

WALL ST

Securities and Shareholder Litigation
2013 YEAR-END REVIEW

BASS BERRY  SIMS PLC

1.

INTRODUCTION

2.

U.S. SUPREME COURT UPDATE

4.

SIXTH CIRCUIT UPDATE

8.

OTHER SIGNIFICANT DEVELOPMENTS IN 2013
AND OBSERVATIONS FOR THE YEAR AHEAD

12.

NOTABLE 2013 DISTRICT COURT OPINIONS
FROM THE SIXTH CIRCUIT

14.

ABOUT BASS, BERRY & SIMS PLC SECURITIES
& SHAREHOLDER LITIGATION PRACTICE GROUP

15.

BASS, BERRY & SIMS PLC SECURITIES &
SHAREHOLDER LITIGATION TEAM

This survey examines trends and developments in securities and shareholder litigation during 2013, at both the U.S. Supreme Court level and within the jurisdiction of the U.S. Court of Appeals for the Sixth Circuit, which covers Tennessee, Kentucky, Ohio, and Michigan.

Introduction

2013 followed 2012 as a year of significant developments in federal securities litigation, and 2014 could be groundbreaking. The U.S. Supreme Court continued its trend of granting certiorari in significant securities cases, resulting in additional clarification of the legal requirements for class certification and the running of the statute of limitations in SEC enforcement actions. Relatedly, the Supreme Court upheld the validity of contractual provisions requiring class arbitration, another decision with potentially broad implications. Looking ahead to 2014, the Supreme Court appears to be on the verge of reconsidering the fraud-on-the-market presumption of reliance, which plays a crucial role in class actions brought under Section 10(b) of the Securities Exchange Act of 1934 (the "1934 Act") and Rule 10b-5. The Court also will revisit the preclusive scope of the Securities Litigation Uniform Standards Act ("SLUSA") and the availability of the presumption of prudence in ERISA stock-drop actions at the pleading stage.

Closer to home, the U.S. Court of Appeals for the Sixth Circuit addressed the pleading requirements for claims brought under the Securities Act of 1933 (the "1933 Act") premised on the alleged failure to disclose "soft" information which includes statements of opinion and chose to diverge from other Circuits by holding that a plaintiff does not have to plead or prove actual knowledge of the falsity of an opinion in order to give rise to liability under Section 11. The Sixth Circuit also issued opinions applying the standard for pleading scienter, the requirements for approving class action settlements under the

Federal Rules of Civil Procedure, and, on the derivative front, the elements of Tennessee's demand futility analysis.

The overall landscape for securities litigation continues to change, in terms of the number and types of cases being filed. Merger objection lawsuits—in which a shareholder of a company being sold typically brings a class action in state court against the company's board of directors seeking to enjoin the transaction—continue to constitute a significant portion of the lawsuits being filed, along with shareholder derivative lawsuits and actions brought by individual plaintiffs opting out of class actions. According to numerous reports by observers, 2012 and 2013 look very similar in terms of the number of federal securities class actions being filed, with 2013 possibly seeing a slight increase, while remaining well below historical norms.

But perhaps most fascinating are the potential developments that might occur in the year ahead. The Supreme Court has granted certiorari yet again in the *Halliburton* litigation, in which Defendants seek to challenge the validity of *Basic v. Levinson's* fraud-on-the-market presumption of reliance—a decision that could wreak havoc on plaintiffs' ability to certify a securities class and prove the elements of reliance and loss causation on a class-wide basis. Other issues that merit watching in 2014 include the Supreme Court's upcoming consideration of the scope of SLUSA preclusion and the ERISA presumption of prudence; further application of the Second Circuit's *Indymac* decision holding that the 1933 Act's statute of repose cannot be tolled under the *American Pipe* class action tolling doctrine; the impact of the

Dodd-Frank whistleblower bounty provisions; and the extent to which the SEC's enforcement division will stand behind its promise of stricter enforcement and refusal to accept "neither-admit-nor-deny" settlements.

U.S. Supreme Court Update

U.S. Supreme Court Clarifies Class Certification Requirements.

The U.S. Supreme Court issued several decisions in 2013 regarding class actions and has granted certiorari in more cases that should be decided in 2014. These decisions address how plaintiffs must prove, and defendants can rebut, the requirements for class certification under Federal Rule of Civil Procedure 23. In *Amgen Inc. v. Connecticut Retirement Plans and Trust Funds*, 133 S. Ct. 1184 (2013), the Court held that plaintiffs in a Rule 10b-5 securities class action who invoke the fraud-on-the-market theory of reliance need not prove the materiality of an alleged misrepresentation or omission as a prerequisite to obtaining class certification. In a 6-3 decision written by Justice Ginsburg, the Court held that the materiality of an alleged misrepresentation or omission is a "merits" question, and thus, inappropriate for determination at the class certification stage.

While the Court's holding in *Amgen* is significant in that it clarifies class certification requirements, it is also worth noting that four Justices appeared to question the continuing viability of the fraud-on-the-market theory itself. The "presumption of reliance," also known as the "fraud-on-the-market" presumption, protects a class of investor plaintiffs from individually having to prove reliance on an alleged misstatement or omission, so long as they can prove that the affected shares traded in an efficient market and the alleged misrepresentations were publicly available information. *Basic v. Levinson*, 485 U.S. 224, 242 (1988). Absent such a presumption, plaintiffs likely would be required to prove the element of reliance on an individualized basis, defeating the "commonality" and "predominance" requirements of Rule 23 and rendering class certification difficult, if not impossible. As further discussed herein, the Court recently has granted certiorari in *Halliburton Co. v. Erica P. John Fund, Inc.*, No. 13-317, and apparently intends to revisit the viability of this presumption in 2014.

