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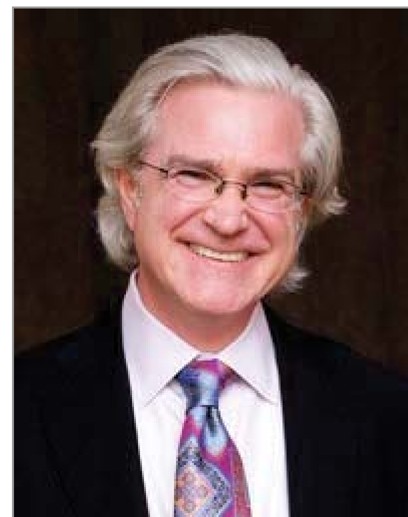
Top 5 Securities Cases Of 2014: No Halliburton II



Douglas W. Greene

Law360, New York (January 02, 2015, 12:33 PM ET) -- 2014 will be remembered as the year of the Super Bowl of securities litigation, Halliburton Co. v. Erica P. John Fund Inc. ("Halliburton II"), 134 S. Ct. 2398 (2014), the case that finally gave the U.S. Supreme Court the opportunity to overrule the fraud-on-the-market presumption of reliance, established in 1988 in Basic v. Levinson.

Yet, for all the pomp and circumstance surrounding the case, Halliburton II may well have the lowest impact-to-fanfare ratio of any Supreme Court securities decision, ever. Indeed, it does not even make my list of the Top 5 most influential developments in 2014 — developments that foretell the types of securities and corporate-governance claims plaintiffs will bring in the future, how defendants will defend them, and the exposure they present.

Topping my Top 5 list is a forthcoming Supreme Court decision in a different, less-heralded case — Omnicare Inc. v. Laborers District Council Construction Industry Pension Fund. Despite the lack of fanfare, Omnicare likely will have the greatest practical impact of any Supreme Court securities decision since the court's 2007 decision in Tellabs Inc. v. Makor Issues & Rights Ltd., 551 U.S. 308 (2007). After discussing my Top 5, I will explain why Halliburton II does not make the list.

5. City of Providence v. First Citizens BancShares

A Further Step Toward Greater Scrutiny of Meritless Merger Litigation

In City of Providence v. First Citizens BancShares, 99 A.3d 229 (Del. Ch. 2014), Chancellor Andre Bouchard upheld the validity of a board-adopted bylaw that specified North Carolina as the exclusive forum for intracorporate disputes of a Delaware corporation. The ruling extended former Chancellor Leo Strine's ruling last year in Boilermakers Local 154 Retirement Fund v. Chevron, 73 A.3d 934 (Del Ch. 2013), which validated a Delaware exclusive-forum bylaw. These types of bylaws largely are an attempt to bring some order to litigation of shareholder challenges to corporate mergers and other transactions.

Meritless merger litigation is a big problem. Indiscriminate merger litigation is a slap in the face to careful directors who have worked hard to understand and approve a merger, or to CEOs who have spent many months or years working long hours to locate and negotiate a transaction in the shareholders' best interest. It is cold comfort to know that nearly all mergers draw shareholder litigation, and that nearly all of those cases will settle before the transaction closes without any payment by the directors or officers personally. And we know the system is broken when it routinely allows meritless suits to result in significant recoveries for plaintiffs' lawyers, with virtually nothing gained by companies or their shareholders.

Two years ago, I advocated for procedures requiring shareholder lawsuits to be brought in the company's state of incorporation. Exclusive state-of-incorporation litigation would attack the root cause of the merger-litigation problem: the inability to consolidate cases and subject them to a

motion to dismiss early enough to obtain a ruling before negotiations to achieve settlement before the transaction closes must begin. Although the problem is virtually always framed in terms of the oppressive cost and hassle of multiforum litigation, good defense counsel can usually manage the cost and logistics. Instead, the bigger problem, and the problem that causes meritless merger litigation to exist, is the inability to obtain dismissals. This is primarily so because actions filed in multiple forums can't all be subjected to a timely motion to dismiss, and a dismissal in one forum that can't timely be used in another forum is a hollow victory. If there were a plenary and meaningful motion-to-dismiss process, less-meritorious cases would be weeded out early, and plaintiffs' lawyers would bring fewer meritless cases. The solution is that simple.

