New Developments in Securities Litigation

Leading Lawyers on Adapting to Trends in Securities Litigation and Regulatory Enforcement

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Recent Developments in Securities and M&A Litigation

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ASPATORE
Introduction

For several years, the overriding trend in securities litigation has been a decline of federal class action lawsuits and a corresponding rise of state-court merger and acquisition (M&A) claims. The US Supreme Court has made it significantly more difficult to bring a successful securities class action, while state courts (in Delaware and elsewhere) are more open to shareholder suits. As a result, the plaintiffs’ bar is diversifying its inventory by moving into state court. No longer a specialty area, M&A litigation is now a bread-and-butter practice for most securities litigators, alongside federal securities claims and Securities and Exchange Commission (SEC) enforcement proceedings.

The first part of this chapter addresses recent developments in federal securities litigation, focusing on recent Supreme Court jurisprudence. The second part addresses recent trends in M&A litigation.

Federal Securities Litigation

In the last six years, the U.S. Supreme Court has devoted extraordinary attention to federal securities class actions. The Roberts Court has altered the landscape of federal securities jurisprudence in numerous respects: narrowing the territorial reach of the federal securities laws, limiting claims against secondary actors, redefining the pleading standards to establish scienter, and addressing questions of materiality, loss causation, and the statute of limitations.

Between 2006 and 2011, the Supreme Court issued no fewer than eight seminal decisions interpreting the federal securities laws.\(^1\) In early 2013, the

Supreme Court issued two more important opinions—one requiring the SEC to act more swiftly in pursuing fraud charges and the other making it significantly easier for private plaintiffs to pursue securities fraud claims on a class-wide basis.

In *Amgen Inc. v. Connecticut Retirement Plans and Trust Funds*, the Supreme Court held that plaintiff shareholders of Amgen Inc. could pursue securities fraud claims against the biotechnology company on a class-wide basis, without first having to prove that the company’s alleged misrepresentations materially inflated its stock price. The six-to-three ruling resolves a circuit split over whether the element of “materiality” should be considered at the class certification stage.

In *Gabelli v. Securities and Exchange Commission*, a unanimous Supreme Court established a five-year deadline for the SEC to pursue claims after the occurrence of an alleged fraud. The SEC had argued that the five-year clock should not start ticking until the date on which it discovered the alleged fraud, which may be significantly after the date on which the defendant’s misconduct took place. The Supreme Court rejected this argument. Unlike private plaintiffs, the SEC is not entitled to rely on the “discovery” rule to extend its limitations period.

Both of these decisions will have an immediate impact on securities litigation. The *Gabelli* decision will likely result in increased SEC activity, including more rigorous SEC examinations, faster-paced investigations, and potentially more actions being filed. The *Amgen* decision removes a barrier that discouraged the filing of securities cases in certain circuits, but may set up a new battle—whether the fraud-on-the-market doctrine, a key foundation of securities class actions, should be revised or abandoned altogether.

In January 2013, the Supreme Court also granted a writ of *certiorari* to address the scope of the Securities Litigation Uniform Standards Act (SLUSA), which pre-empts certain securities class actions arising under state law. In the fall of 2013, the Court will hear oral argument in three related

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cases arising from the alleged Ponzi scheme of Allen Stanford.⁴

*Amgen Inc. v. Connecticut Retirement Plans and Trust Funds*⁵

Congress and the Supreme Court have recognized the adverse impact that securities litigation can have on public companies. The costs of defense are high and the potential liability can be ruinous, often forcing defendants to settle even unmeritorious claims.

In 1995, Congress passed the Private Securities Litigation Reform Act (PSLRA), which created significant pleading hurdles for plaintiffs who attempt to bring class action claims under the federal securities laws. More recently, in several opinions issued between 2007 and 2011, the Supreme Court has further narrowed the playing field for securities plaintiffs.⁶

In addition to the foregoing limitations, several decisions from lower federal courts have created new hurdles for plaintiffs at the class certification stage. Those decisions have focused on the level of proof necessary to invoke the “fraud-on-the-market” presumption, established in 1988 by the Supreme Court’s decision in *Basic v. Levinson.*⁷ The fraud-on-the-market theory creates a rebuttable presumption that investors have relied on any material misrepresentations or omissions disseminated to the general public.

In *Basic*, the Court explained that the fraud-on-the-market presumption is supported by “common sense and probability,” noting that “an investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price. Because most publicly available information is reflected in market price, an investor’s reliance on any public material

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⁴ The cases are *Chadbourne & Park LLP v. Troice*, 12-79; *Willis of Colorado Inc. v. Troice*, 12-86; and *Proskauer Rose LLP v. Troice*, 12-88. The author is counsel for one of the petitioners at the Supreme Court.


misrepresentations, therefore, may be presumed for purposes of a Rule 10b-5 action.” The ability to invoke this presumption is crucial to class-action plaintiffs. Without it, individual issues of reliance and causation would be likely to dominate over common questions.