The "presumption of reliance," also known as the "fraud-on-the-market" presumption, protects a class of investor plaintiffs from individually having to prove reliance on an alleged misstatement or omission, so long as they can prove that the affected shares traded in an efficient market and the alleged misrepresentations were publicly available information. ***Basic v. Levinson*, 485 U.S. 224, 242 (1988).**

In *Comcast Corp. v. Behrend*, 133 S. Ct. 24 (2013), the Court examined the obligation of a plaintiff to show harm on a class-wide basis in order to satisfy the predominance requirement of Federal Rule of Civil Procedure 23(b) (3). The plaintiffs in that case asserted four theories of class-wide injury to support their antitrust claims and offered expert testimony purporting to show price increases attributable to anticompetitive conduct.

In a 5-4 decision written by Justice Scalia, the Court held that class certification was improperly granted because the plaintiffs' damages model

failed to demonstrate that damages could be measured on a class-wide basis. Class issues, therefore, did not predominate over individual issues. Reiterating the Court's opinion in *Wal-Mart v. Dukes*, 131 S. Ct. 2541, 2545 (2011), the Court noted that a district court is free to address the merits of the underlying suit at the class certification stage when the merits overlap with issues of class certification.

The Supreme Court's recent decisions in *Wal-Mart v. Dukes* and now *Comcast* arguably provide defendants with more aggressive means to challenge class certification using arguments that might directly implicate the merits of plaintiffs' underlying claims. Although *Amgen* closes the opportunity to challenge materiality at the class certification stage, presumably because materiality is a "pure merits" issue that does not speak to whether class treatment is appropriate, the upcoming decision in *Halliburton* provides an opportunity for the Supreme Court to provide further guidance on permissible challenges to class certification.

The "Discovery Rule" Does Not Apply to the Statute of Limitations Governing SEC Enforcement Actions.

In *Gabelli v. Securities & Exchange Commission*, 133 S. Ct. 1216 (2013), the U.S. Supreme Court unanimously rejected the SEC's position that the "discovery rule"—the doctrine holding that a cause of action cannot begin to accrue until the discovery of the alleged misconduct—applies to the five-year statutory limitation governing SEC enforcement actions. The Court held that the five-year clock to bring a civil penalty action against an investment advisor for securities fraud begins to tick when the fraud occurs, not when the SEC discovers the fraud. For those companies who are or were concerned about possible SEC enforcement proceedings related to their conduct during the 2007-2009 financial credit crisis, the *Gabelli* decision makes clear just how long they need to hold their breath.

In reversing the Second Circuit's holding that the "discovery rule" applied to enforcement actions, the Supreme Court noted that the discovery rule historically had been applied only in cases where a defrauded victim was seeking recompense, not when a government agency was bringing a

civil enforcement action, and that there were important reasons for the distinction:

The discovery rule exists in part to preserve the claims of victims who do not know they are injured and who reasonably do not inquire as to any injury. Usually when a private party is injured, he is immediately aware of that injury and put on notice that his time to sue is running. But when the injury is self-concealing, private parties may be unaware that they have been harmed. Most of us do not live in a state of constant investigation; absent any reason to think we have been injured, we do not typically spend our days looking for evidence that we were lied to or defrauded. And the law does not require that we do so.

Gabelli, 133 S. Ct. at 1222.

By contrast, the Court explained, the primary mission of the SEC is to investigate and "root out" fraud, and it has many legal tools at its disposal to do so, including: demanding that brokers and dealers submit detailed information, even before a suit is filed; offering and paying monetary awards to whistleblowers; and issuing subpoenas for documents and witnesses it deems relevant to an investigation. As such, "[c]harged with this mission and armed with these weapons, the SEC as enforcer is a far cry from the defrauded victim the discovery rule evolved to protect," and the Supreme Court refused to read the discovery rule into the plain language of the statute.

As a result of *Gabelli*, the SEC now will be under pressure to move more quickly in its investigations, and the agency will face tougher decisions on which cases to pursue because it must take into account the time required to conduct an investigation prior to filing enforcement proceedings. There is, however, at least one additional consideration: *Gabelli* is limited to actions that provide for a civil, or monetary, penalty. The SEC has other enforcement remedies available, such as injunctions or suspensions, and the Supreme Court did not address whether these other remedies are considered "penalties" within the meaning of the statute. Consequently, the SEC may have some "wiggle room" to bring actions requesting these kinds of non-monetary remedies after the time that cases might otherwise be time-barred by the five-year rule.

Courts Must Enforce Waivers of Class Arbitration.

In *American Express v. Italian Colors Restaurant*, 133 S. Ct. 1236 (2013), the U.S. Supreme Court held that the Federal Arbitration Act (“FAA”) does not permit courts to invalidate a contractual waiver of class arbitration simply because the plaintiff’s cost of individually arbitrating a federal statutory claim would exceed any potential recovery. Justice Scalia, writing for the majority, found that a waiver of class arbitration was enforceable under the FAA. Absent any valid reason that the contract itself might be invalid, or absent any legislative action establishing that certain federal causes of action confer an entitlement to a class action proceeding, such provisions will be enforced.

While this decision falls outside the securities litigation context, in that it involves an arbitration provision contained in a bilateral commercial contract between two presumably sophisticated entities, companies eager to avoid the morass of costly federal court or multijurisdictional securities litigation already have begun inserting similar provisions into their articles of incorporation or bylaws, and have met with some success in doing so. This year, a Maryland trial court upheld corporate bylaws in which a real estate investment trust (“REIT”) required shareholders to arbitrate their claims. *See Corvex Mgmt., L.P. v. Commonwealth REIT*, No. 24-C-13-001111, 2013 Md. Cir. Ct. LEXIS 3 (May 8, 2013). In a slightly different context, the Delaware Chancery Court upheld forum selection bylaws requiring that any litigation be brought in Delaware as statutorily and contractually valid under Delaware law. *See Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, Civ. A. No. 7220-CS (Del. Ch. June 25, 2013); *but see Edgen Group, Inc. v. Genoud*, C.A. No. 9055-VCL (Del. Ch. Nov. 5, 2013) (declining to temporarily enjoin action brought in Louisiana against company with charter containing Delaware forum selection provision). It remains to be seen whether the Supreme Court will continue its trend of strictly enforcing arbitration provisions should it be faced with the issue of whether a class arbitration waiver or similar provision could be enforced against investors.

