambles that Cornelius Vanderbilt took in building his corporate dynasty, from his humble beginnings on Staten Island to the founder of modern capitalism.

Claims Against Madoff Feeder Fund Dismissed In Substantial Part, *SEC v. Cohmad Sec. Corp.*, No. 09 Civ. 5680, 2010 WL 363844 (S.D.N.Y. Feb. 2, 2010)

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was too successful to need new investment and that he would only begrudgingly allow a privileged few (and well-connected) investors to give him money to manage."

The SEC alleged two broad categories of claims, characterized by the Court as "securities fraud claims" and "technical" violations claims. The SEC asserted that the Defendants violated and aided and abetted Madoff's violations of Section 10(b) of the Securities Exchange Act of 1934, and Section 17(a) of the Securities Act of 1933, and Sections 206(1) and (2) of the Investment Advisers Act of 1940. The alleged technical violations included aiding and abetting violations of registration, compensation, and filing regulations under the Exchange Act of 1934 and the Investment Advisers Act of 1940. Unlike the securities fraud claims, these technical violations did not require the SEC to plead the Defendants' fraudulent intent.

Dismissing the securities fraud claims against all Defendants, Judge Louis Stanton concluded that "nowhere does the complaint allege any fact that would have put defendants on notice of Madoff's fraud. Rather, the complaint supports the reasonable inference that Madoff fooled the defendants as he did individual investors, financial institutions, and regulators." The court also held that "one who conducts normal business activities while ignorant that the activities are furthering a fraud is not liable for securities fraud." The court allowed the technical violations claims to proceed, and granted the SEC leave to file an amended complaint.

The *Cohmad* decision, one of a number of claims in state and federal courts against Madoff, is significant, as the SEC, court-appointed trustee, and numerous private plaintiffs try to recoup at least a portion of their losses. A recent Florida state court case against various feeder funds, which asserted only state law claims, alleging that defendants failed to perform their professional duties but simply turned over funds to Madoff, is also going forward with claims. *Cocchi et. al. v. Tremont Group Holdings, et al.*, 502009 CA 016230 (Fifteenth Judicial Circuit, Palm Beach County, Florida). Although the massive amount of Madoff-related litigation will likely continue for years, these decisions show that certain claims against registered broker dealers marketing securities may survive motions to dismiss in limited fashion. It remains to be seen whether the victims of Madoff's fraud will recover even a very small portion of their losses.

Georgia Supreme Court Allows Securities Claims To Proceed Under State Law

By Nathan Zipperian, Esquire and Karen M. Leser-Grenon, Esquire

On February 8, 2010, the Georgia Supreme Court in *Holmes v. Grubman,* --- S.E.2d ----, 2010 WL 424225 (Feb. 8, 2010, Ga.), held that, under Georgia common law: (1) fraud claims based on forbearance in the sale of publicly traded securities ("holder claims") are actionable; (2) plaintiffs in misrepresentation or omission claims involving publicly traded securities must prove loss causation; and (3) a limited fiduciary relationship exists between registered representatives and clients, even in non-discretionary accounts.

First, the Court unanimously found that Georgia common law does indeed recognize "holder" claims, holding that "it is well settled that one of the elements of the tort of fraud in Georgia is an 'intention to induce the plaintiff to act or refrain from acting.'" The Court explained that Georgia's well-settled elements for fraud claims are consistent with the general rule that "'induced forbearance can be the basis for tort liability.'" The Court also explained that, although the U.S. Supreme Court had previously held that "holder" claims are not available under Rule 10(b)(5), it had expressly noted that "holder" claims may be available under State law. The Court did, however, impose two requirements on "holder" claims brought under Georgia law: direct communication and specific reliance. "Direct communication" requires that "'plaintiffs allege that the

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Georgia Supreme Court Allows Securities Claims To Proceed Under State Law