There has been considerable disagreement among lower courts concerning the requisite proof needed to invoke the presumption at the class certification stage. Two years ago, in *Erica P. John Fund Inc. v. Halliburton Co.*, the Supreme Court unanimously rejected a proposed barrier to class certification created by the Fifth Circuit. The Supreme Court held that plaintiffs do not have to prove “loss causation”—i.e., that the defendant’s misconduct directly caused the plaintiffs’ losses—to invoke the fraud-on-the-market doctrine.

The Fifth Circuit had required plaintiffs to prove, at the class certification stage, that the defendants’ alleged misstatements (as opposed to other contemporaneous disclosures or market forces) independently moved the market before they were entitled to invoke *Basic’s* fraud-on-the-market presumption of reliance. The Supreme Court, however, found that the Fifth Circuit’s loss causation requirement was “not justified by *Basic.*” Chief Justice Roberts explained:

> Such a rule contravenes *Basic’s* fundamental premise—that an investor presumptively relies on a misrepresentation so long as it was reflected in the market price at the time of his transaction. The fact that a subsequent loss may have been caused by factors other than the revelation of a misrepresentation has nothing to do with whether an investor relied on the misrepresentation in the first place, either directly or presumptively through the fraud-on-the-market theory. Loss causation has no logical connection to the facts necessary to establish the efficient market predicate to the fraud-on-the-market theory.

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8 *Id.* at 247.


10 *Id.* at 2182.

11 *Id.* at 2186.
Although *Halliburton* eliminated the certification-stage examination of loss causation, many lower courts continued to require proof of the *materiality* of the defendant’s alleged misrepresentation at the class certification stage to invoke the fraud-on-the-market presumption. In *Amgen*, the Supreme Court made clear that proof of materiality also is improper at the class certification stage.

The specific questions presented in *Amgen* were: (1) whether the district court must require proof of materiality before certifying a plaintiff class based on the fraud-on-the-market theory; and (2) whether the district court must allow the defendant to present evidence rebutting the applicability of the fraud-on-the-market theory before certifying a plaintiff class. The Court answered “no” to both questions.

Writing for the majority, Justice Ruth Bader Ginsburg emphasized that the key question is not whether materiality is an essential element of the fraud-on-the-market theory—“indisputably it is.”

Rather, the question is whether proof of materiality is necessary at the class certification stage to demonstrate that common questions will predominate over individual issues.

For two reasons, the Supreme Court concluded that proof of materiality is not required at the class certification stage. First, the question of materiality “is an objective one, involving the significance of an omitted or misrepresented fact to a reasonable investor.” Therefore, “materiality can be proved through evidence common to the class.”

Second, a failure of proof on the element of materiality does not result in individual questions. “Instead, the failure of proof on the element of materiality would end the case for one and for all; no claim would remain in which individual reliance issues could potentially predominate.”

The Court stressed that the early stages of class-action litigation are meant to ensure that cases are litigated fairly and efficiently. *Amgen* “would have us put the cart before the horse,” Ginsburg wrote. “Congress, we count it

12 Id. at 1195.
13 Id.
14 Id. at 1196.
significant, has addressed the settlement pressures associated with securities-fraud class actions through means other than requiring proof of materiality at the class-certification stage.”\textsuperscript{15}

On its face, \textit{Amgen} represents a victory for the plaintiffs’ bar, especially coming on the heels of the Court’s previous ruling in \textit{Halliburton}. In both cases, the Supreme Court has rejected lower court attempts to raise the bar for plaintiffs at the class certification stage. Plaintiffs will continue to face strict scrutiny of their complaints at the pleading stage, but if they can survive a motion to dismiss, the road to certification has become easier. From the defense perspective, the Court’s decision is likely to increase legal costs and force defendants to engage in lengthy legal battles before they can dispose of unmeritorious claims.

Ultimately, however, \textit{Amgen} may lead to a fundamental reconsideration of the fraud-on-the-market doctrine, which would be a significant victory for the defense bar. At least four justices appear willing to revisit the holding in \textit{Basic}. Writing in dissent, Justice Scalia argued that \textit{Basic} itself was “regrettable” and the majority opinion in \textit{Amgen} is “unquestionably disastrous.”\textsuperscript{16} According to Justice Scalia, while investors may indeed rely on the stock market to set the correct price for a stock, that does not mean that every misrepresentation a company makes contributed to that price—only those that are demonstrably material.

Justice Thomas (joined by Justice Kennedy) also dissented from the Court’s opinion, arguing that plaintiffs should be required to prove materiality to invoke the fraud-on-the-market doctrine. Thomas added:

\begin{quote}
The \textit{Basic} decision itself is questionable. Only four Justices joined the portion of the opinion adopting the fraud-on-the-market theory. Justice White, joined by Justice O'Conner, dissented from that section, emphasizing that “[c]onfusion and contradiction in court rulings are inevitable when traditional legal analysis is replaced with economic theorization by the federal
\end{quote}

\textsuperscript{15} \textit{Id.} at 1200.
\textsuperscript{16} \textit{Id.} at 1206 (Scalia, J., dissenting).
courts” and that the Court is “not well equipped to embrace novel constructions of a statute based on contemporary microeconomic theory.” Justice White’s concerns remain valid today.\(^{17}\)