In an apparent case of first impression, the Sixth Circuit recently addressed the “arbitrability” of the issue of whether class arbitration is permissible. In *Reed Elsevier, Inc. v. Crockett*, 734 F.3d 594 (6th Cir. 2013), the court held that whether an arbitration agreement permits classwide arbitration is a “gateway” question to be decided by courts unless the parties’ agreement expressly authorizes the arbitrator to decide the issue. The court then

refused to order classwide arbitration on the grounds that the arbitration agreement did not provide for it, and that the arbitration agreement was not unconscionable even though the cost of pursuing a single claim in arbitration would not be economically feasible, citing the Supreme Court’s opinion in *American Express*. Because the Sixth Circuit is the first appellate court to address the issue of who decides classwide arbitrability, this issue also may appear before the Supreme Court in the not-too-distant future.

Sixth Circuit Update

Plaintiffs Need Not Prove Objective & Subjective Falsity of Statements of Opinion Under Section 11.

In *Indiana State District Council of Laborers v. Omnicare*, 719 F.3d 498 (6th Cir. 2013), the Sixth Circuit contributed to a split of authority regarding what constitutes a false or misleading statement of opinion for purposes of liability under the 1933 Act, which effectively imposes strict liability for misrepresentations and omissions in an issuer’s registration statement. The



Sixth Circuit took this most recent opportunity to reaffirm that strict liability under Section 11 is indeed strict liability in the truest form, and that strict liability applies even with regard to statements that traditionally constituted “soft” information, such as statements of legal compliance or statements of opinion.

Omnicare involved a healthcare company that allegedly included false and misleading statements regarding legal compliance in a registration statement related to a public stock offering. Plaintiffs alleged that the registration statement was misleading because it failed to disclose that the company was engaging in illegal kickback arrangements with pharmaceutical companies and submitting false claims to Medicare and Medicaid. Defendants originally obtained dismissal at the district court level, based in part on the fact that plaintiffs did not plead facts demonstrating that the statements regarding legal compliance were both objectively and subjectively false. In short, they had failed to plead facts demonstrating that the defendants did not actually hold the opinion in question, that the company was in compliance with applicable laws and regulations.

The *Omnicare* opinion diverges from recent jurisprudence out of the U.S. Court of Appeals for the Second and Ninth Circuits, with the Sixth Circuit expressly “declin[ing] to follow the Second and Ninth Circuits” in holding that the U.S. Supreme Court’s ruling in *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083 (1991), mandates that, to give rise to a Section 11 claim based on a statement of opinion, a complaint must allege with particularity that statements were both objectively and subjectively false and misleading. In *Fait v. Regions Financial*, 655 F.3d 105 (2d Cir. 2011), the Second Circuit held that a bank’s accounting for goodwill impairment and the adequacy of its loan loss reserves were statements of opinion, and that in order for such statements to be actionable under the 1933 Act, the issuer must have known of the reserve’s inadequacy at the time the statement was made (i.e., the statement must have been objectively and subjectively false). The mere fact that the bank later had to restate or increase its goodwill and reserves in response to changing market conditions did not give rise to liability under Section 11. *See also Rubke v. Capital Bancorp., Ltd.*, 551 F.3d 1156 (9th Cir. 2009) (holding that fairness opinions incorporated into a registration statement is a question of opinion that could only give rise to liability under Section 11 if they were “both objectively and subjectively false and misleading”). The Sixth Circuit held that the Second and Ninth Circuits read too much into *Virginia Bankshares*, which was a Section 14(a) case,

and relied too heavily on dicta in that case. Within the Sixth Circuit, “if the defendant discloses information that includes a material misstatement, that is sufficient and a complaint may survive a motion to dismiss without pleading knowledge of falsity.” *Indiana State District Council*, 719 F.3d at 505.

The Sixth Circuit also distinguished its own opinions in *Helwig v. Vencor*, 251 F.3d 540 (6th Cir. 2001) (“[M]aterial statements which contain the speaker’s opinion are actionable under Section 10(b) of the [1934 Act] if the speaker does not believe the opinion and the opinion is not factually well-grounded”) and *Omnicare I*, 583 F.3d 935 (6th Cir. 2009) (same) on the grounds that these decisions involved Section 10(b)/Rule 10b-5 claims, in which liability only exists if any statement—not just statements of opinion—is made with knowledge or in reckless disregard of its falsity.

The Sixth Circuit’s decision in *Omnicare* should give pause to issuers within the Court’s jurisdiction, particularly those who are required to include a statement that the company is in compliance with all applicable laws and regulations governing the company’s operations. Every effort should be made to ensure the content of registration statements is accurate.

Sixth Circuit Clarifies Requirements for Approval of Class Action Settlements.

Rule 23(e) of the Federal Rules of Civil Procedure mandates that “claims, issues, or defenses of a certified class may be settled, voluntarily dismissed, or compromised **only with the court’s approval.**” (emphasis added). For class actions, litigants must also follow the settlement mandates of the Class Action Fairness Act, 28 U.S.C. Section 1711 et seq.

In 2013, the Sixth Circuit overturned a district court’s approval of a consumer class action settlement in *In re Dry Max Pampers Litig.*, 724 F.3d 713, 716 (6th Cir. 2013). Although not a securities class action, this decision raises several points to consider when negotiating class action settlements in the Sixth Circuit. First, litigants need to be careful when providing for opt outs. In *Dry Max*, the plaintiffs had sought certification under Federal Rules of Civil Procedure 23(b)(1) and (b)(3), which allow class members to opt-out of a class. The settlement, however, provided for certification of a non-opt-out settlement class under Rule 23(b)(2), under which absent class members could not opt out of the deal. The court found the definition of the settlement class

and what it observed to be the unduly preferential treatment of the named class members and their counsel problematic and ultimately fatal to class certification. Second, the court reiterated that district courts “must carefully scrutinize” whether the fiduciary obligations of class representatives and class counsel have been met. *Id.* at 718. The court listed red flags for district courts to consider when evaluating proposed class action settlements: high attorney fees, preferential treatment to certain class members, settlement value to unnamed class members, and the benefits to class counsel compared to the actual class. District courts also must consider “the alignment of interests and incentives” of the class representatives by analyzing (1) whether the named party representatives have common interests with the unnamed members of the class, and (2) whether the representatives will “vigorously prosecute the interests of the class through qualified counsel.” *Id.* at 721 (citation omitted). This decision shows that the Sixth Circuit expects the lower courts to actively scrutinize class action settlement prior to granting approval.

