SFMS Securities Law Bulletin

Spring 2011

A quarterly publication for institutional investors

Inside this issue:

The Supreme Court's Latest (Unanimous) Word On Materiality	1
SFMS Commences Litigation Challenging 401k Fees	1
Auditor Malpractice - A New Path For Recovery In Ponzi Schemes Involving Non-Covered Securities?	2
Supreme Court To Rule On Consumers' Rights In Class Actions: AT&T v. Concepcion	3
The Dodd-Frank Whistleblower Provisions - The Specifics And Implications Of The Same	3
Court Deals A Blow To Investors In Wachovia Securities Litigation	4
Update Of SEC's Proposal To Reform Mutual Fund Fees	5
Materiality Standard Addressed By Second Circuit	6
SFMS Institutes Securities Class Action On Behalf Of Investors Of Elan Corporation	6
The Supreme Court Grants Certiorari In Halliburton Securities Litigation	7
Class Certification Denied In First American Securities Litigation	7
Undue Deference To The SEC?	8
SEC v. Mark Cuban: Insider Trading Enforcement	9
SFMS Represents Client In Section 220 Proceeding Under Delaware Law Against Allergan	9
Recommended Readings	11
SFMS News	16

Shepherd, Finkelman, Miller & Shah, LLP
Attorneys at Law

California • Connecticut • Florida
New Jersey • Pennsylvania • Wisconsin

The Supreme Court's Latest (Unanimous) Word On Materiality

By Patrick A. Klingman, Esquire

The Supreme Court has long taken a very pragmatic view of what is "material information," the finding of which is a prerequisite to liability under the federal securities laws. Concerned that mandating disclosure of information of "dubious significance" would cause corporations "simply to bury the shareholders in an avalanche of trivial information," the Supreme Court over twenty years ago adopted a standard that measures materiality by the extent to which a "reasonable investor" would view the information as "significantly alter[ing] the 'total mix' of information made available." *Basic Inc. v. Levinson*, 485 U.S. 224, 231 (1988) (quoting *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)). As explained by the *Basic* court, the materiality requirement is not intended to "attribute to investors a child-like simplicity," but rather "to filter out essentially useless information that a reasonable investor would not consider significant, even as part of a larger 'mix' of factors to consider in making his investment decision." *Id.*, 485 U.S. at 234. Overall, materiality is an "inherently fact-specific finding," requiring the "delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him." *Id.*, 485 U.S. at 236.

(Continued on page 10)

SFMS Commences Litigation Challenging 401K Fees

By James E. Miller, Esquire and Eric L. Young, Esquire

On February 22, 2011, SFMS commenced litigation on behalf of one of its clients challenging the practices of ING Life Insurance and Annuity Company, including its receipt of so-called revenue sharing payments from mutual funds that it offers to its 401k retirement plan customers. The complaint filed by SFMS specifically asserts that ING has entered into revenue sharing agreements with various mutual funds and similar entities pursuant to which ING receives kickbacks for its own benefit from these mutual funds in violation of, among things, the prohibited transaction rules of the Employee Retirement Income Security Act ("ERISA"), as well as ERISA's fiduciary responsibility rules. The complaint states that the kickback payments at issue are essentially part of a pay-to-play scheme in which ING receives substantial payments from mutual funds in the form of 12b-1 fees, administration fees, service fees, sub-transfer agent fees and/or similar fees (so-called "revenue sharing payments") in return for providing the mutual funds with access to its retirement plan customers, including its 401k plan customers, and that ING receives these fees in addition to the compensation it

(Continued on page 5)

Auditor Malpractice - A New Path For Recovery In Ponzi Schemes Involving Non-Covered Securities?

By Jayne A. Goldstein, Esquire and Patrick A. Klingman, Esquire

Economic downturns tend to more readily expose fraudulent investment schemes, particularly "Ponzi" schemes in which new investors' "contributions" are used to pay older investors' "returns." As new capital dries up, so does cash flow (and the payment of subsequent returns). The most recent economic crisis exposed not only Bernard Madoff's multi-billion dollar fraud, but also somewhat lesser-known Ponzi schemes orchestrated by Thomas Petters in Minnesota, Nicholas Cosmo in Long Island, New York and allegedly by Allen Stanford in Texas.

Because of the nature of Ponzi schemes, while liability against the perpetrators is often established, recovery can prove much more elusive. Understandably, defrauded victims also look to establish the culpability of professionals, such as auditors, lawyers and banks, who lend the fraudulent enterprise an air of credibility and perhaps even performed audits or other services without detecting the fraudulent nature of the operation. In such contexts, it is liability that proves more elusive, as courts are generally reluctant to apply 20/20 hindsight against professionals who may have been duped just as much as the victims.

Nevertheless, one avenue currently being explored by victims of Ponzi schemes is a claim for negligent misrepresentation or professional malpractice; for example, against an auditing firm which failed to detect the fraud and nonetheless issued a clean audit opinion. However, because the victims often lack a direct relationship (such as a contract) with the auditors, success on these claims depends on which states' law applies.

Because it requires a relaxation of privity (*i.e.*, a contractual relationship), courts have struggled with the boundaries of a non-client's claim for professional negligence. In the words of Benjamin Cardozo, then Chief Judge of the New York Court of Appeals, "[i]f liability for negligence exists, a thoughtless slip or blunder, the failure to detect a theft or forgery beneath the cover of deceptive entries, may expose accountants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class." *Ultramares Corp. v. Touche*, 255 N.Y. 170, 179 (1931). As developed under New York law (followed by several other states), liability attaches only if the accountants were aware that the results of their engagement were to be used for a particular purpose, knew that particular parties would rely on their results, and there was some conduct showing that the accountants understood those third parties' reliance. *Credit Alliance Corp. v. Arthur Andersen & Co.*, 65 N.Y.2d 536, 551 (1985). This does not require privity in the strict sense, but does require a relationship "so close as to approach that of privity." *Id.*, 65 N.Y.2d at 546.

Such state law-based claims are particularly well-suited to allegations of professional negligence arising from Ponzi scheme audits for the simple reason that they are still permissible after passage of the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"). SLUSA was enacted shortly after the Private Securities Litigation Reform Act ("PSLRA") in response to the perception that otherwise federal securities claims were being brought in state courts in order to evade the PSLRA's strict pleading requirements. *See Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 82 (2006). Thus, SLUSA principally bars class actions of fifty of more members "based upon the statutory or common law of any State" that allege "a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security." 15 U.S.C. § 78bb(f)(i)(A). Critically, SLUSA defines a "covered security" as "one traded nationally and listed on a regulated national exchange." *Dabit*, 547 U.S. at 83; *see* 15 U.S.C. § 77r(b)(1).

Because most Ponzi schemes involve purported investments in something other than "covered securities," such as interests in limited liability companies or promissory notes, claims against auditors arising from such frauds generally are not pre-empted by SLUSA. For example, last year the U.S. District Court for the Southern District of New York allowed negligence claims to proceed against the auditors of a series of "feeder funds" which invested with Bernard Madoff. *Anwar v. Fairfield Greenwich Ltd.*, 728 F.Supp.2d 372 (S.D.N.Y. 2010). Applying the *Credit Alliance* factors (*i.e.*, awareness that the audited reports were to be used for a particular purpose, intending that the investors (a "known party") would rely on the reports, and "linking conduct" showing the auditors' understanding of the investors' reliance), the *Anwar* court concluded that the auditors of the funds owed a duty of care to the funds' investors, and that the breach of that duty supported a claim for damages by the investors against the auditors. *Id.*, 728 F.Supp.2d at 454-457.

It is too soon to tell whether these claims will ultimately provide any compensation to defrauded investors. However, application of these claims at least provides the chance that victims of fraudulent schemes such as those perpetrated by Madoff and others will have an opportunity to provide evidence against those entities that allowed the schemes to continue.

Supreme Court To Rule On Consumers' Rights In Class Actions: *AT&T v. Concepcion*

By Karen M. Leser-Grenon, Esquire

In the case captioned *AT&T Mobility LLC v. Concepcion*, No. 09-893, the U.S. Supreme Court granted certiorari of a 9th Circuit Opinion (*Laster v. AT&T Mobility LLC*, 584 F.3d 849 (9th Cir. 2009), and will decide whether the Federal Arbitration Act preempts state contract law when state courts find class arbitration waivers unconscionable.