Justice Alito concurred with the majority, but did so only because “the petitioners did not ask us to revisit Basic’s fraud-on-the-market presumption.” According to Justice Alito, “more recent evidence suggests that the presumption may rest on a faulty economic premise. In light of this development, reconsideration of the Basic presumption may be appropriate.”\(^{18}\)

Even Justice Ginsburg acknowledged the concerns over Basic’s economic underpinnings, but concluded that Amgen was “a poor vehicle” for revisiting the Basic decision.\(^{19}\)

When the fraud-on-the-market theory was adopted by the Supreme Court in 1988, securities markets were widely viewed as efficient, in that the price of a stock was believed to reflect all available information about the company—including any misstatements. Empirical research has demonstrated, however, that modern stock markets are not perfectly efficient. Markets incorporate certain kinds of information more quickly than others, and many trades are not based on the fundamental value of a company, but on speculation, momentum, and high-frequency algorithms.

With only four justices required to take up a new case, the Supreme Court may be ready to revisit the fraud-on-the-market theory. If so, Amgen may be remembered as a hollow victory for the plaintiffs’ bar.

*Gabelli v. SEC*\(^ {20}\)

In *Gabelli*, the SEC alleged that two officials at Gabelli Funds LLC, a registered investment advisor, aided and abetted a fraud between 1999 and

\(^{17}\) *Id.* at 1209 n.4 (Thomas, J., dissenting).

\(^{18}\) *Id.* at 1204 (Alito, J., concurring).

\(^{19}\) *Id.* at 1197 n.6.

2002 by permitting a large investor to secretly engage in “market timing” in a *quid pro quo* arrangement. In 2008, the SEC filed claims against the two officials under the Investment Adviser Act, seeking disgorgement, injunctive relief, and a civil monetary penalty. The defendants argued that the SEC’s claims were time-barred under 28 U.S.C. § 2462, which provides that “an action, suit or proceeding for the enforcement of any civil fine, penalty or forfeiture … shall not be entertained unless commenced within five years from the date when the claim first accrued.”

The district court agreed that the SEC’s request for a monetary penalty was time-barred, and it dismissed that claim. The Second Circuit reversed, reinstating the SEC’s civil-penalty claim. The appellate court held that the SEC is entitled to the benefit of the “discovery rule,” which means that its deadline to file a civil-penalty claim did not begin until it discovered (or reasonably could have discovered) the fraud.

The Supreme Court reversed the Second Circuit’s decision. In a unanimous opinion authored by Chief Justice Roberts, the Court held that when the government seeks a civil penalty, “the five-year clock begins to tick” when the fraud occurs, not when it is discovered.

Chief Justice Roberts explained that the SEC does not need the protections afforded by the discovery rule. The rule was created to protect fraud victims “where a defendant’s deceptive conduct may prevent a plaintiff from even knowing that he or she has been defrauded.” The time for filing a fraud suit is extended because “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.”

But the SEC is different. “Unlike a private party who has no reason to suspect fraud, the SEC’s very purpose is to root it out, and it has many legal tools at hand to aid in that pursuit.” The SEC may examine the books and records of an investment advisor at any time, and it may issue

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21 Id. at 1219.
22 Id. at 1220.
23 Id. at 1222.
subpoenas for documents and testimony without filing suit. The Court opined that “[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.”24

Furthermore, the Supreme Court was troubled by the impracticality of applying the discovery rule to the government, since trial courts would be forced to determine, among all of the agency’s offices, employees, and leadership, when the agency knew or should have known of the claim. Moreover, allowing the government to rely on the discovery rule would “leave defendants exposed” to punishment “not only for five years after their misdeeds, but for an additional uncertain period in the future,” which the Court found to be “utterly repugnant to the genius of our laws.”25

While the Court drew a bright-line rule for government actions seeking civil penalties, it did not define, beyond a monetary penalty, what types of remedies constitute a civil penalty under 28 U.S.C. § 2462. The SEC commonly seeks other remedies, such as disgorgement of ill-gotten gains, injunctions barring individuals from working in the securities industry, and injunctions barring individuals from serving as officers or directors of a public company. The Court’s decision leaves open the question of whether these and other such remedies are also subject to a strict five-year statute of limitations.26

In the Fifth Circuit, this question has been resolved. In SEC v. Bartek,27 the court held that an injunction permanently barring defendants from serving as officers or directors at any public company is a “penalty” under § 2462,

24 Id.
25 Id. at 1223.
26 Gabelli comes on the heels of Credit Suisse Sec. v. Simmonds, 132 S. Ct. 1414 (2012), in which the Supreme Court held that the two-year statute of limitations applicable to privately filed actions under Section 16(b) of the Exchange Act begins to run on the date of the improper profit. In so holding, the Court rejected arguments that the limitations period should be tolled until after the filing of a Section 16(a) disclosure statement. Together with Gabelli, Credit Suisse signals a trend toward stricter interpretation of statutes of limitations—for private plaintiffs, as well as the SEC.
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and therefore subject to a strict five-year limitations period. It remains to be seen whether the other circuit courts will reach a similar conclusion.