Sixth Circuit Elaborates on the Pleading Requirements for Scier in a Section 10(b) Action.

In *Ricker v. Zoo Entertainment, Inc.*, No. 12-3951, 2013 U.S. App. LEXIS 18117 (6th Cir. Aug. 27, 2013), the Sixth Circuit affirmed a district court’s dismissal of shareholder plaintiff’s Section 10(b) and 20(a) claims because their complaint



The Sixth Circuit’s decision in *Omnicare* should give pause to issuers within the Court’s jurisdiction, particularly those who are required to include a statement that the company is in compliance with all applicable laws and regulations governing the company’s operations. Every effort should be made to ensure the content of registration statements is accurate.

failed to plead facts that would give rise to a strong inference of scienter. Plaintiff in that case alleged that the company’s form 10-Qs for the first, second, and third quarters of 2010 had been filed “with . . . reckless disregard of their falsity.” *Id.* at *4. These allegations were based on the facts that, on the closing date of the proposed class period, the company filed a Form 8-K disclosing that it had discovered “errors in recording certain transactions in the company’s unaudited consolidated financial statements,” which meant revenues stated in its previously-filed 10-Qs could no longer be relied upon. The company’s stock price fell by more than a third on the following day. *Id.* at *3-4.

Despite allegations purporting to show inaccuracy of the financial statements and loss causation, neither the district court nor the Sixth Circuit found plaintiff’s allegations sufficient to support an inference of scienter. As

evidence of recklessness giving rise to the level of scienter, Plaintiff offered the following: a confidential witness from the company's accounting department who had raised concerns about problems with collections from a particular customer's account; a lawsuit that was settled during the class period; allegedly weak internal accounting controls; the magnitude of the accounting errors referenced in the 8-K; that management knew how to follow GAAP; that three high-ranking executives departed; and that defendants had a motive to commit fraud because they wished to raise capital.

The Sixth Circuit explained that recklessness can only satisfy Section 10(b)'s scienter element "if plaintiffs demonstrate that defendants engaged in 'highly unreasonable conduct which is an extreme departure from the standards of ordinary care.'" *Id.* at *11 (citations omitted, emphasis in original). It found that no such finding could be made from the facts alleged. The district court found - and the Sixth Circuit agreed - that the allegations, taken together, showed "at most, that Zoo was financially mismanaged, not that Defendants fraudulently misled the public." *Id.* at *10, *14. Mere financial mismanagement without scienter does not give rise to Section 10(b) and 20(a) claims.

Sixth Circuit Applies Tennessee Law Governing Demand Futility.

In *Lukas v. McPeak*, 730 F.3d 635 (6th Cir. 2013), the Sixth Circuit interpreted Tennessee law and articulated a test for determining whether a shareholder plaintiff has adequately pled demand futility in a shareholder derivative action. In *Lukas*, the shareholder brought a derivative suit against the corporation and its directors alleging breaches of fiduciary duties and other claims. Defendants filed a motion to dismiss because the plaintiff failed to make a pre-suit demand on the board of directors, and the plaintiff opposed by arguing that pre-suit demand should be excused as futile because the majority of directors were named as defendants. The district court granted the motion because plaintiff had failed to plead facts sufficient to establish futility of a demand.

The Sixth Circuit reviewed the district court's ruling de novo and affirmed. Applying Tennessee law, the court explained that pre-suit demand is required unless the complaint states "'with particularity' why demand was futile." *Id.* at 638 (citing Tenn. Code Ann. Section 48-17-401; Tenn. R. Civ. P. 23.06). Plaintiff argued that a very old Tennessee Supreme Court case, *Deaderick*

v. Wilson, 67 Tenn. 108, 131 (1874), stood for the proposition that pre-suit demand is excused where the majority of directors are named as defendants. The Sixth Circuit disagreed and held that the Tennessee Court of Appeals in *Lewis ex rel. Citizens Sav. Bank & Trust Co. v. Boyd*, 838 S.W.2d 215 (Tenn. Ct. App. 1992), had clarified *Deaderick* by endorsing a version of the Delaware demand futility analysis as explained in *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984). According to the Sixth Circuit, a plaintiff arguing futility of demand under Tennessee law must plead specific facts that establish "(1) that the board is interested and not independent and (2) that the challenged transaction is not protected by the business judgment rule." *Lukas*, 730 F.3d at 638 (citing *Lewis*, 838 S.W.2d at 222). In fact, based on the Sixth Circuit's interpretation of Tennessee law, a shareholder plaintiff's burden to establish futility is even more difficult than under Delaware law. "Although Delaware courts read the *Aronson* test as disjunctive, requiring a plaintiff to meet only one of the two prongs to demonstrate demand futility, *Lewis* states the rule in the conjunctive, appearing to require a plaintiff to meet the requirements of both prongs." *Id.* at 640.

“Although Delaware courts read the *Aronson* test as disjunctive, requiring a plaintiff to meet only one of the two prongs to demonstrate demand futility, *Lewis* states the rule in the conjunctive, appearing to require a plaintiff to meet the requirements of both prongs.” *Id.* at 640.