The plaintiffs in the case, the Concepcions, signed a contract with AT&T to obtain a package discount on two mobile phones. The Concepcions alleged that AT&T engaged in false advertising when it advertised a discounted package and then charged the plaintiffs tax on the full price of both phones. The plaintiffs brought the suit in the U.S. District Court for the Southern District of California. In response, AT&T filed a motion to dismiss, arguing, among other things, that the plaintiffs should be forced to resolve the dispute through arbitration and not through a class action based upon a class action waiver in the underlying contract. The District Court denied AT&T's request to dismiss the case. Courts in California have traditionally found contracts with these clauses, which force consumers to arbitrate, are unconscionable, in that they often contain unfair terms and conditions, and no ability for the consumer to bargain with the company. AT&T appealed the decision to the 9th Circuit Court of Appeals, which upheld the District Court's decision. AT&T then appealed to the Supreme Court.

The Supreme Court heard oral argument on the case in November 2010. Several Justices made comments which suggested that they were uncomfortable telling states that they cannot decide for themselves what constitutes an unconscionable contract. For example, Justice Scalia commented, "What if a State finds it unconscionable to have an arbitration clause in an adhesion contract which requires the arbitration to be held at a great distance from where the other party is and requires that party to pay the cost of the arbitration? Can a State not find that to be unconscionable?" Justice Kagan likewise commented, "…how about a provision prohibiting certain kinds of attorney's fees? How about a provision prohibiting certain kinds of—a law prohibiting certain kinds of discovery provisions? And you said that would be fine, for the State courts to hold those things unconscionable, but it's not fine for the State court to hold a class arbitration prohibition unconscionable. So what separated the two? How do we know when something is on one side of the line and something is on the other?"

(Continued on page 10)

The Dodd-Frank Whistleblower Provisions—The Specifics And Implications Of The Same

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

In recognition of the fact that robust whistleblower protection may be critical to preventing another financial crisis, Congress included in the Dodd-Frank Financial Services Reform Bill (H.R. 4173) numerous provisions designed to encourage whistleblowing and to provide significant protection from retaliation. These provisions create monetary awards for whistleblowers who provide original information to the SEC or CFTC, strengthen the whistleblower protection provisions of the Sarbanes-Oxley Act and the False Claims Act, and create additional whistleblower retaliation causes of action. Many believe that, in light of the fact that courts have rendered private securities laws more difficult to enforce, the future of securities regulation and enforcement may become centered on whistleblower cases.

Rewards for Whistleblowing to the SEC and Prohibition Against Retaliation (Section 922): Under Section 922 of Dodd-Frank, the SEC will be required to pay a reward to individuals who provide original information to the SEC which results in monetary sanctions exceeding $1 million. The award will range from 10 to 30 percent of the amount recouped and the amount of the award will be at the discretion of the SEC. Factors to be considered in determining the amount of the award include the significance of the information provided by the whistleblower, the degree of assistance provided by the whistleblower, the programmatic interest of the SEC in deterring violations of the securities laws by making awards to whistleblowers, and other factors that the SEC may establish by rule or regulation. If the amount awarded is less than 10 percent or more than 30 percent of the amount recouped, a whistleblower may appeal the SEC's determination by filing an appeal in the appropriate federal court of appeals within 30 days of the determination.

Section 922 prohibits the SEC from providing an award to a whistleblower who is convicted of a criminal violation related to the judicial or administrative action for which the whistleblower provided information; who gains the information by auditing financial statements as required under the securities laws; who fails

(Continued on page 12)

Court Deals A Blow To Investors In Wachovia Securities Litigation

By Laurie Rubinow, Esquire

On March 31, 2011, Judge Richard J. Sullivan of the United States District Court for the Southern District of New York dealt a blow to investors when he dismissed four consolidated complaints on behalf of investors in *In re Wachovia Equity Securities Litigation*, 2011 WL 1344027 (S.D.N.Y. March 31, 2011).

The cases arose after, on October 1, 2006, Wachovia completed its acquisition of Golden West Financial Corporation ("Golden West"), an Oakland-based mortgage lender, for more than $24 billion. Prior to the Golden West acquisition, a majority of the loans funded by Wachovia were traditional fixed-rate mortgages. Golden West's main product, however, was a payment option adjustable rate mortgage ("Option ARM") known as the Pick–A–Payment ("Pick–A–Pay") mortgage, which allowed borrowers to choose from multiple payment options each month. Among those options was a "minimum" payment that, because it did not cover the monthly interest, actually increased the principal of the loan—a phenomenon known as "negative amortization."

In the *Wachovia* case, investors alleged that, following the Golden West acquisition, Wachovia began to focus on selling Pick–A–Pay loans rather than the traditional loans that had previously comprised the bulk of its residential mortgage business. Plaintiffs also alleged that Wachovia weakened the credit quality of the Pick–A–Pay portfolio by lowering minimum credit scores, failing to verify borrower income levels, implementing quotas and sales incentives for loan officers, and relying on inflated third-party appraisals of home value. According to the Plaintiffs, Wachovia adopted debased underwriting standards and aggressive marketing strategies in order to maximize Pick–A–Pay loan volume "at all costs."

The Plaintiffs in *Wachovia* identified a number of allegedly false and misleading statements made by Wachovia, including the following statements:

- On a May 8, 2006 conference call announcing the Golden West acquisition, Defendant G. Kennedy Thompson ("Thompson"), the President and CEO of Wachovia, indicated that Golden West was "obsessed with conservative underwriting," had "no subprime origination," and maintained a "very conservative portfolio."
- On an April 16, 2007 call, Thompson similarly touted the "superior credit quality" of Wachovia's mortgage portfolio. "It would be ha[r]d for me to imagine," Thompson said, "how anybody could look at our underwriting of these loans and draw any conclusion ... other than [that] we are very responsible underwriters."
- As the housing market continued to decline, Defendants allegedly misrepresented the comparative advantages of the Pick–A–Pay mortgage relative to the troubled subprime market. On a July 20, 2007 conference call, Defendant Donald K. Truslow, Wachovia's Chief Risk Officer, stated that "we've actively managed our business to minimize our exposure to the subprime market. So as a result there's been little impact to our businesses with the turbulence in the subprime markets...."
- On a January 22, 2008 earnings call, Defendant Thomas J. Wurtz ("Wurtz"), Wachovia's Chief Financial Officer, referred to a series of charts comparing the Pick–A–Pay portfolio with prime, subprime, and Alt–A industry performance. Wurtz concluded that "[t]here is clear evidence that our Pick–A–Pay portfolio is, to date, performing very similar to the average prime portfolio in the industry...."

Plaintiffs also alleged that, during 2006 and 2007, Wachovia created, structured, and underwrote approximately $10.11 billion of collateralized debt obligations ("CDOs") backed by pools of subprime mortgages. Until November 9, 2007, however, Wachovia allegedly concealed that it had retained more than $2.1 billion of those CDOs. Wachovia carried these CDOs at par value until October 19, 2007, despite the fact that their value was allegedly impaired no later than February 2007.

As the Plaintiffs detailed in their securities complaints, the true "risks and realities" of the Pick–A–Pay portfolio began to seep out in early 2008. In an April 14, 2008 conference call, Wachovia disclosed for the first time that 14% of the $120 billion Pick–A–Pay portfolio had loan-to-value (LTV) ratios above 100%. Defendants simultaneously admitted that due to Pick–A–Pay losses, Wachovia would need to raise billions in new capital and could not afford to continue its dividend payout. Thompson was forced to resign as CEO on June 2, 2008. The new CEO, Lanty Smith, later admitted to investors that "there has been a complete recognition at the Board level that Golden West was a mistake and that we have to deal with the consequences of it."

By late September 2008, Wachovia's share price fell below $1 per share for a market capitalization loss of approximately $109.8 billion from early 2007. Following a proposed acquisition by Citigroup, Wachovia subsequently merged with Wells Fargo in a $12 .7 billion transaction—less than Wachovia had originally paid for Golden West.

In a somewhat surprising decision that has negative implications for the rights of investors, the Court held that, among other things, the plaintiffs in the traditional securities fraud cases had failed to allege sufficient facts to establish that Defendants acted with the requisite degree of scienter (*i.e.*, fraudulent intent) and, on that basis, dismissed the vast majority of claims by investors. It will be interesting to see if the investors in these cases appeal this decision and if the Court's decision in *Wachovia* is permitted to stand.