In the last few years, the SEC has made significant changes to its enforcement program, resulting in an increase of enforcement activity. The Gabelli decision is likely to generate more changes at the Commission. Those changes may include additional referrals from compliance examiners to the enforcement division, an increased number of informal inquiries by enforcement staff, faster-paced investigations, and almost certainly, additional requests for tolling agreements with persons being investigated.

The Troice Cases

The Securities Litigation Uniform Standards Act (SLUSA) prohibits state-law class actions alleging fraud “in connection with” the purchase or sale of “covered” securities—i.e., securities that are traded on a national exchange such as the New York Stock Exchange (NYSE). SLUSA was enacted in 1997 to prevent plaintiffs from circumventing the restrictions imposed under the federal securities laws by filing alternative claims in state court.

In the Stanford (Troice) cases, the plaintiffs allege that they were misled into purchasing fraudulent certificates of deposit (CDs) based, at least in part, on the representation that their CD investments were backed by a portfolio of securities traded on major exchanges. Stanford is insolvent; therefore, plaintiffs have targeted various third-party professionals—including Stanford’s banks, clearing brokers, law firms, and insurers—accusing them of facilitating the alleged fraud.

Under federal law, private litigants are not permitted to bring “aiding and abetting” claims against third parties. The Stanford plaintiffs have sought to avoid this limitation by asserting claims under state law, rather than federal law. The issue on appeal is whether such claims are pre-empted by SLUSA.

28 Chadbourne & Park LLP v. Troice, 12-79; Willis of Colorado Inc. v. Troice, 12-86; and Proskauer Rose LLP v. Troice, 12-88.
The Supreme Court petitioners are law firms and insurance brokers that performed professional services for Stanford. The petitioners moved to dismiss the plaintiffs’ state-law claims at the district court on the grounds that they were pre-empted by SLUSA. The defendants acknowledged that the Stanford CDs themselves were not “covered securities” within the meaning of SLUSA, but argued that plaintiffs’ claims were nevertheless precluded because of Stanford’s misrepresentations that the CDs were backed by SLUSA-covered securities.

The district court recognized a split in authority over the meaning of SLUSA’s “in connection with” requirement, and it chose to follow the Eleventh Circuit test. Under that standard, a state-law class action is precluded if the plaintiffs’ allegations “depend upon” the purchase or sale of SLUSA-covered securities, or if the plaintiffs were “induced” to invest through misrepresentations regarding covered securities. The Stanford cases clearly satisfied this test, and the district court granted the defendants’ motions to dismiss.

The Fifth Circuit reversed, holding that SLUSA did not apply because the plaintiffs’ complaints also contained other alleged misrepresentations that did not relate to Stanford’s alleged portfolio of covered securities. The Fifth Circuit acknowledged that “the CDs’ promotional material touted that [Stanford’s] portfolio of assets was invested in ‘highly marketable securities issued by stable governments, strong multinational companies, and major international banks,’” but nonetheless found that this was “but one of a host of (mis)representations” made by Stanford. The court ultimately concluded that Stanford’s misrepresentations about its securities portfolio were only “tangentially related” to the heart of its alleged fraud.30

The petitioners contend that the Fifth Circuit’s decision is contrary to the plain language of SLUSA. The statute provides that a state-law class action is precluded if the complaint alleges “a” misrepresentation in connection with the purchase or sale of a covered security. Therefore, a single misrepresentation is all that is required. The statute does not contemplate a balancing of various allegations to determine whether the SLUSA-implicating misrepresentations are important enough to warrant consideration.

30 Roland v. Green, 675 F.3d 503, 521 (5th Cir. 2012).
Before the Supreme Court granted the petition for writ of certiorari, it invited the U.S. Solicitor General to submit an amicus brief. The Solicitor General argued that the Court should refuse the case because of the complexity and unusual nature of the Stanford Ponzi scheme, but expressly recognized that “the Fifth Circuit erred in its application of SLUSA’s preclusion provision.”

The Supreme Court will consider the following question: “whether a covered state law class action complaint that unquestionably alleges ‘a’ misrepresentation ‘in connection with’ the purchase or sale of a SLUSA-covered security nonetheless can escape the application of SLUSA by including other allegations that are farther removed from a covered securities transaction.”

The petitioners have argued that the Fifth Circuit’s decision undermines one of the core policy goals underlying SLUSA—preventing plaintiffs from asserting state-law claims as a means to avoid the careful restrictions that Congress and the Supreme Court have placed on federal securities claims. This argument may get traction with the Court. In a recent non-securities case involving the Class Action Fairness Act (CAFA), the Court unanimously rejected the plaintiff’s effort to keep a class action out of federal court through artificial limits on class-wide damages.31

The Court will hear oral argument in the Troice cases in the fall of 2013.