Exclusive litigation in Delaware for Delaware corporations is preferable, because of Delaware's greater experience with merger litigation and likely willingness to weed out meritless cases at a higher rate. But the key to eradicating meritless merger litigation is consolidation in some single forum, and not every Delaware corporation wishes to litigate in Delaware. So, I regard First Citizens' extension of Chevron to a non-Delaware exclusive forum as a key development

4. SEC v. Citigroup

The Forgotten Important Case

On June 4, 2014, in SEC v. Citigroup, 752 F.3d 285 (2d Cir. 2014), the Second Circuit held that Judge Jed Rakoff abused his discretion in refusing to approve a proposed settlement between the SEC and Citigroup that did not require Citigroup to admit the truth of the SEC's allegations. Judge Rakoff's decision set off a series of events that culminated in the ruling on the appeal, about which people seemed to have forgotten because of the passage of time and intervening events.

Once upon a time, way back in 2012, the SEC and Citigroup settled the SEC's investigation of Citigroup's marketing of collateralized debt obligations. In connection with the settlement, the SEC filed a complaint alleging nonscienter violations of the Securities Act. The same day, the SEC also filed a proposed consent judgment, enjoining violations of the law, ordering business reforms and requiring the company to pay $285 million. As part of the consent judgment, Citigroup did not admit or deny the complaint's allegations. Judge Rakoff held a hearing to determine "whether the proposed judgment is fair, reasonable, adequate, and in the public interest." In advance, the court posed nine questions, which the parties answered in detail. Judge Rakoff rejected the consent judgment.

The rejection order rested, in part, on the court's determination that any consent judgment that is not supported by "proven or acknowledged facts" would not serve the public interest because:

- the public would not know the "truth in a matter of obvious public importance," and
- private litigants would not be able to use the consent judgment to pursue claims because it would have "no evidentiary value and no collateral estoppel effect."

The SEC and Citigroup appealed. While the matter was on appeal, the SEC changed its policy to require admissions in settlements "in certain cases," and other federal judges followed Judge Rakoff's lead and required admissions in SEC settlements. Because of the SEC's change in policy, many people deemed the appeal unimportant. I was not among them; the Second Circuit's decision remained of critical importance, because the extent to which the SEC insists on admissions will depend on the amount of deference it receives from reviewing courts — which was the issue before the Second Circuit. It stands to reason that the SEC would have insisted on more admissions if courts were at liberty to second-guess the SEC's judgment to settle without them. Greater use of admissions would have had extreme and far-reaching consequences for companies, their directors and officers, and their D&O insurers.

So, it was quite important that the Second Circuit held that the SEC has the "exclusive right" to decide on the charges, and that the SEC's decision about whether the settlement is in the public

interest "merits significant deference."

3. Wal-Mart Stores Inc. v. Indiana Elec. Workers Pension Trust Fund IBEW

Delaware Supreme Court's Adoption of the Garner v. Wolfinbarger "Fiduciary" Exception to the Attorney-Client Privilege Further Encourages Use of Section 220 Inspection Demands

On July 23, 2014, the Delaware Supreme Court adopted the fiduciary exception to the attorney-client privilege, which originated in Garner v. Wolfinbarger, 430 F.2d 1093 (5th Cir. 1970), and held that stockholders who make a showing of good cause can inspect certain privileged documents. Although this is the first time the Delaware Supreme Court has expressly adopted Garner, it had previously tacitly adopted it, and the Court of Chancery had expressly adopted it in Grimes v. DSC Communications Corp., 724 A.2d 561 (Del. Ch. 1998).

In my view, the importance of Wal-Mart is not so much in its adoption of Garner — given its previous tacit adoption — but instead is in the further encouragement it gives stockholders to use Section 220. Delaware courts for decades have encouraged stockholders to use Section 220 to obtain facts before filing a derivative action. Yet the Delaware Supreme Court, in the Allergan derivative action, Pyott v. Louisiana Municipal Police Employees' Retirement System ("Allergan"), 74 A.3d 612 (Del. 2013), passed up the opportunity to effectively require pre-litigation use of Section 220. In Allergan, the court did not adopt Vice Chancellor Travis Laster's ruling that the plaintiffs in the previously dismissed litigation, filed in California, provided "inadequate representation" to the corporation because, unlike the plaintiffs in the Delaware action, they did not utilize Section 220 to attempt to determine whether their claims were well-founded. Upholding the Court of Chancery's presumption against fast-filers would have strongly encouraged, if not effectively required, shareholders to make a Section 220 demand before filing a derivative action.