SFMS Commences Litigation Challenging 401K Fees

(Continued from page 1)

receives directly from its customers - *i.e.*, the 401k plans themselves. As the complaint details, the challenged revenue sharing payments are based, in whole or in part, on a percentage of the retirement plans' investments in a mutual fund that are delivered to it by ING and/or based on the magnitude of the investments by such retirement plans in the mutual fund and, while the revenue sharing payments are often internally described by service providers, such as ING, as "services fees" and reimbursement for expenses incurred in providing services for, to or on behalf of the mutual funds, the amount of the revenue sharing payments bear absolutely no relationship to the cost or value of any such services. The complaint also asserts that ING has engaged in acts of self-dealing with respect to the retirement assets of the 401k plans at issue and, in so doing, has independently violated the prohibited transaction rules of ERISA. The complaint seeks equitable relief and damages under ERISA on behalf of all 401k plans in the United States that have used ING as a service provider.

Update Of SEC's Proposal To Reform Mutual Fund Fees

By James C. Shah, Esquire

As detailed in the separate summary of the case recently commenced by SFMS on behalf of 401k plans in the United States against ING Life Insurance and Annuity Company, the issue of mutual fund fees and what they are used to pay is one of exceptional importance to retirement plans and their beneficiaries. As detailed below, although the SEC has proposed certain significant reforms with respect to mutual fund fees, it appears that retirement plan and other mutual fund investors may have to wait until 2012 or later before such regulatory reform is achieved. In the meantime and pending review of such regulations, through the provisions of ERISA and other applicable law, SFMS will continue to act to protect the interests of its clients with respect to their retirement and other investment assets.

The SEC on July 21, 2010 proposed rule changes designed to significantly reform the regulation of distribution fees paid by mutual funds. Under the proposal, the SEC would replace existing Rule 12b-1 under the Investment Company Act of 1940 ("1940 Act") with new Rule 12b-2. In addition, the SEC would amend certain related rules and forms. Currently, Rule 12b-1 allows distribution fees to be deducted from mutual fund assets.

Under new Rule 12b-2, fund sponsors would continue to be able to offer funds that bear promotional, marketing and other distribution costs in addition to imposing sales-related charges at the time of purchase. Under proposed revisions to Rule 6c-10, funds would be allowed to change ongoing sales charges subject to a maximum limit. The proposed rules would make a number of significant changes, including: additional disclosure about sales charges in a fund's prospectus, annual and semi-annual reports and investor confirmation statements; revised fund director oversight duties; and the ability of funds to permit dealers to set and propose their own sales charges under certain circumstances.

New Rule 12b-2: Under the SEC's proposal, Rule 12b-1 would be rescinded in its entirety and replaced with Rule 12b-2. That rule would split distribution fees into two categories: (i) marketing and service fees and (ii) ongoing sales charges.

Marketing and Service Fees: Under Rule 12b-2, a fund could pay an asset-based fee for "distribution activities." This fee would be called a "marketing and service fee." A fund could charge a marketing and service fee up to the service fee limit imposed by NASD Conduct Rule 2830, which is currently 25 basis points annually. A fund could use this fee to pay any distribution activity (in contrast to NASD Conduct Rule 2830, which limits the types of expenses that qualify for payment as service fees). Proposed Rule 12b-2 defines "distribution activity" broadly to mean "any activity which is primarily intended to result in the sale of shares issued by a fund, including, but not necessarily limited to, advertising, compensation of underwriters, dealers, and sales personnel, the printing and mailing of prospectuses to other than current shareholders, and the printing and mailing of sales literature." In the Proposing Release, the SEC gave the following examples of the way a fund could use marketing and service fees:

> pay costs associated with participation on a distribution platform, such as a fund "supermarket," pay trail commissions to broker-dealers in recognition of the ongoing services they provide to fund investors, pay retirement plan administrators for services provided to participants, offset the costs of shareholder call centers, pay servicing fees like those currently permitted by FINRA rules, and traditional distribution-related services.

The SEC stated that a fund could use the marketing and service fee to pay for non-distribution-related services, such as sub-transfer

(Continued on page 14)

Materially Standard Addressed By Second Circuit

By Patrick A. Klingman, Esquire and Nathan Zipperian, Esquire

In *Landmen Partners, Inc. v. The Blackstone Group, L.P.*, No. 09-4426, 2011 WL 447050 (2nd Cir. Feb. 10, 2011), the United States Court of Appeals for the Second Circuit reduced the burden on plaintiffs when pleading materiality under the federal securities laws. The underlying case was brought on behalf of investors who purchased the common units of Blackstone Group, L.P. ("Blackstone") at the time of the company's initial public offering. Plaintiffs sought remedies under Section 11, 12(a)(2), and 15 of the Securities Act of 1933, 15 U.S.C. §§ 77k, 771(a)(2), 77o, for alleged material omissions from, and misstatements in, Blackstone's registration statement and prospectus. The plaintiffs alleged that Blackstone failed to disclose risks associated with its private equity funds' investments in FGIC Corp. ("FGIC") and Freescale Semiconductor, Inc. ("Freescale"). Further, plaintiffs alleged that Blackstone made material misstatements regarding the risks facing its real estate funds in light of the downturn in the subprime residential market. The District Court dismissed plaintiffs' complaint, holding that the alleged misrepresentations or omissions regarding FGIC and Freescale were neither quantitatively nor qualitatively material, and further holding that the misrepresentations alleged by plaintiffs were insufficient, as they failed to specify how the residential mortgage downturn would have a foreseeable material effect on Blackstone's real estate investment. Plaintiffs appealed to the Second Circuit.

The Second Circuit concluded that the District Court erred in dismissing plaintiffs' complaint because plaintiffs plausibly alleged that material information was omitted from, or misstated in, defendants' initial public offering registration statement and prospectus, in violation of Sections 11 and 12(a)(2) of the Securities Act of 1933. The Court noted that "were we to hold otherwise, we would effectively sanction misstatements in a registration statement or prospectus related to particular portfolio companies so long as the net effect on revenues of a public private equity firm like Blackstone was immaterial." The Court concluded that the firm's Corporate Private Equity division was its flagship segment, and because it played such a central role to financial services, a reasonable investor "would almost certainly want to know information related to that segment that Blackstone reasonably expects will have a material adverse effect on its future revenues." The Court also found that "plaintiffs provide significant factual detail about the general deterioration of the real estate market and specific facts, that drawing all reasonable inference in plaintiffs' favor, directly contradict statements made by Blackstone in the Registration Statement."

The Blackstone decision is important, as many cases involving the subprime and credit crisis were filed in the Southern District of New York and, to date, courts have struggled with the pleading requirements at the motion to dismiss stage. Since *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007) and *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009), much greater scrutiny has been applied to securities class action complaints. In *Blackstone*, the Court stated that a "33 Act complaint 'need only satisfy the basic notice pleading requirements" and "where the principal issue is materiality, an inherent fact-specific finding, the burden on plaintiffs to state a claim is even lower."

SFMS Institutes Securities Class Action On Behalf Of Investors Of Elan Corporation, PLC

By Karen M. Leser-Grenon, Esquire

On February 23, 2011, SFMS filed a lawsuit in the United District Court for the Southern District of New York on behalf of investors who purchased publicly traded stock or American Depository Shares ("ADS's") of Elan Corporation, PLC (NYSE: ELN)("Elan" or the "Company") between July 2, 2009 and August 5, 2009 (the "Class Period"). The Complaint is filed as a class action and asserts claims under the federal securities laws against Elan, G. Kelly Martin, the Company's President and Chief Executive Officer, and Shane Cooke, Elan's Chief Financial Officer. The case is assigned to the Honorable Shira A. Scheindlin and bears the docket number 11-CV-01232-SAS.

The complaint alleges that, during the Class Period, defendants made materially false and misleading statements about a transaction between Elan and Johnson & Johnson ("JNJ"). Defendants allegedly stated that JNJ had agreed to pay $1 billion for 18.4% ownership of Elan and 50.1% ownership of a new company, Janssen Alzheimer Immunotherapy

(Continued on page 13)

The Supreme Court Grants Certiorari In Halliburton Securities Litigation

By Natalie Finkelman Bennett, Esquire and Karen M. Leser-Grenon, Esquire

On January 7, 2011, the U.S. Supreme Court agreed to hear a case initially brought by Erica P. John Fund, formerly known as Archdiocese of Milwaukee Support Fund (the "Fund"), on behalf of investors of Halliburton Company ("Halliburton"). The Supreme Court case is captioned, *Erica P. John Fund Inc. v. Halliburton*, No. 09-1403. In the underlying case, plaintiff alleged that Halliburton and certain of its officers attempted to inflate the stock price of Halliburton by underestimating asbestos liabilities, overstating revenues in its engineering and construction business and overstating the benefits of its merger with Dresser Industries. The issue before the Supreme Court concerns the standard that applies in securities cases at the class certification stage. Specifically, the Supreme Court will decide whether the Fifth Circuit Court of Appeals correctly held, that plaintiffs in securities fraud actions must establish loss causation at the class certification stage by a preponderance of evidence without merits discovery. The answer to this question will determine whether the Fund can pursue a securities fraud lawsuit as a class action against Halliburton and certain of its officers.

