SIMPSON THACHER

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This month's Alert discusses the Supreme Court's decision in *Matrixx* rejecting a statistical significance standard for the disclosure of adverse event reports, as well as the Southern District of New York's decision in the *Sanofi-aventis* litigation applying the *Matrixx* ruling. This Alert also addresses four more decisions from the Southern District of New York: one dismissing two double derivative actions against Merrill Lynch's directors and officers; another dismissing Section 10(b) claims arising out of the collapse of Wachovia Corporation; one addressing the use of "neither admit nor deny" language in Securities & Exchange Commission ("SEC") settlements; and finally, a decision dismissing a shareholder derivative suit against Morgan Stanley's board of directors and several executive officers.

This Alert also covers the Third Circuit's decision in favor of the bright-line attribution rule for secondary actor liability under Section 10(b); the Northern District of California's rejection of the "listing theory" of Section 10(b) liability; a Southern District of Texas decision dismissing the Franklin Bank subprime suit; and a Northern District of Texas decision dismissing the MetroPCS Communications class action.

Finally, from the Delaware courts, we discuss the allocation of plaintiffs' counsel fees in the *Allion* litigation, and the Chancery Court's decision adopting the findings of special counsel in a collusion inquiry arising out of the Nighthawk Radiology-Virtual Radiologic merger litigation settlement.

The Supreme Court Rejects the Bright-Line Statistical Significance Standard for the Disclosure of Adverse Event Reports

In a unanimous opinion delivered by Justice Sonia Sotomayor on March 22, 2011, the Supreme Court declined to adopt a bright-line rule requiring pharmaceutical companies to disclose only statistically significant adverse event reports. *See Matrixx Initiatives, Inc. v. Siracusano*, 2011 WL 977060 (U.S. Mar. 22, 2011). Reaffirming the "total mix" of information standard for materiality set forth in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), the Court held that "the materiality of adverse event reports is a 'fact-specific' inquiry that requires consideration of the source, content, and context of the reports." *Matrixx*, 2011 WL 977060 at *10 (internal citation omitted).

The Court stated that "[a]pplication of *Basic*'s 'total mix' standard does not mean that pharmaceutical

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manufacturers must disclose all reports of adverse events." *Id*. at *11. Rather, the question turns on whether "reasonable investors would have viewed reports of adverse events as material even though the reports did not provide statistically significant evidence of a causal link." *Id*.

Background

In April 2004, investors sued Matrixx, claiming that the company had failed to disclose a possible link between Zicam, an over-the-counter cold remedy, and the loss of the sense of smell (a condition known as anosmia). The District of Arizona dismissed the complaint, finding that the alleged omission was not material because the plaintiffs had "failed to present evidence of a *statistically significant* correlation between the use of Zicam and anosmia…." *Siracusano v. Matrixx Initiatives, Inc*., 2005 WL 3970117, at *7 (D. Ariz. Dec. 15, 2005) (Murguia, J.) (emphasis added).

The Ninth Circuit found that the district court had "erred in relying on the statistical significance standard to conclude that [the plaintiffs] failed adequately to allege materiality." *Siracusano v. Matrixx Initiatives, Inc*., 585 F.3d 1167, 1178 (9th Cir. 2009). Citing *Basic*, the Ninth Circuit held that the question of materiality cannot be resolved by bright-line rules but instead requires "delicate assessments of the inferences a reasonable shareholder would draw from a given set of facts[.]" *Id*. (internal quotations omitted).

On June 14, 2010, the Court granted *certiorari* to determine whether a plaintiff can state a claim under Section 10(b) "based on a … company's nondisclosure of adverse event reports even though the reports are not alleged to be statistically significant." Petition for Writ of Certiorari at *i, *Matrixx Initiatives, Inc. v. Siracusano*, 2010 WL 1063936 (U.S. 2010) (No. 09-1156), *cert. granted*, 130 S. Ct. 3411 (June 14, 2010) (No. 09-1156).

The Supreme Court Holds That Statistical Significance Is Not the Benchmark for Materiality

Rejecting a "categorical" statistical significance standard, the Court reiterated its holding in *Basic* that "'[a]ny approach that designates a single fact or occurrence as always determinative of … materiality, must necessarily be overinclusive or underinclusive.'" *Id*. at *8-9 (*quoting Basic*, 485 U.S. at 236). The Court held that like the bright-line rule advanced and rejected in *Basic*, Matrixx's proposed statistical significance standard could "'artificially exclud[e]'" information that "'would otherwise be considered significant to the trading decision of a reasonable investor.'" *Id*.

The Court found "flawed" the premise that "statistical significance is the only reliable indication of causation." *Id*. at *9. "Given that medical professionals and regulators act on the basis of evidence of causation that is not statistically significant," the Court explained that "it stands to reason that in certain cases reasonable investors would as well." *Id*. at *10.