While the standard set forth in *Lukas* should be considered controlling precedent for federal courts within the Sixth Circuit, that does not necessarily mean that the *Lukas* court will have the final word on this issue. As the dissent pointed out in arguing for certifying the question to the state supreme court, Tennessee precedent is not perfectly clear in this area and “in need of clarification.” *Lukas*, 730 F.3d at 642 (Dowd, J., dissenting). As such, the Tennessee Supreme Court may later give contrary instructions, if it ever addresses the issue. Until then, however, *Lukas* provides the clearest explanation of what Tennessee law requires a plaintiff to plead to establish futility of pre-suit demand.

Other Significant Developments and Observations for the Year Ahead

The Second Circuit Refuses to Toll the 1933 Act’s Statute of Repose.

Neither the U.S. Supreme Court nor the Sixth Circuit has yet had an opportunity to address an unsettled area of the law: whether the three-year statute of repose in Section 13 of the 1933 Act can be tolled pursuant to the often-invoked class-action tolling rule. The Second Circuit, however, did address this important issue in *Police & Fire Retirement System of Detroit v. IndyMac MBS, Inc.*, 721 F.3d 95 (2d Cir. 2013). The class-action tolling rule was first established by the Supreme Court in *American Pipe & Constr. Co. v. Utah*, 414 U.S. 538, 554 (1974), which held that “the commencement of a class action suspends the applicable statute of limitations as to all asserted members of the class who would have been parties had the suit been permitted to continue as a class action.” The Second Circuit held that *American Pipe* tolling does not apply to Section 13’s statute of repose because *American Pipe* concerned a statute of limitations, and a statute of repose is conceptually distinct. Currently, a circuit split exists as to the potential reach of *American Pipe*’s tolling rule, based largely on diverging opinions as to whether class action tolling is an equitable or legal doctrine. Importantly, the Second Circuit tries to bring the diverging circuit decisions together and explains why tolling is not proper for a statute of repose under *any* circumstances. Additionally, the Second Circuit held that unnamed parties that are included as members of the putative class cannot use Fed. R. Civ. P. 15(c) or Rule 24’s “relation back” doctrine to intervene in an action and circumvent the applicable statute of repose. Any party facing a possible statute of repose issue in the Sixth Circuit in a case where class action tolling might be raised should analyze the arguments asserted by both parties in *IndyMac MBS* and the decision the

court rendered. Defendants across the country likely will take advantage of *IndyMac MBS* in an effort to obtain dismissal of individual actions—including opt-out actions filed by members of a putative class after the statute of repose has expired.

The SEC Indicates That It Will Seek Admissions of Wrongdoing from Settling Defendants.

One of the most talked about developments of the year has been the SEC’s new policy, announced in June 2013, of seeking admissions of liability from Defendants in regulatory enforcement actions, at least where the SEC finds that there has been severe or egregious misconduct, or widespread harm to investors. This new policy is a fairly obvious reaction to judicial pushback on “neither admit nor deny” settlements, the most well-known of which was the opinion issued by Judge Rakoff of the U.S. District Court for the Southern District of New York, in which he rejected a proposed settlement by Citigroup, in part on the grounds that the public would never know what had happened. *SEC v. Citigroup Global Markets*, 827 F. Supp. 2d 328 (S.D.N.Y. 2011). That decision currently is being appealed to the Court of Appeals for the Second Circuit, with a decision likely forthcoming in 2014. Speaking at the Practising Law Institute’s conference on Securities Regulation and Enforcement in early November 2013, both Commission Chair Mary Jo White and Andrew Ceresney, co-head of the SEC’s division of enforcement, confirmed the SEC’s desire to seek admissions where they deemed it warranted, even if the policy would result in the SEC taking more cases to trial.

Members of the defense bar have indicated that more trials almost certainly would be the result of such a policy. Defendants who admit to “findings of fact” in a regulatory consent order or settlement agreement face a host of potential collateral consequences, ranging from the admissions being deemed binding in parallel civil litigation and/or criminal proceedings to triggering exclusions in a director and officer liability insurance policy. The negative implications of admitting wrongdoing in a settlement with the SEC serves as a strong incentive for defendants to roll the dice at trial.

And recent results call into question the wisdom of the SEC incentivizing more defendants to go to trial. While the SEC won a judgment against former Goldman Sachs Trader Fabrice “The Fabulous Fab” Tourre for his role in creating a “designed to fail” synthetic collateralized debt obligation (“CDO”) in 2006-

2007 and (allegedly) fraudulently marketing the deal to investors, the SEC also lost a very high profile insider trading case against Dallas Mavericks owner Mark Cuban—who wasted no time in portraying the agency as misguided and overzealous. The SEC also lost another case against the CFO of government contractor NIC, Inc., Stephen Kovzan, who was accused of aiding accounting misconduct and covering up improper payments to the company's CEO.

At the end of the day, the controversy may be overblown. So far, the SEC successfully has procured admissions in two major enforcement actions: the J.P. Morgan “London Whale rogue trader” matter and the case against Philip Falcone and Harbinger Capital Management, with only one set of defendants (Harbinger/Falcone) actually copping to what could be considered “fraudulent” misconduct. J.P. Morgan ultimately admitted to deficiencies in its record keeping and internal controls, with many suspecting that the “admissions” of “wrongdoing” were carefully crafted by counsel to avoid triggering costly collateral consequences for the bank. Harbinger and Falcone, on the other hand, admitted to acting “recklessly”, and Falcone admitted that he improperly borrowed client funds to pay his personal income taxes and accepted a five-year minimum ban from the financial services industry.

The U.S. Supreme Court Will Reconsider the Fraud-on-the-Market Presumption.