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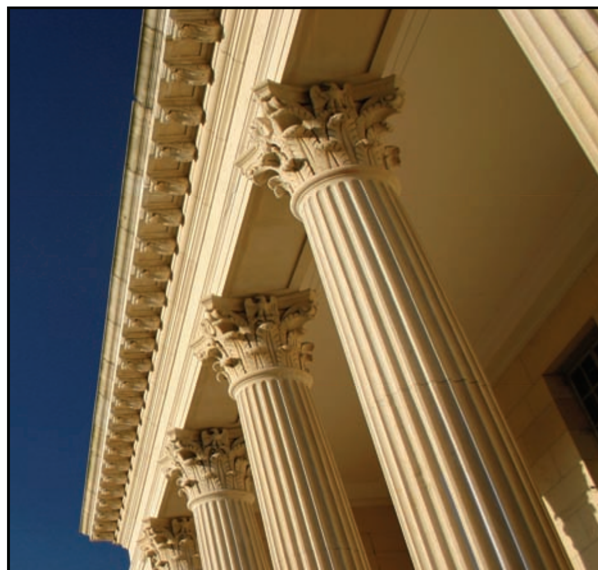
misrepresentations were directed at them to their injury.'" "Specific reliance" requires that plaintiffs "'allege actions, as distinguished from unspoken or unrecorded thoughts and decisions, that would indicate that the plaintiff actually relied on the misrepresentations.'" The Court further held that negligent misrepresentation claims, subject to the same limitations, can also be based on forbearance in the sale of publicly traded securities.

The Court also examined the question of whether, with respect to a tort claim based on misrepresentations or omissions concerning publicly traded securities, proximate cause is adequately pleaded under Georgia law when a plaintiff alleges that his injury was a reasonably foreseeable result of the defendant's false or misleading statements but does not allege that the concealed fact caused a drop in the price of the security. The Court addressed the burden placed on a plaintiff at trial to prove proximate cause with respect to a tort claim based on misrepresentations or omissions concerning publicly traded securities. The Court began its analysis by noting that it has long been the law in Georgia that "in order to recover in tort for fraud, the plaintiff must prove that he sustained loss or damage as the proximate result of the alleged misrepresentations." The Court then noted that, unlike "holder" claims, Georgia's common law requirement that plaintiffs prove proximate causation is in accord with Supreme Court precedent.

Finally, the Court examined whether a fiduciary duty exists under Georgia law between a brokerage firm and the holder of a non-discretionary account. The Court recognized the limited scope of the fiduciary duty that a broker may owe to a client



holding a non-discretionary account and recognized circumstances when a broker would owe a "heightened" duty to clients holding non-discretionary accounts. Typically, a broker owes a limited duty to non-discretionary clients, "'including the duty to transact business only after receiving prior authorization from the client and the duty not to misrepresent any fact material to the transaction.'" The Court approved of this standard and noted that brokers "generally have a heightened duty, even to the holder of a non-discretionary account, when recommending an investment which the holder has previously rejected or as to which the broker has a conflict of interest."

The Bankruptcy Examiner's Report in Lehman Bros. – Who Knew What, And When?

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review the pertinent transactions and documents, and allow the parties to make an informed determination as to their substantive rights. *See id.*

Some parties to the Lehman bankruptcy may question the examiner's supposed objectivity, as the Report uses legally charged language such as "materially misleading" and "actionable balance sheet manipulation." Newspaper articles indicate that the examiner, a former U.S. Attorney for the Northern District of Illinois, has been in contact with the Department of Justice and the Securities & Exchange Commission throughout his investigation, and Senator Dodd, the Chair of the Senate Banking Committee, has formally requested the Attorney General to form a task force based on the Report's findings.

The aspect of the Report that has garnered most of the attention is the revelation that Lehman routinely used a little-known accounting technique, known internally as "Repo 105," to temporarily move large amounts of collateralized debt off its balance sheets – often just days before quarter end – so it could be recorded as sales, and thereby reduce the amount of debt to be reported to shareholders and securities regulators. According to the Report, this created "a materially misleading picture of [Lehman Bros.'] financial condition in late 2007 and 2008;" the

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The Bankruptcy Examiner's Report in Lehman Bros. – Who Knew What, And When?

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former global head of Lehman's accounting policy group described the accounting maneuver as "a lazy way of managing the balance sheet as opposed to legitimately meeting balance-sheet targets at quarter end," and the former Lehman global financial controller told the examiner that "the only purpose or motive for the transactions was reduction of the balance sheet," adding that "there was not substance to the transactions."