The Court made it clear that "the mere existence of reports of adverse events … says nothing in and of itself about whether the drug is causing the adverse events" and "will not satisfy this ['total mix'] standard." *Id*. at *11. Rather, the Court concluded that "[s]omething more is needed" to require the disclosure of adverse event reports, "but that something more is not limited to statistical significance and can come from 'the source, content, and context of the reports[.]'" *Id*.

The *Matrixx* Court Holds That the Plaintiffs Adequately Alleged Materiality

Applying the 'total mix' standard, the Court held that the plaintiffs had adequately pleaded materiality. The Court found that "[t]his is not a case about a handful of anecdotal reports…." *Id*. at *12. Here, the plaintiffs alleged that "Matrixx received information that plausibly indicated a *reliable causal link* between Zicam and anosmia." *Id*. (emphasis added). "Consumers likely would have viewed the risk associated with Zicam (possible loss of smell) as substantially outweighing the benefit of using the product (alleviating cold symptoms), particularly in light of the existence of many alternative products on the market." *Id*.

"Viewing the allegations of the complaint as a whole," the Court determined that "the complaint alleges facts suggesting a significant risk to the commercial viability of Matrixx's leading product." *Id*. "It is substantially likely that a reasonable investor would have viewed this information 'as having significantly altered the "total mix" of information made available.'" *Id*. (*quoting Basic*, 485 U.S. at 232).

The Court Rules That the Plaintiffs Adequately Alleged Scienter

On the question of scienter, the Court "assume[d], without deciding," that the "deliberate recklessness" standard applied by the Ninth Circuit is "sufficient to establish scienter." *Id*. at *13. (To date, the Court has "not decided whether recklessness suffices to fulfill the scienter requirement." *Id*.)

Based on the allegations in the complaint, the Court held that "[t]he inference that Matrixx acted recklessly (or intentionally, for that matter) is at least as compelling, if not more compelling, than the inference that it simply thought the reports did not indicate anything meaningful about adverse reactions." *Id*. at *14. The Court found that the allegations, "'taken collectively,' give rise to a 'cogent and compelling' inference that Matrixx elected not to disclose the reports of adverse events not because it believed they were meaningless but because it understood their likely effect on the market." *Id*. (*quoting Tellabs, Inc. v. Makor Issues & Rights, Ltd*., 551 U.S. 308, 323, 324 (2007)).

The Southern District of New York Applies *Matrixx* to Deny Dismissal of a Securities Fraud Action Against Sanofi-aventis

In what is apparently the first decision to apply the Supreme Court's holding in *Matrixx Initiatives, Inc. v. Siracusano*, 2011 WL 977060 (U.S. Mar. 22, 2011), the Southern District of New York cited *Matrixx* in a footnote to deny dismissal of a securities fraud complaint alleging that Sanofi-aventis SA ("sanofi") and several of its executives "misled investors regarding the commercial viability of rimonabant," an obesity drug. *In re Sanofi-aventis Sec. Litig*., 2011 WL 1196052, at *6 (S.D.N.Y. Mar. 30, 2011) (Daniels, J.).

The plaintiffs alleged that "sanofi publicly touted rimonabant and released only good news about rimonabant," simultaneously "withholding bad news" concerning a potential link between rimonabant and

suicidal tendencies. *Id*. According to the complaint, investors were led to believe that "'everything was going fine with the [Food and Drug Administration ("FDA")] review process'" for rimonabant, when in fact the FDA had "raised concern" about a possible relationship between rimonabant and suicidality. *Id*. at *2.

The Southern District of New York relied on *Matrixx* to hold that the defendants "are not entitled to dismissal of the [complaint] on the basis that they lacked a duty to disclose the suicidality information." *Id*. at *7 & n. 9. Because sanofi was "regularly commenting about a pending [FDA] application" for rimonabant, the court found that the company had "an unwaivable duty to be both accurate and complete when it spoke to investors" regarding the product. *Id*.

While the *Matrixx* decision centered on the relevance of statistical significance to materiality, this issue did not arise in the *sanofi* action. The plaintiffs in *sanofi* alleged that "'the link between rimonabant and suicidality was [in fact] statistically significant.'" *Id*. at *2.