2014 will likely see what may be one of the most significant U.S. Supreme Court opinions since *Basic v. Levinson*. The Court has granted certiorari yet again in *Erica P. John Fund v. Halliburton*. In what will soon be referred to as *Halliburton I*, the Court reversed the U.S. Court of Appeals for the Fifth Circuit and held that plaintiffs seeking to certify a class bringing claims under Section 10(b) of the 1934 Act and Rule 10b-5 did not have to prove loss causation at the class certification stage. In *Halliburton II*, Defendants have asked the Court to “overrule *Basic* or at least substantially modify the threshold for invoking a presumption of reliance.” Defendants urge the Court to reject what they characterize as *Basic*'s “naive understanding of market efficiency and its simplistic view that market prices rationally convey information,” because such concepts “are at war with economic reality.” At a minimum, “plaintiffs should at least be required to prove that the alleged misrepresentations actually distorted the market price. This approach would more closely align the presumption of reliance with economic reality and

with a plaintiff's burden under Rule 23 to show that common issues in fact predominate.”

Fueling this challenge is the fact that four justices of the Supreme Court, in the *Amgen* opinion (discussed previously), expressed some doubt regarding the ongoing viability of the “market efficiency” hypothesis underlying the fraud-on-the-market presumption. In dissent, Justice Thomas (joined by Justices Scalia and Kennedy), noted that the Court may need “to revisit *Basic*'s fraud-on-the-market presumption” because *Basic* “itself is questionable.” Justice Alito, concurring, held that “reconsideration of the *Basic* presumption may be appropriate” because “recent evidence suggests that the presumption may rest on a faulty economic premise.” A decision in *Halliburton II* overturning *Basic* would have significant implications for securities class actions brought pursuant to Section 10(b) and Rule 10b-5. Securities litigators on both sides of the bar are understandably anxious about what a decision overturning *Basic* might mean for their practices, although these concerns are probably overblown.

There is no question that it would be more difficult for a shareholder plaintiff to get a class certified in a Section 10(b)/10b-5 action. Plaintiffs might be unable to meet the requirements of Federal Rule of Civil Procedure 23(b)(3), because individual questions of reliance would arguably predominate in light of the fact that proving class-wide reliance would be nearly impossible. The impact of such a development, however, may be muted by other emerging trends in securities litigation. For example, we—and many others—already have observed that prototypical securities class action lawsuits alleging that a fraudulent misstatement gave rise to a stock drop upon disclosure are in decline, and have been declining in numbers for the past several years, as plaintiffs' firms file more merger objection litigation, shareholder derivative lawsuits and individual actions. The passage of the Private Securities Litigation Reform Act (“PSLRA”) and SLUSA have made it progressively more difficult for Section 10(b) and Rule 10b-5 class actions to survive a motion to dismiss, much less class certification. These alternative lawsuits, often based on state law and filed in state courts, represent a quicker road to a settlement. On the federal side, the 1933 Act provides a quasi-strict liability regime for misstatements and omissions in a registration statement or prospectus. Investors suing under these provisions do not need to prove reliance.

Moreover, it also should be noted that the fraud-on-the-market presumption would not necessarily affect suits brought by individual investors in a non-class proceeding, provided that those investors can prove that they actually relied on an alleged fraudulent statement. Larger institutional investors such as pension funds have been opting out of class actions and pursuing their own claims in increasing numbers, because they feel the chance of a significant recovery is higher.

All of this discussion of what the world might look like post-*Halliburton II* may still be in vain. The Supreme Court could sidestep overturning *Basic* in its entirety, using *Halliburton II* as an opportunity to clarify the extent of the burden a plaintiff must satisfy in order to invoke the fraud-on-the-market presumption, and whether a defendant may introduce “price impact” evidence in order to rebut the presumption of reliance. The *Halliburton* Defendants’ petition for a writ of certiorari discussed a circuit split, with the Second and Third Circuits’ holding that defendants may introduce evidence concerning the absence of price impact at the class certification stage, while the Fifth and Seventh Circuits have held that such evidence is improper.

A recent opinion issued out of the Southern District of New York provides an interesting illustration of how “price impact” evidence might be used to better rebut the *Basic* presumption, in the event the Supreme Court declines to overturn it. In *George v. China Automotive Systems, Inc.*, 2013 U.S. Dist. LEXIS 93698 (S.D.N.Y. July 3, 2013), the district court denied plaintiffs’ motion for class certification on the grounds that plaintiffs had failed to prove market efficiency by a preponderance of the evidence. While plaintiffs presented expert testimony on the issue of market efficiency, the district court found that the rebuttal expert offered by defendants had successfully pointed out the “methodological shortcomings” of the market efficiency analysis. Importantly, the Court seemed to find the absence of price impact particularly persuasive: “the Court cannot help but note the numerous days during the class period when news events did not result in price movement, or statistically significant price movement was not associated with a news event.”

U.S. Supreme Court to Address SLUSA’s “In Connection With” Requirement.

In addition to the fraud-on-the-market presumption, the U.S. Supreme Court is set to address the preclusive scope of SLUSA, which was passed in 1998. SLUSA provides, in relevant part, that “[n]o covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging . . . a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security” 15 U.S.C. Section 78bb(F)(1). The Court granted certiorari in three consolidated cases, *Chadbourne & Parke LLP v. Troice* (12-79), *Willis of Colorado, Inc. v. Troice* (12-86), and *Proskauer Rose LLP v. Troice* (12-88), that involve claims against two law firms and an insurer who provided services to Stanford International Bank (“SIB”), that was issuing certificates of deposit (“CDs”) allegedly backed by safe and liquid securities, when in reality SIB was a Ponzi Scheme.

The Court of Appeals for the Fifth Circuit reversed the district court’s finding that the plaintiffs-respondents’ claims were precluded by SLUSA, holding that SLUSA did not apply because the purchases of the covered securities in question (those SIB claimed backed the CDs) were only tangentially related to the crux or gravamen of respondents’ claims, which concerned investors’ purchase of non-covered securities (the CDs). Petitioners disagreed, arguing that the Fifth Circuit erred and that the Supreme Court should adopt a broad construction of SLUSA and find the claims precluded because the representation about SIB having purchased covered securities played a role in investors’ decisions to purchase the CDs, thereby satisfying SLUSA’s materiality and “in connection with” requirements.