SEC v. Apuzzo32

In August 2012, the Second Circuit issued a significant decision expanding the power of the SEC to bring “aiding and abetting” cases against secondary actors who contribute to securities fraud. In Apuzzo, the Second Circuit held that the SEC is not required to prove that an alleged aider and abettor “proximately caused” the fraud, rejecting a contrary decision from the district court and effectively lowering the bar for SEC aiding and

31 See Standard Fire Ins. Co. v. Knowles, 133 S. Ct. 1345 (2013) (“The question presented concerns a class-action plaintiff who stipulates, prior to certification of the class, that he, and the class he seeks to represent, will not seek damages that exceed $5 million in total [the dollar threshold that triggers the applicability of CAFA]. Does that stipulation remove the case from CAFA’s scope? In our view, it does not.”).

32 SEC v. Apuzzo, 689 F.3d 204 (2d Cir. 2012).
abetting claims. In March 2013, the defendant filed a petition for writ of 
certiorari in the US Supreme Court.

Although private litigants cannot bring aiding and abetting claims, the SEC
is expressly permitted to do so. To establish aiding and abetting liability, the
SEC must prove that: (1) a primary securities violation occurred; (2) the
 aider and abettor had knowledge of the primary securities violation; and (3)
the aider and abettor provided substantial assistance in the securities
violation. The Second Circuit’s decision in *Apuzzo* dealt with the third
element, addressing the standard of proof to show “substantial
assistance.”

The SEC accused Joseph Apuzzo, the former chief financial officer (CFO)
of Terex, of aiding and abetting the securities fraud of one of Terex’s
customers. Specifically, the SEC accused Apuzzo of assisting Terex’s
customer, United Rentals Inc. (URI), in misrepresenting its financial results
by inflating the profit from the sale of used equipment and in prematurely
recognizing the revenue from those sales. Apuzzo allegedly agreed to allow
Terex to enter into the inflated transactions because URI secretly agreed to
indemnify Terex for any losses and to take over Terex’s resale obligations
and because URI promised to make additional large purchases of new
equipment from Terex.

Relying on earlier Second Circuit decisions, the district court dismissed the
SEC’s complaint against Apuzzo on the grounds that the SEC had failed to
adequately plead the “substantial assistance” prong of the aiding and
abetting standard, since Apuzzo’s actions were not the proximate cause of
URI’s accounting violations. The Second Circuit reversed the district
court, holding that proximate cause was not the appropriate standard for
determining substantial assistance in an SEC enforcement action. The
court reasoned that because the SEC does not need to show injury in an
enforcement proceeding, it was inappropriate to require the government
to show proximate cause (which connects wrongdoing to injury in a
private action). The court further found that a proximate cause standard
would undermine the SEC’s ability to bring aiding and abetting claims,

33 *Id.* at 213-14.
34 *Id.* at 211.
since “almost by definition, the activities of an aider and abettor are rarely the direct cause of the injury brought about by the fraud.”

Reaching back to a 1938 decision written by the famous jurist Learned Hand, the Second Circuit held that substantial assistance requires only that the alleged aider associated himself with the venture, participated in it as something that he wished to bring about, and sought by his action to make it succeed. Applying this standard to the facts alleged, the court had little difficulty in determining that Apuzzo’s actions met this standard, particularly in light of the allegations that he had actual knowledge of the fraud.

This case is a significant victory for the SEC, and it follows another change in the law designed to make it easier for the SEC to bring aiding and abetting cases. The Dodd-Frank Act reduced the SEC’s burden of proof required to establish that an aider and abettor acted with “scienter”—i.e., fraudulent intent—lowering the bar from “knowing” to “reckless” misconduct. The Dodd-Frank amendment did not apply to the Apuzzo case, which was filed before the effective date of the amended statute.

If the Supreme Court agrees to hear Apuzzo on the heels of Gabelli, it may signal a new desire on the part of the Court to scrutinize the SEC’s civil enforcement activities. If not, the SEC will have a new arrow in its quiver, and it is likely to pursue aiding and abetting cases with increased frequency.


In March 2013, the Supreme Court denied a petition for writ of certiorari in a high-profile case that many securities lawyers had expected it to consider. In NECA-IBEW Health & Welfare Fund v. Goldman Sachs & Co., the US Court of Appeals for the Second Circuit permitted a
purchaser of mortgage-backed securities to file class action claims on behalf of purchasers of other related offerings. Sections 11 and 12(a)(2) of the Securities Act impose strict liability for misstatements in a registration statement or a prospectus. In the class-action context, plaintiffs who have purchased securities in one offering often purport to pursue class action claims on behalf of purchasers in other similar offerings by the same issuer, particularly where multiple offerings are made pursuant to a common shelf registration.

In *NECA-IBEW*, Goldman Sachs issued seventeen separate offerings of residential mortgage-backed securities (RMBS). Plaintiff NECA-IBEW purchased certificates in two of those seventeen offerings. Each offering was made pursuant to a registration statement, including a common shelf registration and a unique prospectus supplement. NECA-IBEW purported to assert class-action claims on behalf of purchasers of all seventeen RMBS offerings.

The district court concluded that NECA-IBEW did not have standing to assert claims on behalf of purchasers in the other fifteen offerings. The Second Circuit disagreed, holding that NECA-IBEW could assert claims on behalf of purchasers of related securities offerings implicating the “same set of concerns.”