The Southern District of New York Dismisses Two Double-Derivative Actions Against Merrill Lynch's Directors and Officers

In the last week of March, the Southern District of New York dismissed with prejudice two double derivative actions brought by former Merrill Lynch shareholders (and current Bank of America shareholders pursuant to the Merrill Lynch-Bank of America merger) seeking to compel Bank of America's board of directors to require its subsidiary, Merrill Lynch, to bring claims against a number of Merrill Lynch's officers and directors for making "allegedly reckless investments." *In re Merrill Lynch & Co., Inc., Sec., Der., and ERISA Litig.*, 2011 WL 1134708, at *1 (S.D.N.Y. Mar. 28, 2011) (Rakoff, J.). The plaintiff in the first action (referred to by the court as the "*Derivative* Action") did not make a demand upon the Bank of America board prior to filing suit, on the purported grounds that any such demand would have been futile. The plaintiff in the second action (referred to by the court as the "*Lambrecht* Action") did make a demand upon the Bank of America board, and also made demands upon the pre-merger and post-merger Merrill Lynch boards; all of these demands were rejected.

Upon "careful consideration," the Southern District of New York determined that dismissal of both actions was warranted as "nothing here alleged in the complaints raises a reason to doubt that the [Bank of America] board … was at all times fairly positioned to determine whether bringing an action against Merrill's former officers and directors was in the company's interest." *Id*. The court explained that it did "not take this step lightly, for the allegations of the complaints, if true, describe the kind of risky behavior by high-ranking financiers that helped create the economic crisis from which so many Americans continue to suffer." *Id*.

The Court Holds That the Plaintiff in the *Derivative* Action Failed to Plead Demand Futility

With respect to the *Derivative* Action, the court ruled that the plaintiff "failed to make a legally adequate showing that the [Bank of America] board was so involved in the underlying wrongdoing alleged in the *Derivative* complaint that it could not impartially consider a demand to pursue claims against the *Merrill* officers and directors." *Id*.

The court rejected the defendants' argument that the plaintiff was required to allege demand futility not only as to Bank of America's board, but also as to the post-merger Merrill Lynch board. In *Lambrecht v. O'Neal*, 3 A.3d 277 (Del. 2010), the Delaware

Supreme Court held that shareholders may, in certain circumstances, bring double derivative claims where standard derivative claims are extinguished by an intervening merger. (To read our discussion of the *Lambrecht* decision in the September 2010 edition of the Alert, please click here.) Post-*Lambrecht* Delaware courts have ruled that "a plaintiff in a double derivative action brought on behalf of a wholly owned subsidiary need only show demand futility or otherwise satisfy Rule 23.1 at the parent level." *Hamilton Partners, L.P. v. Englard*, 11 A.3d 1180, 1206 (Del. Ch. 2010); *see also In re Bear Stearns Cos., Inc. Sec., Der., and ERISA Litig.*, 2011 WL 223540, at *102 (S.D.N.Y. Jan. 19, 2011). The Southern District of New York expressed its "complete agreement with the interpretation of Delaware law set forth" in these cases, and concluded that the plaintiff in the *Derivative* Action "need allege futility only with respect to the [Bank of America] board." *Merrill Lynch*, 2011 WL 1134708, at *6.

Turning to the merits of the plaintiff's demand futility claim, the plaintiff's key assertion was that "members of the [Bank of America] board could not make a disinterested and independent assessment of a demand to pursue the asserted claims against the Merrill [d]efendants because a majority of the [Bank of America] board … faced a 'substantial likelihood' of liability for events related to the [Merrill Lynch-Bank of America] [m]erger." *Id.* at *7. The plaintiff contended that "in order to pursue the claims against the Merrill [d]efendants, the [Bank of America] [b]oard members would have to … render themselves liable for securities law violations and breaches of their fiduciary duties." *Id.*

Contrary to the plaintiff's assertions, the court found that "no such admissions would be required" because sixteen of the seventeen counts of the operative complaint in the *Derivative* Action "relate to pre-[m]erger activity, as to which the overwhelming majority of the members of the [Bank of America] board have no potential liability." *Id.*

With respect to the "sole count" of the operative complaint in the *Derivative* Action challenging post-merger conduct, which alleged "corporate waste in connection with the bonus payments" made to Merrill Lynch officers and employees, the Southern District of New York explained that the "'mere threat of personal liability for approving a questioned transaction, standing alone, is insufficient to challenge either the independence or distinterested[ness] of directors….'" *Id.* at *6 (*quoting Aronson v. Lewis*, 473 A.2d 805, 815 (Del. 1984)). Rather, there must be a "'substantial likelihood'" of personal liability for a director's independence or disinterestedness to be called into question. *Id.* The court also found that "there is no such liability" in any event because the Bank of America charter "contains an exculpatory clause limiting the personal liability of [Bank of America's] directors to 'the fullest extent permitted by the General Corporation Law of the State of Delaware.'" *Id.*

The Court Rules That the Business Judgment Rule Protects the Bank of America Board's Rejection of the Demand in the *Lambrecht* Action

While the *Lambrecht* Action involves principally the same factual allegations as the *Derivative* Action, "the distinguishing element of the *Lambrecht* [A]ction is the fact that the plaintiff made several demands upon the

various boards." *Id*. at *11. On July 15, 2009, the Bank of America board "informed [the] plaintiff that it would not cause Merrill [Lynch] to pursue the claims ...." *Id*. The plaintiff contended that the board's "refusal of her demands was wrongful." *Id*.