The Fifth Circuit held that the case could not proceed as a class action, because investors failed to prove by a preponderance of evidence that the misrepresentations caused the stock price to fall, resulting in damages to investors. Lawyers for plaintiff argue that plaintiff should not have to make that showing at the class certification stage, when they have not had a chance for full discovery. Critics of the Fifth Circuit, including the Obama Administration, said that the Fifth Circuit imposes requirements on shareholders that are too stringent. Petitioner argues that no other circuit requires proof of loss causation at class certification by a preponderance of evidence without having merits discovery. The Seventh Circuit recently noted that under the standard set by the Fifth Circuit, plaintiffs would have to prove everything with the exception of falsity before a class could be certified. The court commented that such a standard, "would end the use of class actions in securities cases." *Schleicher v. Wendt*, No. 09-2154, 2010 WL 3271964, at *2 (7th Cir. Aug. 20, 2010). The Supreme Court will hear argument on this case at the end of April 2011 and a decision is expected before the end of June.

Class Certification Denied In *First American* Securities Litigation

By Rose F. Luzon, Esquire

In a blow to the rights of investors, the Honorable Lewis A. Kaplan of the United States District Court for the Southern District of New York denied class certification in *Berks County Employees' Retirement Fund v. First American Corp.*, 2010 WL 3430517 (S.D.N.Y. Aug. 31, 2010). In the *First American* case, investors asserted securities claims against a real estate appraisal firm that allegedly engaged in the fraudulent inflation of real estate appraisal values on behalf of and at the direction of Washington Mutual, Inc. -- a large mortgage lender that was forced to shutter its doors in the wake of the sub-prime mortgage crisis. In denying class certification, Judge Kaplan held that, although the claims of the class admittedly arose from the same nucleus of common facts, class certification should be denied because (1) the lead plaintiff failed to establish that any alleged misrepresentations were material (*i.e.,* information that would be important to a reasonable investor) and, therefore, the fraud-on-the-market presumption could not be invoked to support class certification; and (2) the lead plaintiff failed to establish that any alleged, actionable omissions were material in order to presume reliance under the Supreme Court's decision in *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 92 S.Ct. 1456 (1972)(addressing when reliance on omissions can be presumed by investors in the absence of misrepresentations). Judge Kaplan's decision is disappointing from the perspective of investor rights because, in the *First American* case, the lead plaintiff had presented an expert event study to show why the alleged misrepresentations and omissions were material, but Judge Kaplan effectively decided that this event study was not sufficiently persuasive. In essence, rather than determining whether the lead plaintiff had made an initial showing of materiality, the Court appears to have judged the merits of the underlying dispute and refused to certify the case on the basis of a merits-based

(Continued on page 9)

Undue Deference To The SEC?

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

U.S. District Court Judge Jed S. Rakoff, who sits in the United States District Court for the Southern District of New York in Manhattan, has a well-deserved reputation as a stringent jurist. However, litigants may find some solace in the fact that he is an equal opportunity taskmaster, and his arguably populist positions appear to have inspired other judges to follow his lead in reviewing government-negotiated settlements, which must be fair, reasonable, adequate and in the public interest.

In the Securities and Exchange Commission's ("SEC") 2009 action against Bank of America arising from the undisclosed (and excessive) $5.8 billion in discretionary bonuses paid to former Merrill Lynch executives, Judge Rakoff indicated displeasure with a settlement in which Bank of America agreed to pay a $33 million fine, without admission or denial of the SEC's allegations. Initially, the Court bristled at the prospect of Bank of America's shareholders, rather than corporate officers, paying to resolve charges that the bank, "through its management, effectively lied to its own shareholders." *SEC v. Bank of America Corp.*, No. 09 Civ. 6829 (JSR), 2009 WL 2842940, at *1 (S.D.N.Y. Aug. 25, 2009).

In a later decision following the parties' additional submissions, the Court outright rejected the proposed consent agreement for similar reasons – "even upon applying the most deferential standard of review for which the parties argue, [the Court] is forced to conclude that the proposed Consent Judgment is neither fair, nor reasonable, nor adequate." *SEC v. Bank of America Corp.*, 653 F.Supp.2d 507, 509 (S.D.N.Y. 2009). The Court found that "[t]he proposed Consent Judgment in this case suggests a rather cynical relationship between the parties: the S.E.C. gets to claim that it is exposing wrongdoing on the part of the Bank of America in a high-profile merger; and the Bank's management gets to claim that they have been coerced into an onerous settlement by overzealous regulators." *Id.* at 512. Having rejected the settlement proposal, the Court directed the parties to prepare for trial. Judge Rakoff eventually relented and approved a $150 million settlement on February 22, 2010, but he did so "reluctantly," *SEC v. Bank of America Corp.*, No. 09 Civ. 6829 (JSR), 2010 WL 624581, at *1 (S.D.N.Y. Feb. 22, 2010), and referred to the agreement as "half-baked justice at best" and "inadequate and misguided." *Id.*, 2010 WL 624581, at *5-*6.

Notably, other federal judges have followed Judge Rakoff's lead. After Judge William H. Pauley, III, also of the Southern District of New York, rejected a proposal by the SEC in a different case in March, 2010, the *Wall Street Journal*'s Law Blog questioned whether the judge had "pulled a Rakoff?" In that case, *SEC v. Bear, Stearns & Co., Inc., et al.*, No. 03 Civ. 2937 (WHP), slip op. (S.D.N.Y. March 15, 2010), the SEC's willingness to undo a portion of a landmark 2003 settlement, reached in the wake of revelations that Wall Street firms' analysts were hyping companies to benefit their investment banking counterparts, and which severely limited interactions between the two functions, was "counterintuitive," *id.*, slip op. at 1, would "deconstruct the firewall between research analysts and investment bankers erected by the parties when they settled these actions," and was, among other things, "contrary to the public interest." *Id.*, slip op. at 2.

Later that year, Judge Ellen Segal Huvelle of the D.C. District Court refused to approve a $75 million settlement that the SEC brokered with Citigroup, Inc. regarding the latter's failure to adequately disclose the extent of its subprime-mortgage exposure. During the course of two lengthy hearings, interspersed by the parties' additional briefing, Judge Huvelle repeatedly invoked and echoed Judge Rakoff's criticisms with respect to the SEC's explanation for the consent judgment. *SEC v. Citigroup, Inc.*, CA No. 10-1277 (ESH), slip op. at 1-2 (D.D.C. August 17, 2010); *see* August 16, 2010 and September 24, 2010 hearing transcripts. Although her displeasure was somewhat softened over the course of two lengthy hearings, significant changes to the consent judgment were required before Judge Huevelle approved it. September 24, 2010 Tr. at 57-59.

The same day that Judge Huvelle was voicing her discontent with the proposed *Citigroup* settlement, her colleague, Judge Emmet G. Sullivan, expressed similar concerns regarding a deferred prosecution agreement between federal prosecutors and Barclays Bank PLC, arising from the bank's systemic and purposeful violation of trade sanctions against nations including Cuba, Iran and Libya from 1995 to September, 2006. *USA v. Barclays Bank PLC*, Crim. Action No. 10-218 (EGS) (D.D.C.). As reported by *The New York Times* on August 18, 2010, Judge Sullivan's irritation was reminiscent of Judge Rakoff's – "he expressed concerns that Barclays was not pleading guilty, that no individuals were being prosecuted and that the $298 million would be paid by shareholders, not corporate executives." While Judge Sullivan ultimately approved the $298 million settlement the day after the hearing, he also insisted on periodic monitoring reports going forward.

Most recently, Judge Rakoff has turned his attention to another longstanding practice of the SEC, in which defendants are permitted to settle "without admitting or denying wrongdoing." In *SEC v. Vitesse Semiconductor Corp.*, 10 Civ. 9239 (JSR), 2011 WL 976578 (S.D.N.Y. March 21, 2011), the SEC was initially criticized for treating the Court as a "rubber stamp [by filing] proposed Consent Judgments ... without so much as a word of explanation" regarding why they should be approved or how they meet the criteria for approval. *Id.* However, following subsequent briefing and a hearing, the Court satisfied itself with the fairness and adequacy of the monetary terms of the proposed settlements. *Id.*, 2011 WL 976578, at *3.