In Wal-Mart, however, the Delaware Supreme Court provided the push toward Section 220 that it passed up in Allergan. Certainly, expressly adopting Garner will encourage plaintiffs to make more Section 220 demands. That should cause plaintiffs to conduct more prefiling investigations, which will decrease filings to some extent. But increased use of 220 also means that the cases that are filed will be more virulent, because they are selected with more care, and are more fact-intensive — and thus tend to be more difficult to dispose of on a motion to dismiss.

2. City of Livonia Employees' Retirement System v. The Boeing Company

Will Defendants Win the Battle but Lose the War?

On Aug. 21, 2014, Judge Ruben Castillo of the Northern District of Illinois ordered plaintiffs' firm Robbins Geller Rudman & Dowd to pay defendants' costs of defending a securities class action, as Rule 11 sanctions for "reckless and unjustified" conduct related to reliance on a confidential witness ("CW") whose testimony formed the basis for plaintiffs' claims. 2014 U.S. Dist. LEXIS 118028 (N.D. Ill. Aug. 21, 2014).

I imagine that some readers may believe that, as a defense lawyer, I'm including this development because one of my adversaries suffered a black eye. That's not the case at all. Although I'm not in a position to opine on the merits of the Boeing CW matter, I can say that I genuinely respect Robbins Geller and other top plaintiffs' firms. And beware those who delight in the firm's difficulties: few lawyers who practice high-stakes litigation at a truly high level will escape similar scrutiny at some point in a long career.

But beyond that sentiment, I have worried about the Boeing CW problem, as well as similar problems in the SunTrust and Lockheed cases, because of their potential to cause unwarranted scrutiny of the protections of the Private Securities Litigation Reform Act. I believe the greatest risk to the Reform Act's protections has always been legislative backlash over a perception that the Reform Act is unfair to investors. The Reform Act's heavy pleading burdens have caused plaintiffs' counsel to seek out former employees and others to provide internal information. The investigative process is often difficult and is ethically tricky, and the information it generates can be lousy. This is so even if plaintiffs' counsel and their investigators act in good faith — information can be

misunderstood, misinterpreted and/or misconstrued by the time it is conveyed from one person to the next to the next to the next. And, to further complicate matters, CWs sometimes recant, or even deny, that they made the statements on which plaintiffs rely. The result can be an unseemly game of he-said/she-said between CWs and plaintiffs' counsel, in which the referee is ultimately an Article III judge. At some point, Congress will step in to reform this process.

Judge Rakoff seemed to call for such reform in his post-dismissal order in the Lockheed matter:

> The sole purpose of this memorandum … is to focus attention on the way in which the PSLRA and decisions like Tellabs have led plaintiffs' counsel to rely heavily on private inquiries of confidential witnesses, and the problems this approach tends to generate for both plaintiffs and defendants. It seems highly unlikely that Congress or the Supreme Court, in demanding a fair amount of evidentiary detail in securities class action complaints, intended to turn plaintiffs' counsel into corporate 'private eyes' who would entice naïve or disgruntled employees into gossip sessions that might help support a federal lawsuit. Nor did they likely intend to place such employees in the unenviable position of having to account to their employers for such indiscretions, whether or not their statements were accurate. But as it is, the combined effect of the PSLRA and cases like Tellabs are likely to make such problems endemic.

Rather than tempt Congress to revisit the Reform Act's protections (which defendants should want to avoid) and/or allow further unseemly showdowns (which plaintiffs and courts should want to avoid), plaintiffs, defendants and courts can begin to reform the CW process through some basic measures, including requiring declarations from CWs, requiring them to read and verify the complaint's allegations citing them, and requiring plaintiffs to plead certain information about their CWs. As I've previously written, these reforms would have prevented the problems at issue in the Boeing, SunTrust and Lockheed matters, and would result in more just outcomes in all cases.