The Second Circuit’s decision conflicts with *Plumbers’ Union Local No. 12 Pension Fund v. Nomura Asset Acceptance Corp.*, in which the First Circuit held that a plaintiff cannot assert class-action claims relating to securities that he did not individually purchase. In light of this circuit conflict, Goldman Sachs filed a petition for writ of certiorari, asking the Supreme Court to decide whether the Second Circuit erred in concluding “that a representative plaintiff has standing to assert on behalf of absent class members claims for relief that the representative plaintiff lacks standing to assert on its own behalf.” On March 18, 2013, the Supreme Court denied Goldman Sachs’s petition. For now, the circuit split will remain.

40 *Plumbers’ Union Local No. 12 Pension Fund v. Nomura Asset Acceptance Corp.*, 632 F.3d 762, 769-71 (1st Cir. 2011).
41 Goldman Sachs’ Petition for Writ of Certiorari, at *i.
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Federal Securities Litigation by the Numbers

Federal securities class action filings declined “sharply” in 2012. Only 152 federal securities class actions were filed in 2012—the second-lowest number of annual filings in sixteen years. This represents a 19 percent decrease from 2011 filings and a 21 percent decrease from the 1997–2011 annual average.42

Moreover, filing activity declined throughout the year, perhaps signaling a trend that will continue into 2013. There were only sixty-four filings in the second half of the year, compared with eighty-eight in the first half. And fourth-quarter activity was particularly slow—a total of only twenty-five filings, the lowest number in any quarter in the last sixteen years.43

The 2012 decrease is largely due to a precipitous decline in federal M&A litigation. According to Cornerstone, only thirteen federal M&A suits were filed in 2012, compared with forty and forty-three in 2010 and 2011, respectively.44 M&A suits are now filed almost exclusively in state courts.

The number of securities class action settlements also declined. There were fifty-three court-approved settlements in 2012, which is a fourteen-year low. This is an 18 percent decrease from the number of approved settlements in 2011, and it represents a decline of more than 45 percent from the ten-year average from 2002 through 2011.45

While the total number of settlements was down, the cumulative dollar value of those settlements increased dramatically. The average reported settlement rose in excess of 150 percent over 2011 levels—from an inflation-adjusted total of $21.6 million in 2011 to $54.7 million in 2012.46 The median settlement amount increased from an inflation-adjusted $5.9

43 Id. at 1.
44 Id.
45 See Ellen Ryan & Laura Simmons, Securities Class Action Settlements—2012 Review and Analysis (Cornerstone Research 2013).
46 Id. at 2.
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million in 2011 to $10.2 million in 2012. Moreover, there were six “mega-settlements” in excess of $100 million in 2012, a 100 percent increase over 2011.

**M&A Litigation**

In 2012, shareholder plaintiffs challenged almost all large U.S. mergers and acquisitions. Lawsuits were filed in 96 percent of all M&A deals with a value in excess of $500 million. This is an astonishing number, signifying that shareholder litigation is a virtual certainty in the aftermath of a merger announcement. Indeed, most transactions generate multiple lawsuits—an average of 5.4 lawsuits per transaction for deals valued at more than $500 million. Smaller deals did not fare much better. Shareholder suits were filed in 93 percent of M&A transactions with a value in excess of $100 million.

In a typical M&A suit, the plaintiff shareholder (on behalf of a class or sometimes derivatively on behalf of the corporation) alleges that the target’s board of directors violated its fiduciary duties by conducting a flawed sales process that failed to maximize shareholder value. The plaintiffs’ allegations may include attacks on the process used to identify a purchaser (such as the absence of a competitive auction or a failure to shop the company to other potential bidders), concerns about deal protections that may discourage other competitive bids, or the impact of various conflicts of interests on the part of management or investment bankers. In almost every case, plaintiffs allege that the company failed to disclose important information about the deal to shareholders, thereby depriving shareholders of the ability to make informed decisions in the voting process. In most cases, these disclosure allegations drive the lawsuit and form the basis of a settlement. Most M&A cases are settled in exchange for an agreement by the company to disclose additional information about the sale process, the reasons for the board’s actions, financial projections, and any fairness opinions.

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47 *Id.* at 3.
48 *Id.*
50 *Id.* at 1.
M&A litigation is hardly new, but the ubiquity of such claims is a fairly recent phenomenon. In 2007, approximately 50 percent of large M&A deals resulted in shareholder claims.51 And in 2000, only 11 percent of announced M&A offers generated litigation.52

Plaintiff law firms often announce “investigations” of target companies and their boards of directors within hours of a merger announcement, and they file lawsuits an average of fourteen days later. Most of these cases settle, and they do so fairly quickly—an average of forty-two days after the initial filing of the lawsuit.53 In more than 80 percent of these settlements, the only relief to shareholders was additional disclosures.