The Report highlights several provocative aspects of Lehman's use of Repo 105. Among other things, because it could find no U.S. law firm to "bless" its use of this accounting device, Lehman obtained an opinion letter from Linklaters LLP, a London-based international law firm, which approved the "true sale" treatment of the transfers under English law (which meant that, in practice, all such transfers were directed through Lehman's London-based subsidiary and conducted with non-U.S. banks, such as Germany's Deutsche Bank AG and the United Kingdom's Barclay's PLC). In addition, although Lehman initially established a cap on the amount of debt that could be transferred via a Repo 105 "transaction" ($22 billion in the summer of 2006), within a year that limit was consistently exceeded – "[b]eginning in mid-2007 – the very time the market began to particularly focus on investment banks' leverage – Lehman breached its internal limit on Repo 105 activity at every quarter end, temporarily removing as much as $50.38 billion in securities inventory from its balance sheet in second quarter 2008."

The Report flatly concludes that Lehman's failure to disclose the extent to which its use of Repo 105 impacted its balance sheet, particularly from mid-2007 through 2008, "materially misrepresented Lehman's true financial condition." Although the list of senior Lehman management who "professed ignorance" of specific aspects of Repo 105 is notable (and includes, among others, Lehman's CEO, Richard Fuld, and the three CFOs of Lehman who served between September, 2007 through September, 2008), Lehman's auditor, Ernst & Young LLP, figures prominently in the Report's discussion of Repo 105. In particular, the Report indicates that Ernst & Young was long aware of Lehman's use of Repo 105 and that, together with Lehman's own Corporate Audit group, investigated allegations about "balance sheet substantiation" problems raised in a May, 2008 "whistleblower" letter, including interviewing the letter's author in June, 2008, but yet failed to mention the allegations in a meeting of the Board of Directors' Audit Committee the very next day.

Among other findings, the Report concludes that "sufficient evidence exists to support the finding of colorable claims against Richard Fuld [and Lehman's three CFOs] in connection with their actions in causing or allowing Lehman to file periodic reports that did not disclose Lehman's use of Repo 105 transactions and against Ernst & Young for its failure to meet professional standards in connection with that lack of disclosure." While it remains to be seen what the bankruptcy trustee or government regulators will do with the examiner's Report, it is unlikely that Lehman's shareholders will gain any benefit. As shareholders of a bankrupt company, their claims have a much lower priority than creditors. Moreover, with respect to possible claims against Ernst & Young for "aiding and abetting" Lehman's violation of the federal securities laws, such claims were eliminated by the U.S. Supreme Court in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), and that prohibition was recently extended to so-called "scheme liability" in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148 (2008). While there are legislative proposals to revive "aiding and abetting" liability for private litigants, whether they ultimately will be enacted is unclear, but it will likely be too late for shareholders of Lehman Brothers.

Is A Trend Arising In Mortgage-Related Securities Cases?

(Continued from page 2)

reasonable belief that the statements were, in fact, false or misleading. Further, the Court found that the complaint merely "speculated" that defendants intended to deceive investors when they stated that MGIC's books were "problem-free." The Court also concluded that the complaint had not pled sufficient facts to support the allegation that defendants misled or intended to deceive investors regarding C-BASS's liquidity.

To the extent plaintiffs believed they could cure the pleading deficiencies, the Court allowed them to move for leave to file an amended complaint, which plaintiffs filed on March 18, 2010. To date, no decision has been made on this motion.