Nonetheless, it is the SEC's policy of permitting a defendant to neither admit nor deny a complaint's allegations, with concomitant agreement not to publicly challenge their factual basis, that the Court found "more troubling" and perhaps not in the public interest. *Id.* The Court found that the result was "a stew of confusion and hypocrisy unworthy of such a proud agency as the S.E.C.," *id.*, 2011 WL 976578, at *4, and pointed out that the Justice Department's Criminal Division had long ago largely eliminated the similar option of *nolo contendere* pleas because "the public regards consent to such a plea by the Government as an admission that it has only a technical case at most and that the whole proceeding was just a fiasco." *Id.*, 2011 WL 976578, at *5 (citation omitted). Although the facts of *Vitesse* (defendants' previous guilty criminal pleas) did not warrant disapproval of the proposed settlements, Judge Rakoff clearly put the SEC on notice that such provisions will be closely inspected in his courtroom. Moreover, if the reaction of other judges to Judge Rakoff's previous rulings is any indication, there will be increased judicial scrutiny in other courtrooms as well.

SEC v. Mark Cuban: Insider Trading Enforcement

By Karen M. Leser-Grenon, Esquire

Mark Cuban, owner of the Dallas Mavericks and Landmark theaters, was sued by the Securities and Exchange Commission ("SEC") for, among other things, insider trading violations under the Securities and Exchange Act of 1934 ("Exchange Act"). The principle allegation in the case was that Mr. Cuban received confidential information from the CEO of Mamma.com, a Canadian search engine company in which Mr. Cuban was a minority stakeholder. Upon receiving the confidential information, Mr. Cuban allegedly agreed to maintain the information as confidential, and acknowledged that he could not trade on the information. The information given to Mr. Cuban concerned an upcoming public offering to shareholders, which Mr. Cuban thought would decimate the value of the company's shares, including his shares of Mamma.com. Following the receipt of confidential information, Mr. Cuban sold all of his shares in the company. The SEC alleges that Cuban sold his stake in the company just prior to the collapse of Mamma.com's stock and, thus, violated insider trading laws. The District Court granted Mr. Cuban's motion to dismiss, finding that an oral confidential agreement (to simply keep information confidential) was insufficient to create a fiduciary-type relationship, thereby triggering a duty to abstain from trading under the securities laws. The complaint did not allege facts that showed an explicit agreement not to sell based on the specific information provided. The SEC appealed to the Fifth Circuit, alleging that an oral confidentiality agreement does create a duty to disclose or abstain. The SEC relied on Rule 10b5-2(b)(1), which states that a person has "a duty of trust and confidence" for purposes of misappropriation liability when that person "agrees to maintain information in confidence." The Fifth Circuit believed that additional facts were necessary to conclude whether the parties could have plausibly reached a shared understanding to give rise to insider trading liability. In so holding, the Fifth Circuit noted that it was at least plausible that Mamma.com would provide the terms and conditions of the offering to Mr. Cuban for the purpose of evaluating whether he would participate in the offering. On appeal, in finding for the SEC, the Fifth Circuit vacated the district court's dismissal and remanded to the district court for further proceedings.

It remains to be seen what will happen when the case returns to the District Court, but it is clear that the SEC will continue to pursue insiders trading on information, whether or not they have formal agreements to keep information confidential.

Class Certification Denied In First American Securities Litigation

(Continued from page 7)

determination of the evidence. It will be interesting to see if the reasoning underlying the *First American* decision withstands close judicial scrutiny. As the parties in *First American* entered into a stipulation to dismiss the case following the denial of class certification, from a shareholder rights' perspective, it unfortunately appears that the *First American* decision will not be reviewed directly by the Second Circuit Court of Appeals.

SFMS Represents Client In Section 220 Proceeding Under Delaware Law Against Allergan

By Scott R. Shepherd, Esquire

SFMS is presently pursuing a corporate books and records action against Allergan, Inc. under Section 220 of the Delaware General Corporation Law on behalf of one of its institutional clients. The Section 220 demand for corporate books and records, as well as the subsequent legal action arising from Allergan's failure and refusal to produce all requested documents, arises as a result of Allergan's agreement to pay $600 million and plead guilty to a misdemeanor in settling a U.S. investigation of its marketing practices with respect to Botox. On or about September 1, 2010, Allergan agreed to pay $375 million to the government as part of a "misbranding" charge that the marketing of Botox from 2000 to 2005 led to use in treating headache, pain, muscle stiffness and juvenile cerebral palsy -- purposes for which the Food and Drug Administration had not approved marketing the product for at that time. Allergan also agreed to pay $225 million to resolve civil claims with the Justice Department. Allergan also agreed to a five-year compliance plan under which it will disclose payments to doctors on its website and have senior executives and board members annually certify that divisions meet federal health-care requirements. According to the U.S. Attorney's Office, Allergan "made it a top corporate priority" to maximize sales of unapproved uses of Botox by coaching doctors on how to bill insurers, doubling the size of its reimbursement team, and directing workshops focused on these uses.

SFMS served a demand letter on Allergan on November 5, 2010 and

(Continued on page 11)

The Supreme Court's Latest (Unanimous) Word On Materiality

(Continued from page 1)

As a result, courts following *Basic* and *TSC Industries* have largely avoided setting rigid, bright-line tests for materiality. For example, in *Ganino v. Citizens Utilities Co.*, 228 F.3d 154, 162 (2d Cir. 2000), the Court of Appeals for the Second Circuit held that materiality cannot be measured by "a single numerical or percentage benchmark."

In *Matrixx Initiatives, Inc. v. Siracusano*, No. 09-1156, 2011 WL 977060 (U.S. March 22, 2011), Justice Sotomayor, writing for the unanimous Court, issued a strong endorsement of the "inherently fact-specific" approach to a determination of materiality. *Id.*, 2011 WL 977060, at *8 (quoting *Basic*, 485 U.S. at 236). At issue was whether the manufacturer of Zicam Cold Remedy nasal spray was required to disclose reports that associated use of the product with anosmia (*i.e.*, loss of smell), even though the number of these adverse reports was not statistically significant. The Court noted that, even in the field of medical research, "statistical significance" was not the sole determinant of causation – "[a] lack of statistically significant data does not mean that medical experts have no reliable basis for inferring a causal link between a drug and adverse events." *Id.*, 2011 WL 977060, at *9. Accordingly, "[g]iven that medical professionals and regulators act on the basis of evidence of causation that is not statistically significant, it stands to reason that in certain cases reasonable investors would as well." *Id.* at *10. While "statistical significance" remains relevant, it is not necessarily dispositive because "assessing the materiality of adverse event reports is a 'fact-specific' inquiry ... that requires consideration of the source, content, and context of the reports." *Id.* (citation omitted).

The *Matrixx* court recognized that disclosure is triggered by a duty to speak. Thus, even with respect to information that a reasonable investor might consider material, "companies can control what they have to disclose ... by controlling what they say to the market." *Id.*, 2011 WL 977060, at *11. In *Mattrix*, although the company "told the market that revenues were going to rise 50 and then 80 percent," it was also aware of "information indicating a significant risk to its leading revenue-generating product." *Id.*, 2011 WL 977060, at *12. In addition, although the company "stated that reports indicating that Zicam caused anosmia were 'completely unfounded and misleading' and that 'the safety and efficacy of zinc gluconate for the treatment of symptoms related to the common cold have been well established,'" the company also "had evidence of a biological link between Zicam's key ingredient and anosmia, and it had not conducted any studies of its own to disprove that link." Based on the foregoing, the *Matrixx* court concluded that the adverse report information was material. The decision in *Mattrix* is a significant victory for investors and should put to rest attempts by defendants to defeat legitimate claims on the basis of rigid and unrealistic constructs with respect to materiality.

Supreme Court To Rule On Consumers' Rights In Class Actions: *AT&T v. Concepcion*

(Continued from page 3)

AT&T argued that California's unconscionability law is disproportionately hostile to arbitration waivers. In response, Justice Ginsburg replied that the unconscionability doctrine in California applies to both arbitration and non-arbitration contracts. AT&T replied that, in this case, the lower courts had found the arbitration clause unconscionable simply because it barred the class action device. Justice Alito sided with AT&T when he commented that "traditional unconscionability in California and elsewhere focuses on unfairness to the party who is before the tribunal. So here it would be unfairness to the Concepcions, rather than unfairness to other members of the class who are not before the court."