Nevertheless, for those cases that do generate cash settlements, the dollar amounts can be enormous. Two of the largest M&A settlements on record occurred in 2012: $110 million in the El Paso Corp./Kinder Morgan Inc. deal and $49 million in the acquisition of Delphi Financial Group Inc. by Tokio Marine Holdings Inc.54 In most case, large M&A settlements typically involve allegations of significant conflicts of interest on the part of corporate officers or directors. For example, the Delphi plaintiffs alleged that the company’s chief executive negotiated a premium for the class of shares he owned, and the El Paso shareholders accused the company’s chief executive officer (CEO) of negotiating side deals with acquirers to purchase some of the targets’ assets.

In settlements related to 2012 M&A deals, the average attorney fee award was $725,000. In disclosure-only settlements, the average fee award was $540,000, a decline for the third consecutive year.55 On average, disclosure-only fee awards have declined 24 percent since 2010, evidencing a growing concern on the part of courts (in Delaware and elsewhere) as to the value of certain types of shareholder disclosures. In an October 2012 speech at a Washington, D.C., conference sponsored by the US Chamber of Commerce, Judge Leo Strine of the Delaware Chancery Court made this

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51 Id.
52 See C.N.V. KRISHMAN, RONALD MASULIS, RANDALL THOMAS & ROBERT THOMPSON, SHAREHOLDER LITIGATION IN MERGERS AND ACQUISITIONS 53 (2011).
53 Daines & Koumrian, Shareholder Litigation Involving Mergers and Acquisitions, at 5.
54 Id. at 6.
55 Id. at 9.
explicit: “I’m not going to give big fees for junk, [but] I lose no sleep for rewarding plaintiff lawyers who get real money for the shareholders.”

Choice of Forum: Delaware vs. the Other Forty-Nine

Prior to 2002, the vast majority of M&A lawsuits were filed in the Delaware Court of Chancery. From 2002 through 2007, the plaintiffs’ bar initiated a “flight from Delaware”—filing suit in other states, even if the target company was incorporated in Delaware. (The majority of US-based public companies are incorporated in Delaware, but their principal places of business are elsewhere. Under well-established jurisdictional rules, an M&A case can be filed either in the state of incorporation or in the state where the company’s principal office is located.)

More recently, this trend has reversed, and plaintiffs are moving back into Delaware. The percentage of lawsuits filed in the Delaware Court of Chancery grew in 2011 and 2012, drawing filings away from federal court and other state courts. In 2012, only 16 percent of M&A suits involving Delaware corporations were litigated entirely in other jurisdictions.

On the other hand, plaintiffs rarely file exclusively in Delaware. Most large M&A deals generate simultaneous claims in multiple forums. In 2012, 65 percent of all M&A cases involving Delaware-incorporated companies were litigated in multiple jurisdictions.

The Delaware Chancery Court has expressed strong concerns about multi-jurisdictional M&A claims, and it has been more assertive in asserting itself in the face of jurisdictional challenges. In a January 2013 paper, Chancellor Leo Strine attacked multi-forum litigation as benefiting plaintiffs’ lawyers rather than investors:

> Often motivated by a desire to secure a role in litigation that will justify their share in potential fee awards,

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57 Daines & Koumrian, Shareholder Litigation Involving Mergers and Acquisitions, at 2.
58 Id. at 3.
plaintiffs’ lawyers often bring parallel actions against the same defendant in multiple jurisdictions, hoping to become the lead plaintiffs’ attorney, but if not, working with the other plaintiffs’ attorneys to participate in a settlement by virtue of it having filed suit in another jurisdiction that made the merger litigation difficult to consolidate or cheaper to settle than litigate.59

Chancellor Strine argues that M&A claims should be litigated in the state where a company is incorporated (usually Delaware), even if the first-filed complaint is in another jurisdiction. “Where lawsuits are filed contemporaneously in parallel forums, the courts should give effect to the parties’ expressed choice of the law that is to govern their relationship—in the corporate context, the law of the chosen state of incorporation—by applying a rebuttable presumption that the litigation should proceed in the courts of that state.”60

Strine presents a lengthy doctrinal argument in favor of adjudicating shareholder claims in the state of incorporation, even where other courts would traditionally have priority under the “first-filed” rule. Nevertheless, the plaintiffs’ bar intends to continue filing suit in other jurisdictions. One leading plaintiffs’ lawyer stated: “The Delaware courts seem to be offended by [multi-jurisdictional filing], but I don’t buy it. The idea that we are out to bamboozle state courts—that’s a fallacy. When the case makes sense to be tried in Delaware, that’s where we try it, and we don’t shy away from the Chancery Court.”61

Strine’s arguments will carry considerable weight in Delaware, but it remains to be seen whether judges in other jurisdictions will defer to the Delaware Chancery Court. As one commentator noted, “There are judges who will say, ‘Look, I’m not stupid, and I can handle this as well as a

60 Id. at 3-4.
Chancery judge.’ As long as those judges are out there, we’re going to continue to see this tension.’62

Mandatory Choice-of-Forum through Legislation or Corporate Bylaws

In October 2012, the US Chamber Institute for Legal Reform issued a public report titled “The Trial Lawyers’ New Merger Tax.”63 Expressing concern about the “burden imposed on companies that must defend themselves in multiple state and federal courts around the country,” the Chamber Institute proposes a number of federal legislative solutions to the problems associated with multi-jurisdiction litigation:

- Congress could enact a statute requiring all merger-related securities litigation to be brought in the state of incorporation of the defendant company. That proposal was put forward by the Committee on Securities Litigation of the Association of the Bar of the City of New York.
- Congress could amend the SLUSA “carve out” provision, and the parallel provision of the Class Action Fairness Act, to require that class actions brought under the “carve outs” (and shareholder derivative actions with similar effect) may be filed only in the courts of the defendant company’s state of incorporation.
- To address the multiplication of federal class actions, Congress could enact legislation providing that any lawsuits relating to mergers or acquisitions that are filed in federal court should be transferred immediately to a federal court in the state of incorporation of the company being acquired (if there is more than one federal court in that state, the appropriate district should be the one containing the state capital).64

Many public companies, however, have been unwilling to wait for judicial or legislative solutions to the problems associated with multi-jurisdictional litigation. Instead, they have adopted exclusive forum-selection provisions

62 Id.
64 Id. at 9.
requiring shareholder class action and derivative suits be filed in the state of incorporation. Most companies adopting these provisions have designated the Delaware Court of Chancery as the exclusive venue for shareholder litigation.

Such forum selection bylaws have become increasingly common since the Delaware Chancery Court’s decision in *In re Revlon Inc. Shareholders Litigation.* In *Revlon*, Vice Chancellor Laster commented in dicta that “if boards of directors and stockholders believe that a particular forum would provide an efficient and value-promoting locus for dispute resolution, then corporations are free to respond with charter provisions selecting an exclusive forum for intra-entity disputes.”

Most companies that have adopted forum-selection clauses have done so through board-adopted bylaw amendments, rather than shareholder-approved charter amendments. In 2011, the Northern District of California rejected a forum-selection bylaw as unenforceable because of the absence of shareholder approval. It remains to be seen how courts in other jurisdictions, particularly in Delaware, will view the enforceability of mandatory venue provisions in corporate bylaws.

“Say on Pay”: A New Frontier in State-Court Securities Litigation

Armed with the Dodd-Frank Act’s new requirement of advisory shareholder votes on executive compensation, entrepreneurial plaintiffs’ attorneys sought to expand their product line in 2012. In a new category of lawsuits modeled after M&A litigation, shareholders have begun to challenge the executive compensation disclosures included in annual proxy statements. As in M&A cases, the plaintiffs in these “say on pay” cases seek to enjoin annual shareholder votes because of allegedly insufficient disclosures about executive compensation. At least twenty-five such lawsuits were filed in 2012, and plaintiffs’ firms announced investigations of thirty-three more companies in the last two months of the year.

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65 *In re Revlon Inc. Shareholders Litig.*, 990 A.2d 940 (Del. Ch. 2010).
66 Id. at 960.
These cases have not been particularly successful to date, but some issuers have elected to settle “say on pay” claims to avoid the possibility of a delayed annual shareholder meeting and the expense of litigation. None of the six settlements reported in 2012 generated any cash value for the shareholders, nor did they alter executive compensation. Instead, the target companies agreed to make additional disclosures concerning executive compensation, and they agreed (of course) to pay plaintiffs’ attorneys’ fees.

These claims have continued during the 2013 proxy season, and issuers should be prepared for potential claims arising from annual proxy disclosures. So far, these claims are little more than a nuisance, but the causes of action are evolving, and relatively few courts have weighed in on the issues.

**Conclusion**

The plaintiffs’ bar is endlessly creative, and securities litigation remains a growth industry. The increase in M&A litigation and the recent surge in “say-on-pay” litigation signal an effort by the plaintiffs’ bar to develop new business models as alternatives to traditional securities litigation. This trend is likely to accelerate, as the Supreme Court continues to scrutinize federal class actions.

Times may be changing, but securities class actions remain “the 800-pound gorilla” of federal class action practice. Total settlement dollars actually increased in 2012 by more than 100 percent over 2011 totals because of a number of “mega-settlements” with values in excess of $100 million. For better or worse, federal securities litigation is alive and well, and it should remain so for the foreseeable future.

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69 See Nate Raymond, *Lawyers gain from “say-on-pay” suits targeting U.S. Firms*, **REUTERS** (Nov. 30, 2012).


Key Takeaways

- The trend in securities litigation has been a decline of federal class action lawsuits and a corresponding rise of state-court M&A claims.
- Over the last few years, the U.S. Supreme Court has made it significantly more difficult to bring a successful securities class action.
- In *Amgen*, the Supreme Court eased the burden of proof on plaintiffs seeking to certify a class action, but also signaled that it may soon address whether the fraud-on-the-market doctrine, a key foundation of securities class actions, should be revised or abandoned altogether.
- In *Gabelli*, the Supreme Court established a bright-line five-year deadline for the SEC to pursue claims after the occurrence of an alleged fraud.
- M&A litigation activity has skyrocketed, and courts are struggling to deal with multi-jurisdictional disputes.

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