***Yu v. State Street Corp.*, No. 08 Civ. 8235 (RJH), 2010 WL 668645 (S.D.N.Y. Feb. 25, 2010)**

Plaintiffs are investors of a Yield Plus Fund ("Fund"), which in turn invested in mortgage-related securities. Defendants included State Street Corp. and its investment management arm, State Street Global Advisors ("SSGA"), which managed the Fund and offered Fund shares to the public. Plaintiffs' complaint alleged violations of the Securities Act of 1933 based on alleged misrepresentations in the Fund's public offering documents. More specifically, the complaint alleges that the offering documents misled investors by stating that the Fund invested in "high-quality" securities, even though it invested in risky mortgage-related instruments, by failing to disclose the extent of the Fund's mortgage-related holdings, and by overvaluing those holdings. Defendants moved to dismiss, and the U.S. District Court for the Southern District of New York granted that motion, holding that the complaint failed to plead actionable material misrepresentations in the offering documents. As in the preceding cases, the Court undertook a detailed analysis of the alleged misstatements and concluded, as a matter of law, that the allegations lacked factual support. Regarding the quality of the Fund's securities, for example, the Court was troubled by the complaint's failure to provide factual allegations concerning the Fund's mortgage-related securities, including specifics on the extent to which those securities were backed by subprime loans as opposed to loans to credit-worthy borrowers. Likewise, as to the classification of the Fund's holdings, the Court explained that, due to "the absolute dearth of factual content concerning the characteristics of the Fund's mortgage-related holdings," it was impossible to discern whether the alleged misstatements distorted the Fund's risk profile, or whether such distortion would have been significant to the reasonable investor in deciding how to act. The Court also found plaintiffs' overvaluation claims to be deficient, as they failed to allege which securities were overvalued, how defendants' valuation conflicted with the prescribed methods, and how the subprime market turmoil related to the accuracy of the Fund's valuations. For the foregoing reasons, the Court dismissed plaintiffs' complaint with prejudice, thereby precluding plaintiffs from filing an amended complaint. On March 17, 2010, plaintiffs filed a motion asking the Court to reconsider its "with prejudice" ruling and to allow plaintiffs to amend their complaint. A decision on this motion is currently pending.

A principal lesson emerging from this line of cases is that sufficient facts must be pled that identify and describe in detail (1) the mortgage-related securities at issue, (2) how the alleged statements or omissions are material and false or misleading, (3) the legal duties owed by defendants to investors, (4) the methodology and reasons for concluding that the securities were inaccurately valued or otherwise misrepresented, (5) the connection between the ongoing mortgage crisis and the impact on the subject securities, and (6) defendants' intent to deceive investors, among other key allegations. Indeed, as the District Court in *State Street* aptly explained in rejecting plaintiffs' overvaluation claims:

> In reaching this decision, the Court does not ignore historical context. Numerous financial entities, including mutual funds, have been accused of carrying mortgage-related securities in their books at inflated values in 2007 and 2008. . . But this historical context only works to emphasize the deficiency in plaintiffs' claims. Juxtaposed against the existence of information suggesting that other institutions overvalued their mortgage-related holdings, the Complaint's failure to identify information about how State Street overvalued its holdings is telling. To take a specific example, when the SEC sanctioned one mutual fund for its inaccurate valuations, it identified discrepancies between the mutual fund's stated valuation methods and the methods it actually used to assign values to certain mortgage-backed holdings. *In re Evergreen Investment Mgmt. Co.*, SEC Admin. Proceeding File No. 3-13507 (June 8, 2009) (finding that Evergreen deviated from disclosed fair value procedures by overriding prices provided by third-party pricing vendors). Plaintiffs' overvaluation claims fail because they offer no facts to render plausible the assertion that State Street similarly deviated from its disclosed valuation methods.

In *New Jersey Carpenters Vacation Fund v. The Royal Bank of Scotland*, No. 08-5093, 2010 WL 1172694 (S.D.N.Y. March 26, 2010), the Court also dismissed virtually all of the claims asserted in the case, which involved prospectuses related to mortgage backed securities, on the same or similar grounds.

The potential for mortgage-related securities class actions will undoubtedly increase as the country continues to struggle with the mortgage crisis. Therefore, to successfully prosecute these cases, investors must pay careful attention to fastening the factual gaps highlighted by the *TMI*, *MGIC*, and *State Street* cases.

District Court Re-Defines Class Definition While Certifying Class in AIG Securities Litigation, *In re American International Group, Inc. Securities Litigation*, No. 04 Civ. 8141 (DAB), 2010 WL 646720 (S.D.N.Y. Feb. 22, 2010)

(Continued from page 3)

defendants associated with AIG. The complaint alleges violations of Sections 11 and 15 of the Securities Act of 1933, Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, and SEC Rule 10b-5. Lead plaintiffs moved to certify a class of all persons who purchased or otherwise acquired AIG securities, including equity, fixed income and all other securities during the alleged class period. The District Court granted in part and denied in part the motion for class certification.