1. Omnicare

In My Opinion, the Most Important Supreme Court Case Since Tellabs

Omnicare concerns what makes a statement of opinion false. Opinions are ubiquitous in corporate communications. Corporations and their officers routinely share subjective judgments on issues as diverse as asset valuations, strength of current performance, risk assessments, product quality, loss reserves, and progress toward corporate goals. Many of these opinions are crucial to investors, providing them with unique information and insight. If corporate actors fear liability for sharing their genuinely held beliefs, they will be reluctant to voice their opinions, and shareholders would be deprived of this vital information.

The standard that the federal securities laws use to determine whether an opinion is "false" is therefore of widespread importance. Although this case only involves Section 11, it poses a fundamental question: What causes an opinion or belief to be a "false statement of material fact"? The court's answer will affect the standards of pleading and proof for statements of opinion under other liability provisions of the federal securities laws, including Section 10(b), which likewise prohibit "untrue" or "false" statements of "material fact."

In the Sixth Circuit decision under review, the court held that a showing of so-called "objective falsity" alone was sufficient to demonstrate falsity in a claim filed under Section 11 of the Securities Act — in other words, that an opinion could be false even if was genuinely believed, if it was later concluded that the opinion was somehow "incorrect." On appeal, Omnicare contends, as did we in our amicus brief on behalf of the Washington Legal Foundation ("WLF"), that this ruling was contrary to the U.S. Supreme Court's decision in Virginia Bankshares Inc. v. Sandberg, 501 U.S. 1083, 1095 (1991). Virginia Bankshares held that a statement of opinion is a factual statement as to what the speaker believes — meaning a statement of opinion is "true" as long as the speaker honestly believes the opinion expressed, i.e., if it is "subjectively" true.

Other than a passing and unenthusiastic nod made by plaintiffs' counsel in defense of the Sixth Circuit's reasoning, the discussion at the oral argument assumed that some showing other than so-called "objective falsity" would be required to establish the falsity of an opinion. Most of the

argument by Omnicare, the plaintiffs, and the solicitor general revolved around what this additional showing should be, as did the extensive and pointed questions from Justices Stephen Breyer, Elena Kagan and Sumel Alito.

It thus seems unlikely from the tone of the argument that the court will affirm the Sixth Circuit's holding that an opinion is false if it is "objectively" untrue. If the pointed opening question from Chief Justice John Roberts is any indication, the court also may not fully accept Omnicare's position, which is that an opinion can only be false or misleading if it was not actually believed by the speaker. It seems more probable that the Supreme Court will take one of two middle paths — one that was advocated by the solicitor general at oral argument, essentially a "reasonable basis" standard, or one that was advanced in our brief for the WLF, under which a statement of opinion is subjected to the same sort of inquiry about whether it was misleading as for any other statement. Under WLF's proposed standard, plaintiffs would be required to demonstrate either that an opinion was false because it was not actually believed, or that omitted facts caused the opinion — when considered in the full context of the company's other disclosures — to be misleading because it "affirmatively create[d] an impression of a state of affairs that differs in a material way from the one that actually exists." Brody v. Transitional Hosps. Corp., 280 F.3d 997, 1006 (9th Cir. 2002).

Such a standard would be faithful to the text of the most frequently litigated provisions of the federal securities laws — Section 11, at issue in Omnicare, and Section 10(b) — which allow liability for statements that are either false or that omit material facts "required to be stated therein or necessary to make the statements therein not misleading ..." At the same time, this standard would preserve the commonsense holding of Virginia Bankshares — that an opinion is "true" if it is genuinely believed — and prevent speakers from being held liable for truthfully expressed opinions simply because someone else later disagrees with them.

Why Halliburton II is Not a Top 5 Development

After refusing to overrule Basic, the Halliburton II decision focused on defendants' fallback argument that plaintiffs must show that the alleged misrepresentations had an impact on the market price of the stock, as a prerequisite for the presumption of reliance. The court refused to place on plaintiffs the burden of proving price impact, but agreed that a defendant may rebut the presumption of reliance, at the class certification stage, with evidence of lack of price impact. Halliburton II has a narrow reach. The ruling only affects securities class actions that have survived a motion to dismiss — class certification is premature before then. It wouldn't be economical to adjudicate class certification while parties moved to dismiss under Rule 12(b)(6) and the Reform Act, and adjudicating class certification before rulings on motions to dismiss could result in defendants waiving their right to a discovery stay under the Reform Act. Moreover, most securities class actions challenge many statements during the class period. Although there could be strategic defense benefit to obtaining a ruling that a subset of the challenged statements did not impact the stock price — for example, shortening the class period or dismissing especially awkward statements — a finding that some statements had an impact would support certification of some class, and thus would allow the case to proceed.