To date, the Sixth Circuit has interpreted SLUSA’s reach more broadly than other circuits. *See Daniels v. Morgan Asset Mgmt.*, 497 Fed. Appx. 548, 553 (6th Cir. 2012) (observing that the Sixth Circuit has “a more expansive reading of SLUSA’s reach than other circuits have adopted”); *Atkinson v. Morgan Asset Mgmt., Inc.*, 658 F.3d 549 (6th Cir. 2011) (same). The Supreme Court’s upcoming decision could either support the Sixth Circuit’s position or rein

in SLUSA's preclusive reach. The plaintiff and defense bars obviously have strong competing interests in the outcome of this case. Should the Supreme Court issue yet another defense-friendly broad interpretation of SLUSA, following up on its decision in *Merrill Lynch v. Dabit*, 547 U.S. 71 (2006), it will be more difficult for plaintiffs to bring state-law class actions that in any way relate to transactions in covered securities.

U.S. Supreme Court to Review Sixth Circuit's Application of ERISA "Presumption of Prudence."

Finally, the U.S. Supreme Court will address a circuit split concerning the applicable pleading requirements governing claims that ERISA fiduciaries imprudently invested the assets of employee stock ownership plans ("ESOPs") in employer-company stock. Typically, a fiduciary's decision to invest ESOP assets in employer stock is subject to a presumption of prudence (the "*Moench* presumption," see *Moench v. Robertson*, 62 F.3d 553 (3d Cir. 1995)). The presumption makes it more difficult for a plaintiff to state a claim and survive a motion to dismiss, since most Courts of Appeals that have addressed the issue have held that the presumption applies at the pleading stage. Plaintiffs must plausibly allege that it was an abuse of discretion to either offer employer stock as an investment option or to allow the ESOP to remain invested in employer stock.

In *Dudenhoefer v. Fifth Third Bancorp*, 692 F.3d 410 (6th Cir. 2012), the Sixth Circuit departed from this principle, holding that the *Moench* presumption was evidentiary and did not apply at the pleading stage. This decision is bad news for defendants, in that the absence of the presumption of prudence at the pleading stage makes it easier for plaintiffs to survive a motion to dismiss and subject defendants to costly discovery on the basis of what are all too often conclusory allegations steeped in hindsight. Companies who wish to provide their employees with the option to invest in company stock (especially those in the Sixth Circuit) obviously would like to see the presumption of prudence reinstated at the pleading stage. They do not want to face the prospect of a costly ERISA "stock drop" class action every time there is a downturn in the company's stock price.

NOTABLE 2013 DISTRICT COURT OPINIONS FROM THE SIXTH CIRCUIT

Case Name	Case No.	Description of Opinion
Schuh v. HCA Holdings, Inc.	No. 3:11-1033, 947 F. Supp. 2d 882 (M.D. Tenn. 2013)	The court granted defendants' motion to dismiss with respect to plaintiffs' allegations that it violated Sections 11, 12(a)(2), and 15 in connection with the company's IPO by failing to disclose an alleged adverse trend in Medicare revenue growth and the potential impact of proposed state legislation. The court did allow plaintiffs' claims to go forward, however, based on the allegations that defendants failed to disclose that Medicaid revenues per admission declined shortly before the IPO and that the company was experiencing a decline in "high margin" components of Medicare revenue.
North Port Firefighters' Pension-Local Option Plan v. Fushi Copperweld, Inc.	929 F. Supp. 2d 740 (M.D. Tenn. 2013)	Plaintiffs' Section 10(b) and 20(a) claims related to defendants' reporting that a particular SWAP transaction qualified as a "cash flow hedge" and certain acquisitions qualified as "bargain purchase." The defendant company had issued a restatement indicating that the accounting treatment with respect to those transactions did not follow generally-accepted accounting practices. The district court denied defendants' motion to dismiss and found that plaintiffs had sufficiently pled their claims under Section 10(b) and Section 20(a).
Smith v. Robbins & Myers, Inc.	No. 3:12-cv-281, 2013 U.S. Dist. LEXIS 121882 (S.D. Ohio Aug. 27, 2013)	Plaintiffs alleged that defendants violated Section 14(a), Section 20(a), and their fiduciary duties by advising investors, through a proxy statement, that \$60 per share was a fair price with respect to a proposed merger and failing to inform investors that voting for the merger would mean giving up strategic alternatives that could produce long-term value greater than \$60 per share. The court denied defendants' motion to dismiss and held, <i>inter alia</i> , that: (1) Ohio's appraisal statute did not bar plaintiffs' claims because their allegations were not simply about the amount of merger consideration, (2) plaintiffs had standing to assert direct claims considering the allegations that the violations prevented them from exercising their individual rights of corporate suffrage, (3) plaintiffs had pled demand futility due to the board's active participation in the sales process and proxy statement, (4) plaintiffs had pled violations of fiduciary duties with their allegations showing that the board acted improperly to obtain personal benefits, and (5) the omitted information was material.
Florida Carpenters Regional Council Pension Plan v. Eaton Corp.	No. 12 CV 2001, 2013 U.S. Dist. LEXIS 112636 (N.D. Ohio Aug. 9, 2013)	The court granted defendants' motion to dismiss plaintiffs' securities fraud complaint alleging Section 10(b) and 20(a) claims. Plaintiffs alleged that the company engaged in misconduct with respect to an ongoing lawsuit in Mississippi and that defendants issued false and misleading statements regarding those improper litigation practices. The court held that, while the allegations indicated that the company had mismanaged the Mississippi litigation, they did not support an inference that defendants acted with scienter, and it also held plaintiffs' conclusory allegations of loss causation were insufficient.
Hawaii Ironworkers Annuity Trust Fund v. Cole	No. 3:10CV371, 2013 U.S. Dist. LEXIS 85892 (N.D. Ohio June 19, 2013)	The court denied defendants' second motion for reconsideration and request for interlocutory appeal. The court previously had ruled in 2011 that plaintiffs had adequately pled scheme liability against the defendants under Rule 10b-5(a) and (c), which involves allegations that defendants carried out a scheme or course of conduct (other than making a misrepresentation or omission) that operates as a fraud or deceit in connection with the purchase or sale of a security. Defendants requested reconsideration of this ruling in light of an intervening opinion also from the Northern District of Ohio, <i>La. Mun. Ret. Sys. v. KPMG, LLP</i> , 2012 U.S. Dist. LEXIS 124082 (N.D. Ohio 2012). The court held that <i>KPMG</i> was not controlling authority and therefore did not warrant reconsideration, and in any event <i>KPMG</i> did not establish an intra-circuit split regarding the pleading standard for scheme liability claims.