Given the extensive and complex background of this case, a brief summary of the key factual allegations is helpful. According to plaintiffs, AIG engaged in a series of alleged frauds that had the effect of distorting the price of AIG securities. They allege that, since the 1990s, AIG and other insurance companies paid non-party Marsh & McLennan Companies, Inc. ("Marsh") billions of dollars in illegal contingent commissions in return for Marsh steering business toward them, while classifying these payments as "services." This resulted in billions of dollars of revenue for AIG during the class period. Additionally, plaintiffs allege that AIG took part in an illegal scheme to rig bids for quotes that Marsh presented to its clients, ensuring that AIG would be selected by Marsh to win these bids and provide coverage to the clients. As a result of the contingent commissions and bid-rigging schemes, plaintiffs charge that AIG's public statements concerning its financial condition were materially false and misleading, particularly with regard to its revenues and competition in the insurance industry. Plaintiffs also allege that AIG failed to timely disclose an ongoing SEC investigation concerning these matters until September 2003, when the SEC filed a civil action against it. Finally, plaintiffs allege that defendant Greenberg attempted to manipulate the price of AIG stock on several occasions.

After AIG publicly disclosed the alleged illegal conduct, including the misleading statements and omissions, plaintiffs contend that the price of AIG shares suffered significant declines on six separate days during the class period: (1) on October 14, 2004, when the N.Y. Attorney General announced that AIG had been implicated in a scheme to rig bids and pay contingent commissions, causing a decline of 10.43% in AIG's stock price; (2) on October 15, 2004, when defendant Greenberg admitted during a call with analysts that AIG had received a subpoena from the N.Y. Attorney General's Office in September 2004 and had launched an internal investigation, leading to another 3.58% decline; (3) on March 17, 2005, when the media reported that the SEC and N.Y. Attorney General had expanded their probes to include accounting irregularities, causing a decline of 3.34%; (4) on March 30, 2005, when AIG issued a press release relating to the accounting for its Gen Re reinsurance transaction, causing a decline of 1.79%; (5) on March 31, 2005, when the media reported that PwC received a subpoena relating to AIG, causing a decline of 3.06%; and (6) on April 1, 2005, when several media reports revealed that regulators were expanding the scope of the AIG investigation, resulting in a decline of 8.05%.

The Court began its class certification analysis under Rule 23 of the Federal Rules of Civil Procedure by emphasizing that, at this stage in the case, the Court "'resolves factual disputes relevant to each Rule 23 requirement' and must find that 'whatever underlying facts are relevant to a particular Rule 23 requirement have been established' in order to satisfy the applicable legal standard for that requirement." Before undertaking the Rule 23 analysis, the Court first addressed the issue of standing and determined that lead plaintiffs lacked standing to bring a § 11 claim on behalf of a proposed class of bondholders based on an allegedly false and misleading registration statement filed with the SEC. The Court held that "because Lead Plaintiffs were necessarily aware of allegations in the original complaint, including the false and misleading financial information in the class period financial statements, they cannot now plausibly contend that they were unaware that the Registration Statement and Prospectus contained false and misleading financial information at the time that they purchased AIG's 4.25% Notes on and after March 15, 2005." The Court also concluded that lead plaintiffs did not have standing to bring a §15 claim, since that claim is dependent upon a finding of liability under § 11.

Next, the Court thoroughly analyzed each of the Rule 23 factors. The Court found that the numerosity and commonality requirements were met, since the proposed class consists of over two million shareholders, and there were many common questions of law and fact. With regard to the typicality requirement, the Court rejected defendants' argument that lead plaintiffs were atypical because they bought AIG shares after the company's disclosures of its improper conduct. Since lead plaintiffs purchased thousands of AIG shares on multiple occasions prior to any disclosures and since their purchases after the disclosures were made in reliance on the market, the Court found no inter-class conflict. Further, the Court found lead plaintiffs and their counsel to be adequate representatives.