This case will be an important decision for consumers' rights. The class action mechanism is important for consumers in the Concepcions' position. The amount in controversy was approximately $30 and other consumers signed contracts similar to the one signed by the Concepcions. Because of the low dollar amount in controversy, most consumers would not or could not afford to hire a lawyer to recover $30. AT&T could continue to reap millions of dollars through these charges at the expense of consumers. Consumer advocates have disagreed with defendant's position that consumers should be forced to arbitrate, and support plaintiffs and the right to trial by jury and access to the Courts. The *Concepcion* decision is just one of many important class action decisions that will be issued by the Supreme Court this year.

SFMS Represents Client In Section 220 Proceeding Under Delaware Law Against Allergan

(Continued from page 9)

demanded to inspect and copy certain books, records and documents of the Company, including, among other things, the following:

> All Board Materials concerning the Company's sales, marketing, or branding of Botox for both Food and Drug Administration ("FDA") approved and "off-label" uses, conditions, and dosages, including, but not limited to, the establishment, modification, implementation, and/or oversight of any sales, marketing, or branding programs, campaigns, strategies, or the like, including, but not limited to, the: (i) promotion of Botox for the FDA approved treatment of strabismus, blepharospasm, cervical dystonia, primary axillary hyperhidrosis, and increased muscle stiffness in the elbow, wrist and finger muscles in adults with upper-limb spasticity; (ii) promotion of Botox for off-label or unapproved uses through, among other ways, false and fraudulent statements to physicians regarding Botox's efficacy, made through Allergan's salesmen and medical liaisons, Continuing Medical Education programs funded by Allergan, off-label injection training sessions funded by Allergan, articles published in journals and magazines that were written in whole or in part by Allergan employees, and websites funded and controlled by Allergan; (iii) promotion of Botox for off-label or unapproved uses by training physicians to miscode and alter records on claims forms to ensure payment by Medicare, Medicaid, and other federal health care programs; (iv) promotion of Botox for off-label or unapproved uses by providing physicians with "value added support services," including individual patient audits, that would facilitate third party reimbursement payments, maximize payments to doctors, and encourage additional sales of Botox; (v) promotion of Botox for off-label or unapproved uses by providing kickbacks to physicians; (vi) promotion of Botox for off-label or unapproved uses by making false statements to Medicare and other federal health care program contractors to impact coverage determinations; (vii) promotion of Botox for off-label or unapproved uses by paying doctors to attend Advisory Boards, promotional dinners, or to tout Botox's efficacy for off-label uses; (viii) promotion of Botox for off-label or unapproved uses by lobbying healthcare payers to expand coverage for off-label uses; (ix) promotion of Botox by creating and funding organizations to promote off-label uses of Botox; (x) promotion of Botox by providing selective discounts to doctors who predominantly treated off-label conditions; (xi) promotion of Botox for off-label or unapproved uses by other "mechanisms of action"; (xii) promotion of Botox to medical specialists who did not customarily treat patients with any of the conditions that Botox was approved to treat, including headache clinics,

(Continued on page 15)

Recommended Readings

- *Managing the Millennials: Discover the Core Competencies for Managing Today's Workforce*, Chip Espinoza, Mick Ukleia and Craig Rusch - a fascinating and well researched book by SFMS client, Chip Espinoza, and his co-authors about generational values as matters of perception and the best way to manage individuals in their twenties.

- *Ratification*, *The People Debate the Constitution, 1787-1788*, by Pauline Maier - an engrossing read about the time period when the U.S. Constitution was simply a proposal and was a matter of significant debate between the likes of James Madison and Patrick Henry. A page turner for those who enjoy reading about politics and do not mind seeing how little progress we have made as a country over the past two hundred and fifty years in improving the civic tone and intellectual rigor in debates regarding issues of public importance.

- *Unfinished Business*, by Lee Kravitz - an insightful book about an individual who takes stock of his life after losing his job and the ten transformational journeys (including repaying a thirty-year-old debt, making a long-overdue condolence call, finding an abandoned relative and fulfilling a forgotten promise) he takes in establishing a new path for personal growth. In this book, the reader meets a cast of interesting characters at a refugee camp in Kenya, a monastery in California, the desert of southern Iran, a Little League game in upstate New York, and a bar in Kravitz's native Cleveland.

- *Washington: A Life*, by Ron Chernow - an extremely detailed and balanced biography of the "father" of the United States, which explains the manner in which George Washington's morality and sense of justice guided him as he essentially invented the executive branch of the U.S. government while promoting the belief in republican government and acting consistently as a servant first and foremost of the people of this new country.

- *When the Good Pensions Go Away: Why America Needs a New Deal for Pension and Healthcare Reform*, by Thomas J. Mackell - a must read for those concerned about the move to defined contribution plans, the so-called "ownership" society and the dramatic transformation of America's retirement and welfare system since 1980.

The Dodd-Frank Whistleblower Provisions—The Specifics And Implications Of The Same

(Continued from page 3)

to submit information to the SEC as required by an SEC rule; or who is an employee of the DOJ or an appropriate regulatory agency, an SRO, the PCAOB or a law enforcement organization.

Importantly, the rewards for whistleblowing apply to any company subject to the United States securities laws and, as a result, it appears likely that whistleblowing on companies that commit violations of the Foreign Corrupt Practices Act ("FCPA"), which generally prohibits bribery and related conduct, in their overseas operations may become a centerpiece of Dodd-Frank whistleblowing activity.

Section 922 creates a new private right of action for employees who have suffered retaliation "because of any lawful act done by the whistleblower– '(i) in providing information to the Commission in accordance with [the whistleblower incentive section]; (ii) in initiating, testifying in, or assisting in any investigation or judicial or administrative action of the Commission based upon or related to such information; or (iii) in making disclosures that are required or protected under the Sarbanes-Oxley Act of 2002,'" the Securities Exchange Act of 1934, and "'any other law, rule, or regulation subject to the jurisdiction of the [SEC].'" The action may be brought in federal court and remedies include reinstatement, double back pay with interest, as well as litigation costs, expert witness fees, and reasonable attorneys' fees.

New Whistleblower Protection for Financial Services Employees (Section 1057): Section 1057 of Dodd-Frank creates a private right of action for employees in the financial services industry who suffer retaliation for disclosing information about fraudulent or unlawful conduct related to the offering or provision of a consumer financial product or service. The scope of coverage is quite broad in that Section 1057 applies to organizations that extend credit or service or broker loans; provide real estate settlement services or perform property appraisals; provide financial advisory services to consumers relating to proprietary financial products, including credit counseling; or collect, analyze, maintain, or provide consumer report information or other account information in connection with any decision regarding the offering or provision of a consumer financial product or service.

Section 1057 prohibits retaliation against an employee who has engaged in any of the following protected acts: (a) provided, caused to be provided, or is about to provide or cause to be provided, to an employer, the newly created Bureau of Consumer Financial Protection (Bureau), or any other government authority or law enforcement agency, information that the employee reasonably believes relates to any violation of any provision of Title X of the bill, which establishes new consumer financial protections, or any rule, order, standard or prohibition prescribed or enforced by the Bureau; (b) testified or will testify in a proceeding resulting from the administration or enforcement of any provision of Title X; (c) filed, instituted, or caused to be filed or instituted any proceeding under any federal consumer financial law; or (d) objected to, or refused to participate in any activity, practice, or assigned task that the employee reasonably believes to be a violation of any law, rule, standard, or prohibition subject to the jurisdiction of, or enforceable, by the Bureau.

Remedies under Section 1057 include reinstatement, backpay, compensatory damages, and attorneys' fees and litigation costs, including expert witness fees. Where reinstatement is unavailable or impractical, front pay also may be awarded.

Section 1057 also employs a burden-shifting framework that is favorable to employees. A complainant can prevail merely by showing by a preponderance of the evidence that her protected activity was a contributing factor in the unfavorable action. A contributing factor is any factor which, alone or in connection with other factors, tends to affect in any way the outcome of the decision. Once a complainant meets his or her burden by a preponderance of the evidence, the employer can avoid liability only if it proves by clear and convincing evidence that it would have taken the same action in the absence of the employee's protected conduct.

The procedures governing Section 1057 claims are substantially similar to those governing retaliation claims brought under the Consumer Product Safety Improvement Act of 2008, 15 U.S.C. § 2087. The statute of limitations is 180 days and the claim must be filed initially with the Occupational Safety Health Administration (OSHA), which will investigate the complaint and can order preliminary reinstatement. Once OSHA issues its findings, either party can request a hearing before a Department of Labor (DOL) administrative law judge. If the DOL has not issued a final order within 210 days of the filing of the complaint, the complainant has the option to remove the claim to federal court and either party can request a trial by jury. Section 1057 claims are exempt from mandatory arbitration agreements.