Case Name	Case No.	Description of Opinion
<i>Plumbers & Pipefitters Nat'l Pension Fund v. Burns</i>	No. 3:05CV7393, 292 F.R.D. 515 (N.D. Ohio June 3, 2013)	The court granted class certification in a securities fraud class action under Section 10(b) and Section 20(a) for purchasers of the company's stock, but ordered a hearing on the issue of whether class certification would be appropriate for the purchasers of the company's bonds. Specifically, the court held that in order to invoke the fraud-on-the-market presumption, plaintiffs bore the burden of showing that the market in which the company's bonds traded was efficient because the fraud-on-the-market theory cannot be applied to securities that are not traded in an efficient market. The court therefore ordered a hearing on the issue of the efficiency of the market in which the company's bonds were traded before ruling on whether common questions would predominate for the proposed class of bond purchasers.
<i>Robinson Family Trust v. Greig</i>	No. 5:12CV1713, 2013 U.S. Dist. LEXIS 66995 (N.D. Ohio May 10, 2013)	The court granted a motion to dismiss a shareholder derivative "say-on-pay" suit for failure to make the pre-suit demand and failure to adequately plead demand futility. In this case, the board had declined to rescind the company's 2011 executive compensation plan even though shareholders held a vote and rejected the board's executive compensation recommendation. The board was sued for breach of fiduciary duty, unjust enrichment, and violation of Section 14(a) of the Exchange Act. The court held that plaintiffs had failed to issue the required pre-suit demand and had failed to adequately plead demand futility. Plaintiffs had argued that demand was excused because the board already had voted to ignore the shareholder vote on compensation, thereby effectively rejecting the equivalent of a demand. The court declined to follow <i>NECA-IBEW Pension Fund ex rel. Cincinnati Bell, Inc. v. Cox</i> , 2011 U.S. Dist. LEXIS 106161 (S.D. Ohio Sept. 20, 2011), which found demand futility present when the board had already rejected the outcome of a shareholder "say-on-pay" vote.
<i>In re: Omnicare, Inc. Sec. Litig.</i>	No. 11-cv-173-DLB-CJS, 2013 U.S. Dist. LEXIS 42973 (E.D. Ky. Mar. 27, 2013)	Plaintiffs alleged in a securities fraud class action under Section 10(b) and Section 20(a) that defendants made materially false statements when they represented the company's billing practices materially complied with state and federal requirements, even though internal audits revealed that the company might have submitted deficient claims for reimbursement to government programs. The court granted defendants' motion to dismiss, holding that plaintiffs had failed to plead sufficient facts to establish an actionable misstatement or omission because plaintiffs had failed to plead that any of the individual defendants had actual knowledge of the internal audit results, that the individual defendants knew the statements were false when made, or that the company had a duty to disclose the audit results.

About Bass, Berry & Sims PLC Securities and Shareholder Litigation Practice Group

Bass, Berry & Sims' Securities & Shareholder Litigation team members are recognized in *Chambers USA* for corporate and securities litigation, and shareholder class actions. Our team represents more than 35 publicly-traded companies and has successfully defended clients in dozens of complex securities class actions and in merger-related litigation. In the past five years alone, our attorneys have represented clients in several dozen securities-related or corporate governance matters, including more than 25 class actions. We currently serve as lead defense counsel in more than 30 actions involving sub-prime related investments and have defended clients in litigation involving merger and leveraged buy-out transactions totaling over \$75 billion.

Our team of attorneys represent clients in a multitude of securities-related lawsuits and investigations, acting both as zealous advocates and dedicated partners. We represent publicly-traded and privately-held national and international companies and their officers, directors, issuers, underwriters, special committees, financial and investment advisers, accounting firms and venture capital firms in state and federal trial and appellate courts throughout the United States. We also routinely defend clients in securities-related arbitrations, as well as other forms of alternative dispute resolution, throughout the United States.

While we take great pride in our record of favorably resolving cases in their earliest stages through dispositive motions or favorable settlements, we are just as effective in trying cases. We focus on achieving our clients' goals and ensure that their best interests are served. For example, we prevailed as lead trial counsel in a multi-week, nationally publicized trial on behalf of Genesco Inc. in one of the first credit crisis-related trials in the country. In that

case, involving a failed \$1.6 billion merger, we obtained an order of specific performance and, following trial, a \$215 million settlement.

Our team has distinguished itself in every significant type of securities and shareholder litigation, including:

- **Securities fraud class actions**
- **Derivative litigation**
- **Merger-related litigation**
- **SEC enforcement proceedings**
- **Securities-related investigations**
- **Corporate governance**
- **Securities-related arbitration**



Shayne R. Clinton

865.521.0372 TEL
sclinton@bassberry.com



Joseph B. Crace, Jr.

615.742.7896 TEL
jcrace@bassberry.com



Michael L. Dagley

615.742.7718 TEL
mdagley@bassberry.com



Wallace W. Dietz

615.742.6276 TEL
wdietz@bassberry.com



Britt K. Latham

615.742.7962 TEL
blatham@bassberry.com



W. Brantley Phillips, Jr.

615.742.7723 TEL
bphillips@bassberry.com



**Overton
Thompson III**

615.742.7730 TEL
othompson@bassberry.com

BASS BERRY  SIMS

CENTERED TO DELIVER.

NASHVILLE KNOXVILLE MEMPHIS WASHINGTON DC bassberry.com