The predominance requirement proved to be the most contentious of the Rule 23 factors. For all groups of defendants except one, the Court concluded that this requirement was met, because a common course of conduct permeated the various

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District Court Re-Defines Class Definition While Certifying Class in AIG Securities Litigation, *In re American International Group, Inc. Securities Litigation,* No. 04 Civ. 8141 (DAB), 2010 WL 646720 (S.D.N.Y. Feb. 22, 2010)

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alleged frauds. However, as against the issuer's subsidiary and its officers (General Re defendants), the Court found no predominance, since there was no showing or allegation that these defendants made public misstatements or omissions with regard to the issuance of AIG shares, and the claims against them were accordingly dismissed.

In further analyzing the predominance requirement, the Court considered whether the fraud-on-the-market presumption applied to lead plaintiffs. This presumption originates from the U.S. Supreme Court's decision in *Basic v. Levinson*, 485 U.S. 485 (1998), and provides that, in an open and developed securities market, it is assumed that the price of a company's stock is determined by the available material information concerning the company. According to the Second Circuit Court of Appeal in *In re Initial Public Offering Securities Litigation*, 471 F.3d 24 (2nd Cir. 2006), a proper analysis of the predominance factor must, therefore, determine whether a defendant can successfully rebut the fraud-on-the-market presumption. Accordingly, the Court here performed a comprehensive analysis to determine if there existed an efficient market, utilizing a variety of factors. It concluded that lead plaintiffs could not demonstrate that the 0.5% and Zero coupon bonds traded on an efficient market and thus dismissed those claims. Additionally, the Court held that lead plaintiffs need not show loss causation by a preponderance of the evidence at the class certification stage in order to establish the fraud-on-the-market presumption and reliance. Lastly, after analyzing multiple event studies proffered by lead plaintiffs and defendants' experts, the Court found that defendants rebutted the fraud-on-the-market presumption for the price decreases occurring on March 30 and 31, 2005.

After deciding that a class action was the superior method for resolving the controversy, the Court amended the class definition to comport with its Rule 23 analysis. Thus, the new class definition includes those purchasers of AIG equity stock who held such stock over one or more of the days for which the fraud-on-the-market presumption still applies, as well as holders of common stock of HSB Group and American General, both of which were acquired by AIG.

Now that the securities fraud class has been certified, institutional and other investors in AIG securities should assess whether or not they meet the new class definition articulated by the Court, as well as whether they purchased securities that are now excluded from the class definition.

Fifth Circuit Affirms Refusal To Certify Halliburton Securities Class Action On Loss Causation Grounds Affirmed By Fifth Circuit, *The Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.,* 2010 WL 481407 (C.A.5 (Tex.) February 12, 2010)

(Continued from page 4)

that the district court fully understood loss causation under its precedent and that it also correctly applied the legal standard. Concluding that the district court's decision was well supported and was not an abuse of discretion, the appellate court affirmed the lower court's decision holding that: (1) neither the press release in which the corporation reported that it would need to increase its asbestos reserves, nor the SEC report in which the corporation noted that these reserves had been increased, nor the press releases reporting adverse judgments in the corporation's asbestos litigation, showed that the Company's prior statements regarding the adequacy of its asbestos reserves were misleading or deceptive when made; (2) even assuming that the corporation's prior statements regarding the benefits of a merger were anything more than erroneous expectations, the subsequent decrease in the price of the stock following the announcement that the Company's third quarter earnings would be less than previously expected and following the release of negative analyst reports was insufficient to establish the requisite causal connection to the losses; and (3) the plaintiff failed to show that the corporation's press release stating that it would undertake a massive restructuring of its construction business, and subsequent announcement that it would take a fourth quarter charge of $120 million as result of that restructuring, corrected any prior misleading statements or revealed deceptive practices in the corporation's accounting assumptions, as required for the plaintiff to utilize the fraud-on-the-market theory in order to satisfy the reliance element of Rule 10b-5 at the class certification stage. Therefore, the Fifth Circuit required the plaintiff to establish loss causation by a preponderance of all admissible evidence at the class certification stage.

The *Halliburton* decision unfortunately represents just another example of whyinstitutional investors should think long and hard before prosecuting a securities fraud case in the Fifth District – a jurisdiction where, increasingly, it appears that the federal securities laws effectively hardly apply at all. Simply put, the loss causation standards that the Fifth Circuit has created at the class certification stage are so stringent that, increasingly, it is extremely difficult (if not impossible) to establish loss causation to the satisfaction of the Fifth Circuit - a court which, in many ways, appears to be legislating from the bench to amend the federal securities laws as it sees fit.