Reward for Whistleblowing to the CFTC (Section 748): Section 748 of Dodd-Frank amends the Commodity Exchange Act, 7 U.S.C. § 1, *et seq.*, to create a whistleblower incentive program and whistleblower protections similar to those in section 922, including a new private right of action. One notable difference between sections 748 and 922 is the ability of a commodity whistleblower to appeal any determination regarding an award made by the Commodity Futures Trading Commission (CFTC) within 30 days. Protected conduct under section 748 includes providing information to the CFTC in accordance with the whistleblower incentive provision and "assisting in any investigation or judicial or administrative action of the [CFTC] based upon or related to such information."

(Continued on page 13)

The Dodd-Frank Whistleblower Provisions—The Specifics And Implications Of The Same

(Continued from page 12)

Strengthening Sarbanes-Oxley's Whistleblower Protection Provision (Sections 922 and 929A): Sections 922 and 929A contain important amendments to the Sarbanes-Oxley Act (SOX) that broaden the scope of coverage, increase the statute of limitations, exempt SOX whistleblower claims from mandatory arbitration, and clarify that SOX claims removed to federal court can be tried before a jury.

Section 929A clarifies that the whistleblower protection provision of SOX, 18 U.S.C. § 1514A, applies to employees of subsidiaries of publicly-traded companies "whose financial information is included in the consolidated financial statements of [a publicly] traded company." This amendment eliminates a significant loophole that some courts have read into SOX that has substantially narrowed the scope of SOX coverage. Elevating form over substance, some judges have permitted publicly-traded companies to avoid liability under SOX merely because the parent company that files reports with the SEC has few, if any, direct employees, and instead employs most of its workforce through non-publicly traded subsidiaries. Section 922(b) further expands the coverage of section 806 of SOX to include employees of nationally recognized statistical ratings organizations (NRSROs), including A.M. Best Company, Inc., Moody's Investors Service, Inc., and Standard & Poor's Ratings Service. Section 922(c) increases the statute of limitations for SOX whistleblower claims from 90 to 180 days and clarifies that SOX retaliation plaintiffs can elect to try their cases in federal court before a jury. In addition, section 922(c) declares void any "agreement, policy form, or condition of employment, including a predispute arbitration agreement" which waives the rights and remedies afforded to SOX whistleblowers.

Strengthening the False Claims Act's Whistleblower Protection Provision (Section 1079B): Section 1079B amends the anti-retaliation provision of the False Claims Act, 31 U.S.C. § 3730(h), by expanding the definition of protected conduct to include "lawful acts done by the employee, contractor, or agent or associated others in furtherance of an action under this section or other efforts to stop 1 or more violations of [the False Claims Act]," thereby protecting against associational discrimination and covering a broad range of activities that could further a potential qui tam action or could stop a violation of the FCA. Section 1079B clarifies that the statute of limitations for actions brought under section 3730(h) is three years, which brings much-needed clarity in the wake of the Supreme Court's decision in *Graham County Soil & Water Conservation Dist. v. U.S. ex rel. Wilson*, 545 U.S. 409 (2005) (holding that the most closely analogous state statute of limitations applies to FCA retaliation claims).

In sum, the whistleblower provisions of Dodd-Frank are fulsome and should result in an increase in whistleblowing activity and litigation with respect to financial fraud. As with many statutes, however, the full implications of the legislation will not be entirely clear until all regulations are issued by the Administration since the proverbial devil is often in the detail.

SFMS Institutes Securities Class Action On Behalf Of Investors Of Elan Corporation, PLC

(Continued from page 6)

("Janssen"), a subsidiary formed by JNJ to acquire Elan's Alzheimer's immunotherapy program, but that defendants failed to disclose that the agreement with JNJ violated the terms of an existing collaboration agreement between Elan and Biogen Idec Inc. ("Biogen") for the development and sale of the multiple sclerosis drug Tysabri. As the Complaint alleges, Elan was ultimately forced to renegotiate its agreement with JNJ, whereby JNJ paid $115 million less to Elan than previously agreed. When the potential breach of the Elan/Biogen agreement became public, requiring the renegotiation of the JNJ transaction, the price of Elan's ADS's declined as artificial inflation came out of the price of those securities. The complaint seeks the recovery of damages for investors.

Update Of SEC's Proposal To Reform Mutual Fund Fees

(Continued from page 5)

agency type services. Alternatively, a fund could elect to not categorize non-distribution-related expenses as a marketing and service fee and pay for such expenses using fund assets.

Ongoing Sales Charges: The second prong of the revised distribution proposal creates the "ongoing sales charges" category by amending Rule 6c-10 under the 1940 Act to permit funds to deduct asset-based distribution fees in excess of the annual 25 basis point limit on marketing and service fees, subject to certain cumulative limits. The cumulative amount of ongoing sales charges, together with any other sales charges, could not exceed, in percentage terms, the highest front-end sales load imposed by a share class of the same fund that does not impose an ongoing sales charge (the "reference load"). If a fund does not have such a share class, the reference load would be the maximum amount permitted under NASD Conduct Rule 2830 for funds that impose an asset-based sales charge and a service fee, which is currently 6.25%. Subject to these limits, funds could continue to charge a front-end sales load or a contingent deferred sales load together with an ongoing sales charge. The SEC gave the following example illustrating how this aspect of the new rule would work. If a fund has class A shares with a 6% front-end sales load, the fund could pay as much as 6% in total ongoing sales charges in class B shares. If another class of shares charges a front-end sales load of 2%, a total ongoing sales charge of as much as 4% could also be charged (6% minus the 2% front-end load) with respect to that class.

Shareholder Account-Level Fee Limits: One of the most significant changes to the distribution fee regulatory scheme would be that the sales charge limit would be based on the cumulative amount of sales charges that an individual investor pays. This approach differs from the current fund-level approach, which limits how much fund underwriters may collect in asset-based sales charges. In short, the SEC proposes to replace the current fund-level or share-class-level cap with a shareholder account-level cap. Funds would be required to track purchases by shareholder. Each purchase or "lot" would have to be tracked separately. If a shareholder transferred from one fund intermediary to another, the new intermediary would have to track the shares, including accounting for the shares being held at the shareholder's former intermediary. Under the proposal, a fund would have the option of not having to track the actual dollar amounts of the ongoing sales or other charges incurred by each individual shareholder account. Rather, a fund could implement a system in which shares purchased would automatically convert to another share class without an ongoing sales charge by the end of the month during which the fund would have paid on behalf of the shareholder the maximum amount of permitted sales charges based on the cumulative rates charged each year. In addition, a fund could impose a contingent deferred sales load ("CDSL") in combination with an ongoing sales charge, but total sales charges could not exceed the maximum sales charge limitation.

Building on its example set forth above, the SEC stated that a fund offering class A shares with a 6% front-end load could also offer class B shares that are subject to an annual ongoing sales charge of 0.75% with a declining CDSL. The maximum CDSL that the fund could charge on a purchase of class B shares would be 5.25% in the first year, 4.5% in the second year, 3.75% in the third year, and so forth. At the end of the eighth year following the purchase, the fund would be required to convert the class B shares to a share class that does not charge an ongoing sales charge. Thus, regardless of when the shareholder redeems shares, the shareholder's total sales load rate would never exceed 6%, the maximum class A front-end load rate.

The maximum number of months a shareholder could remain invested in a class of shares paying an ongoing sales charge would depend both on the maximum sales load and the rate of the ongoing sales charge. Thus, for example, if the maximum sales load for the fund is 3%, the ongoing sales charge could be 50 basis points annually for six years. Alternatively, for example, the fund could collect 25 basis points annually for 12 years, 75 basis points annually for four years or 150 basis points annually for two years.

Board's New Role with Respect to Distribution Fees: The SEC's proposal, if adopted, would substantially reduce the duties imposed on fund board members with respect to distribution fees by eliminating certain provisions that have required boards to take certain actions and make special findings. The board of directors of a fund would have the ability to authorize the use of fund assets to finance distribution activities without having to adopt a plan related to a marketing and service fee or make any special findings regarding this fee. Rather, a board would authorize such an arrangement pursuant to its fiduciary obligations to the fund and fund shareholders. Consistent with directors' fiduciary duties, fund boards could authorize ongoing sales charges without adopting a plan. The SEC stated that the board would have to consider whether an ongoing sales charge is in the best interests of a fund and its shareholders and it provided in the Release guidance to fund directors with respect to making this determination. In general, a fund's board would view the ongoing sales charges and marketing and service fees as integral parts of a fund's underwriting arrangement and assess those distribution fees in the context of the fund's underwriting contract. Prior to giving approval, the SEC stated that directors should determine, among other things, whether: (a) the contract benefits the fund and its shareholders; (b) the underwriter's compensation is fair and reasonable; and (c) any sales charges, including an ongoing sales charge, are "fair and reasonable in light of the usual and customary charges made by others for services of similar nature and quality."