Defendants face legal and economic hurdles as well. For example, in McIntire v. China MediaExpress Holdings Inc., 2014 U.S. Dist. LEXIS 113446, *40 (S.D.N.Y. Aug. 15, 2014), the court held that a "material misstatement can impact a stock's value either by improperly causing the value to increase or by improperly maintaining the existing stock price." Under this type of analysis, even if a challenged statement does not cause the stock price to increase, it may have kept the stock price at the same artificially inflated level, and thus impacted the price. Plaintiff-friendly results were predictable from experience in the Second and Third Circuits before the Supreme Court's rulings in Amgen Inc. v. Connecticut Retirement Plans and Trust Funds, 133 S. Ct. 1184 (2013) and Halliburton II. Despite standards for class certification that allowed defendants to contest materiality and price impact, defendants seldom defeated class certification.

Halliburton II may also be unnecessary; it is debatable whether the decision even gives defendants a better tool with which to weed out cases that suffer from a price-impact problem. For example, cases that suffer from a price-impact problem typically also suffer from some other fatal flaw, such as the absence of loss causation or materiality. Indeed, the price-impact issue in Halliburton was based on evidence about the absence of loss causation.

Yet defendants no doubt will frequently oppose class certification under Halliburton II. But they will do so at a cost beyond the economic cost of the legal and expert witness work: they will lose the ability to make no-price-impact arguments in settlement discussions in the absence of a ruling about them. Now, defendants will make and obtain rulings on class certification arguments that they previously could have asserted would be resolved in their favor at summary judgment or trial, if necessary. Plaintiffs will press harder for higher settlements in cases with certified classes.

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In addition to Halliburton II, there were many other important 2014 developments in cases in or touching on the world of securities and corporate governance litigation, including: rare reversals of securities class action dismissals in the Fifth Circuit, Spitzberg v. Houston American Energy Corp., 758 F.3d 676 (5th Cir. 2014), and Public Employees' Retirement System of Mississippi v. Amedisys Inc., 769 F.3d 313 (5th Cir. 2014); the filing of cybersecurity shareholder derivative cases against Target (pending) and Wyndham (dismissed); a trial verdict against the former CFO of a Chinese company, Longtop Financial Technologies; the Second Circuit's significant insider trading decision, United States v. Newman, --- F.3d ---, 2014 U.S. App. LEXIS 23190 (2d Cir. Dec. 10, 2014); increasingly large whistleblower bounties, including a $30 million award; the Supreme Court's SLUSA decision in Chadbourne & Parke LLP v. Troice, 134 S. Ct. 1058 (2014); the Delaware Supreme Court's ruling on a fee-shifting bylaw in ATP Tour Inc. v. Deutscher Tennis Bund, 91 A.3d 554 (Del. 2014), and the resulting legislative debate in Delaware and elsewhere; the Supreme Court's ERISA decision in Fifth Third Bancorp v. Dudenhoeffer, 134 S. Ct. 2459 (2014); the Ninth Circuit's holding that the announcement of an internal investigation, standing alone, is insufficient to establish loss causation, Loos v. Immersion Corp., 762 F.3d 880 (9th Cir. 2014); the Ninth Circuit's rejection of Item 303 of Regulation S-K as the basis of a duty to disclose for purposes of a claim under Section 10(b), In re NVIDIA Corp. Sec. Litig., 768 F.3d 1046 (9th Cir. 2014); and the Ninth Circuit's holding that Rule 9(b) applies to loss-causation allegations, Oregon Public Employees Retirement Fund v. Apollo Group Inc., --- F.3d ---, 2014 U.S. App. LEXIS 23677 (9th Cir. Dec. 16, 2014).

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Lane Powell filed an amicus brief in Omnicare Inc. v. Laborers District Council Construction Industry Pension Fund, discussed in this article.

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