Recent Developments In Mutual Fund Fee Litigation

(Continued from page 4)

representation in violation of 10(b). The Second Circuit held that, in light of the SEC's disclosure rules, the misrepresentations were material under 10(b), as a reasonable investor would find it important in the total mix of information made available. *Operating Local 649 Annuity Trust Fund v. Smith Barney Fund Management, LLC*, 595 F.3d 86, 95 (C.A.2 N.Y.2010). A mutual fund is required to file with the SEC a registration statement and prospectus containing fee tables summarizing the expenses deducted from fund assets. *See* 15 USC Sec. 80a-8, 80a-24, 80a-29. According to the SEC, "[t]he fee table is designed to help investors understand the costs of investing in a fund and to compare those costs with the costs of other funds." Registration Form Used by Open-End Management Investment Companies Securities Act, 63 Fed.Reg. 13,916 at 13,924. The SEC requires mutual funds to break out and disclose three separate categories of fund expenses in the front of every fund prospectus: management fees, distribution or 12b-1 fees, and other expenses. Amendments to Proxy Rules for Registered Investment Companies, 59 Fed. Reg. at 52,691. Should an investment advisor seek an increase in its fee, the advisor must issue a comparative fee table if any of the fee categories are to be increased, regardless of whether total expenses would be increased. Amendments to Proxy Rules for Registered Investment Corps., 59 Fed. Reg. 52,689, at 52,691 (Oct. 19, 1994). (codified at 17 C.F.R. pt. 200).

Another recent Second Circuit case, *In re Morgan Stanley Information Fund Securities Litigation*, 592 F.3d 347 (2nd Cir. 2010), also involved disclosure obligations in registration statements and prospectuses filed on Form N-1A pursuant to the Securities Act of 1933 ("Securities Act"). Form N-1A creates a three-part registration statement that can satisfy issuers' prospectus-related obligations under the Securities Act. In the *Morgan Stanley* litigation, the plaintiffs alleged that Morgan Stanley and others omitted certain disclosures relating to the mutual funds that were required under the federal securities laws. Specifically, plaintiffs alleged that defendants failed to disclose that there were internal conflicts of interest at Morgan Stanley that could potentially taint the objectivity of its stock research and that certain Funds relied on Morgan Stanley's research. The District Court, as well as the Appeals Court, agreed with Morgan Stanley, noting that "while defendants are required to make complete and accurate disclosure about the principal risks of investing in the Funds, these mandatory disclosures did not obligate defendants to make disclosures relating to the commonly understood risks associated with securities research."

In *Demings v. Nationwide Life Insurance, Co.*, 593 F.3d 486 (6th Cir. 2009), a sponsor of a section 457 deferred compensation plan brought a class action against Nationwide, asserting claims for breach of fiduciary duty based on Nationwide's alleged receipt of revenue-sharing payments from the mutual funds in which the section 457 plan invested its participants' individual funds. Demings alleged that the plan participants, and not Nationwide, should be entitled to any revenue-sharing payments because that profit was derived directly from the assets of the plan participants. The District Court dismissed Demings' complaint, stating that the case was precluded under the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"). SLUSA precludes most securities fraud class action and related suits brought under state law. The appeals court affirmed the District Court's ruling and found that plaintiff's suit did not fit within the narrow state-actions exception to SLUSA preclusion, because plaintiff was not a state, political subdivision or a state pension plan.

In another significant ruling, in *Leber v. Citigroup, Inc.*, No. 07-9329, 2010 WL 935442 (S.D.N.Y. March 16, 2010), the Court permitted claims for breach of fiduciary duty under Section 404 of ERISA to stand based upon allegations that the Administrative Committee and the Investment Committee of Citigroup's 401(k) retirement plan acted imprudently by steering plan assets to affiliated mutual funds with higher investment advisory fees than those of competing funds, but dismissed prohibited transaction claims based on allegations of self-dealing and conflicts of interest. In a similar case, *In re Regions Morgan Keegan ERISA Litigation*, 2010 WL 809950 (W.D.Tenn. March 9, 2010), however, the Court upheld prohibited transaction and breach of fiduciary duty claims based on very similar facts to those present in the *Citigroup* case.