Shareholder Approval: Rule 12b-2 would require a fund to seek shareholder approval prior to instituting or increasing a marketing and service fee. Funds seeking to implement a marketing and service fee would not be required to obtain shareholder approval if: (a) the fund currently is subject to a Rule

(Continued on page 15)

Update Of SEC's Proposal To Reform Mutual Fund Fees

(Continued from page 14)

12b-1 fee that is 25 basis points or less and the fee rate is not increased; or (b) the fund reduces its Rule 12b-1 fee to 25 basis points or less and renames the fee a "marketing and service fee."

Disclosure: The SEC's proposal would require mutual funds and broker-dealer to disclose their use of marketing and service fees and ongoing sales charges as follows:

Mutual Funds: A fund that imposes ongoing sales charges and marketing and service fees would have to disclose such fees under new headings in its prospectus. A new heading, "Ongoing Sales Charges," would appear in the fee table in a fund's prospectus in the place of the current heading "Distribution [and/or Service] (12b-1) Fees." A new sub-heading, "Marketing and Service Fee" would appear as a separate category of "Other Expenses" under the sub-heading "Marketing and Service Fee." Funds would have to disclose the rates of these fees and the purposes for which they are used. If these fees were charged for services provided to fund investors, a fund also would be required to describe the nature and extent of those services. In addition, funds also would be required to disclose the number of months or years after which the shares would automatically convert to a share class without an ongoing sales charge. Outside of the fee table, funds would be required to describe any marketing and service fees and/or ongoing sales charges, and the principal activities for which they are used.

Funds also would be required to disclose marketing and service fees and ongoing sales charges in the financial statements. The SEC also has proposed certain disclosure requirements governing proxy statements.

Broker-Dealers: Under the SEC's proposal, confirmation statements on mutual fund share transactions would have to describe marketing and service fees, ongoing sales charges, and other charges. Such disclosure would include: (a) the amount of any front-end sales charge in percentage and dollar terms, together with the net dollar amount invested and any applicable breakpoints; (b) the maximum amount of any deferred sales charge, as a percentage of net asset value at time of purchase or redemption; (c) the annual amount of any marketing and service fees or ongoing sales charges and the aggregate amount of ongoing sales charges that may be incurred over time, both expressed as a percentage of net asset value, and the maximum number of months or years that the investor will pay ongoing sales charges; (d) a statement to the effect that the investor will indirectly pay other asset-based fees charged by the fund, such as management fees, in addition to any marketing and service fees or ongoing sales charges; and (e) the amount of any deferred sales charge incurred or to be incurred, expressed in dollars and as a percentage of net asset value, in the case of redemptions.

The SEC also included other regulatory reform proposals with respect to mutual fund fees, but the above summarizes the significant proposals with respect to the same. If enacted, the SEC rules appear designed to enact meaningful and long-needed reform with respect to the area of mutual fund fees - where investors, including retirees, have been victimized by excessive, unreasonable and opaque mutual fund fees for a period of many years. Perhaps not surprisingly, the proposed rules were met with howls of protest from the mutual fund and retirement industry. Based upon recent reports and in light of the SEC's continuing work with respect to Dodd-Frank Act requirements, it appears that no new SEC rule will be issued with respect to mutual fund fees until 2012 at the earliest. SFMS will continue to monitor developments regarding these important proposed rules and to report with respect to the same.

SFMS Represents Client In Section 220 Proceeding Under Delaware Law Against Allergan

(Continued from page 11)

anesthesiologists, pain specialists, and pediatricians; (xiii) promotion of Botox by encouraging doctors to diagnose headache and pain as symptoms of its on-label cervical dystonia indication and other approved indications; (xiv) promotion of Botox for the treatment of pain; (xv) promotion of Botox for the treatment of headaches, including chronic migraine headache, episodic migraine headache, tension type headache, and post-whiplash headache; (xvi) promotion of Botox for the treatment of spasticity; (xvii) promotion of Botox for the treatment of juvenile cerebral palsy; (xviii) promotion of Botox for the treatment of lower back pain; (xix) promotion of Botox for the treatment of tennis elbow; (xx) promotion of Botox for the treatment of temporomandibular joint disorder (TMJ); (xxi) promotion of Botox for the treatment of arthritis; (xxii) promotion of Botox for the treatment of enlarged prostate; (xxiii) promotion of Botox for the treatment of overactive bladder; and (xxiv) promotion of Botox for the treatment of incontinence due to neurogenic bladder.

When Allergan refused to produce all documents responsive to this demand, SFMS instituted a Section 220 action on behalf of its shareholder client and a trial is currently scheduled for later this month to address whether Allergan has properly complied with the Section 220 demand, including whether Allergan should be permitted to shield responsive documents from production on the basis of claims under the attorney-client privilege. SFMS will update its institutional clients on the outcome of this important proceeding and the use of this important shareholder tool in terms of corporate governance.

SFMS News

Nicholas Day Joins SFMS

We are pleased to welcome Nicholas Day, who will be based in the firm's new New York City office. Nick earned his A.B. degree from Duke University and his J.D., with honors, from Villanova University School of Law. Nick has over 15 years of experience practicing corporate law in the private practice setting, as well as serving as General Counsel to a number of companies. Nick began his career as a business attorney for the law firm of Saul Ewing, LLP in Philadelphia, Pennsylvania. Nick has represented companies in every growth phase, from high-tech start-ups to large public companies with operations worldwide. Nick served as General Counsel and Corporate Secretary to UniTek Global Services, Inc., a premier provider of installation, fulfillment and construction services to the telecommunications, cable and satellite television industries. Prior to joining UniTek, Nick was General Counsel and Secretary for Berliner Communications, Inc., a public company providing construction, project management and network development to the wireless telecommunications industry. Nick has also served as Senior Corporate Counsel for Net2Phone, Inc., a Nasdaq-listed provider of voice over internet protocol, or VOIP, telephone products. As General Counsel, he has supervised insurance, safety and risk management, litigation, human resources, and a wide range of legal, business and operational projects. Nick can be reached by email (nday@sfmslaw.com) or by telephone (267-290-8343).

Upcoming Conferences

- IPPFA-Illinois Public Pension Spring Conference – April 28-29, 2011 (Chicago, IL)
- FOCUS PMI SU: Reti per L'internazionallizzazione (Istituto Gugliemo Tagliacarne) – May 13, 2011 (Bologna, Italy)
- IFEBP-International Foundation Education Benefits Compensation's 57th Annual Employee Benefits Conference – October 30 – November 2, 2011 (New Orleans, LA)

Shepherd, Finkelman, Miller & Shah, LLP
Attorneys at Law

SFMS Securities Litigation Bulletin Editors: James E. Miller, Esquire • Patrick A. Klingman, Esquire • Karen M. Leser-Grenon, Esquire
Chiharu Sekino, Institutional Relations Administrator

Please direct all inquiries regarding this publication to James E. Miller at 866-540-5505 or jmiller@sfmslaw.com

SFMS Securities Litigation Bulletin © 2011 Shepherd, Finkelman, Miller & Shah, LLP

THE MATERIALS IN THIS NEWSLETTER ARE STRICTLY FOR INFORMATIONAL PURPOSES ONLY AND ARE NOT INTENDED TO BE, NOR SHOULD THEY BE TAKEN AS, LEGAL ADVICE. THIS NEWSLETTER MAY BE CONSIDERED AND SHOULD BE TREATED AS ATTORNEY ADVERTISING.

California Offices
401 West A. Street, Suite 2350
San Diego, CA 92101
619/235-2416

199 Fremont Street, 20th Floor
San Francisco, CA 94105
415/992-7287

Florida Office
1640 Town Center Circle, Suite 216
Weston, FL 33326
954/515-0123

Pennsylvania Office
35 East State Street
Media, PA 19063
610/891-9880

Connecticut Office
65 Main Street
Chester, CT 06412
860/526-1100

New Jersey Office
475 White Horse Pike
Collingswood, NJ 08107
856/858-1770

Wisconsin Office
111 E. Wisconsin Avenue, Suite 1750
Milwaukee, WI 53202
414/226-9900