On the settlement front, in a case alleging that Marsh & McLennan Companies, Inc. ("MMC") had engaged in a plan to increase insurance placement revenue through improper bid manipulation and illicit client steering, plaintiffs alleged that Defendants violated their fiduciary duties under the Employee Retirement Income Security Act, 29 U.S.C. § 1001 *et seq.* by continuing to hold MMC stock in the MMC Stock Investment Plan when they knew that the Plan's investment in MMC was not a prudent retirement investment. *In re Marsh ERISA Litigation*, No. 04-8157, 2010 WL 451028 (S.D.N.Y. Jan. 29, 2010). The Court ultimately approved the $35 million settlement of this litigation as fair and reasonable.

We will continue to closely monitor developments in mutual fund fee litigation - a fascinating field with important implications for the retirement security of every individual with a U.S. retirement plan.

Update On Financial Regulatory Reform

By James E. Miller, Esquire and Laurie Rubinow, Esquire

Although the current Senate version of financial regulatory reform is not as strong as the House bill reported upon in our last issue, the Senate bill contains some important and strong reforms that appear likely to become law this year. The following is a summary of the key components of the Senate bill:

- Creates a new independent watchdog, housed at the Federal Reserve, with the authority to ensure American consumers get the clear, accurate information they need to shop for mortgages, credit cards, and other financial products, and protect them from hidden fees, abusive terms, and deceptive practices.

- Creates protections against financial firms becoming "too big to fail" by creating a safe means to liquidate failed financial firms; imposing tough new capital and leverage requirements that make it undesirable to get too big; updating the Federal Reserve's authority to allow system-wide support but no longer supporting individual firms; and establishing rigorous standards and supervision to protect the economy and American consumers, investors and businesses.

- Creates a council to identify and address systemic risks posed by large, complex companies, products, and activities before they threaten the stability of the economy.

- Eliminates loopholes that allow risky and abusive practices to go on unnoticed and unregulated - including loopholes for over-the-counter derivatives, asset-backed securities, hedge funds, mortgage brokers and payday lenders.

- Streamlines bank supervision to create clarity and accountability while protecting the dual banking system that supports community banks.
- Provides shareholders with a voice on pay and corporate affairs with a non-binding vote on executive compensation.

- Creates new rules for transparency and accountability for credit rating agencies to protect investors and businesses.

- Strengthens oversight and empowers regulators to aggressively pursue financial fraud, conflicts of interest and manipulation of the system that benefit special interests at the expense of American families and businesses.

Although we are disappointed that the Senate bill does not go further to protect investors and consumers, we recognize that the Senate bill contains some important regulatory reforms. We also remain hopeful that any legislation that is ultimately enacted by Congress will add some of the additional "teeth" contained in the House bill to protect investors and consumers alike from fraudulent and abusive practices.

Upcoming Conferences

SFMS lawyers and other representatives will be presenting or speaking at and attending the following upcoming conferences:

- April 18-21, 2010: The Building and Construction Trades Department's 2010 Legislative Conference at the Washington Hilton and Towers, 1919 Connecticut Avenue, NW, Washington, DC
- April 21-23, 2010: 58th Annual Antitrust Law Spring Meeting at the JW Marriott Hotel and The National Press Club (Washington, DC)
- April 21-22, 2010: National Association of Securities and Consumer Attorneys 2010 Spring Annual Meeting at The Regent Palms (Turks and Caicos)
- May 12-14, 2010: Illinois Public Pension Fund Association at the Pheasant Run Resort (St. Charles, Illinois)
- June 27-30, 2010: Florida Public Pension Trustees Association 26th Annual Conference (Naples Grande Beach Resort, Naples, Florida)
- July 22, 2010: PLI's Class Action Litigation Strategies 2010 at Practicing Law Institute's New York Center, 810 7th Ave, Fl 21, New York

If you are interested in attending one of these conferences or seminars, please email institutionalservices@sfmslaw.com.

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