At the outset, the Southern District of New York explained that "[a] board's decision to reject a demand is entitled to the benefit of the business judgment rule." *Id*. "The business judgment rule presumes that the board made its decision 'on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.'" *Id*. To overcome the presumptions of the business judgment rule, a "shareholder plaintiff [must] carry the considerable burden of showing that the decision not to bring the lawsuit was made in bad faith or was based on an unreasonable investigation." *Id*. "[F]ew, if any, plaintiffs surmount this obstacle." *Id*.

The court explained that "Delaware law does not permit a plaintiff to overcome the business judgment rule simply by asserting that the substance of a board of director's decision was wrong." *Id*. at *13. With respect to the plaintiff's argument that the Bank of America board "acted in bad faith and undertook no investigation of her claims," the court held that the allegations were "almost entirely conclusory" and thus "insufficient to overcome the business judgment rule." *Id*.

As to the assertion that a number of Bank of America board members were not sufficiently independent to evaluate the demand, the court ruled that this claim was "easily dispensed with" because a shareholder who "'chooses to make a demand upon a board of directors ... concedes the independence of a majority of the board.'" *Id*. at *13.

The Southern District of New York Dismisses Section 10(b) Claims Arising from the Collapse of Wachovia Corporation for Failure to Allege Scienter

In a March 31, 2011 decision addressing four distinct complaints, the Southern District of New York dismissed Section 10(b) claims arising from "the financial disintegration Wachovia experienced between its 2006 purchase of Golden West Financial Corporation and its 2008 merger with Wells Fargo & Company." *In re Wachovia Equity Sec. Litig.*, 2011 WL 1344027, at *1 (S.D.N.Y. Mar. 31, 2011) (Sullivan, J.).

The court held that the plaintiffs had failed to plead facts giving rise to a strong inference of scienter. Based on the facts alleged in the complaints, the court found that "[t]he more compelling inference ... is that [the] [d]efendants simply did not anticipate the full extent of the mortgage crisis and the resulting implications for [Wachovia's] Pick-A-Pay loan portfolio." *Id*. at *24. The Southern District of New York acknowledged that Wachovia's failure to foresee how its loan portfolio would fare in a real estate downturn was a "colossal

blunder with grave consequences for many…." *Id.* Nonetheless, the court concluded that "such a failure is simply not enough to support a claim for securities fraud." *Id.* "Bad judgment and poor management are not fraud, even when they lead to the demise of a once venerable financial institution." *Id.*

The court also dismissed Section 11 claims based on securities the plaintiffs did not actually purchase. Finally, the court dismissed all remaining claims but for certain claims brought under Sections 11, 12(a)(2) and 15.

The Court Holds That the Plaintiffs Failed to Plead Motive and Opportunity

"[T]o raise a strong inference of scienter through motive and opportunity to defraud," plaintiffs must plead that the defendants "'benefited in some concrete and personal way from the purported fraud.'" *Id.* at *7. Here, the plaintiffs alleged that the individual defendants engaged in "'highly unusual and suspicious' insider stock sales." *Id.* The court however found that the defendants' "SEC filings … confirm[ ] a substantial net increase in their vested Wachovia stock holdings over the course of the Class Period." *Id.* at *8. The court noted that "[a]lthough a net increase in company holdings does not conclusively negate scienter … purchasing during the class period 'signals only confidence in the future of th[e] company.'" *Id.* (*quoting Avon Pension Fund v. GlaxoSmithKline PLC*, 343 Fed. App'x. 671, 673 (2d Cir. 2009)).

The court found "similarly unavailing" the plaintiffs' allegation that the defendants "inflated Wachovia stock value as 'currency' for corporate acquisitions…." *Id.* Of the 21 allegedly misleading statements at issue, only three were made prior to the October 2006 closing of the Golden West deal. Moreover, the court was "unpersuaded that a transaction announced and completed within the first five months of the Class Period creates an inference of motive to inflate Wachovia's share price in the two years that followed." *Id.* The court found that the plaintiffs have, "[a]t most," alleged only "'a generalized desire to achieve a lucrative acquisition proposal,' which fails to establish scienter." *Id.* (*quoting ECA, Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co.*, 553 F.3d 187, 201 (2d Cir. 2009)).

The Court Rules That the Plaintiffs Failed to Plead Recklessness

"Where motive is not apparent, a plaintiff may raise a strong inference of scienter by showing circumstantial evidence of conscious misbehavior or recklessness…." *Id.* A plaintiff may plead recklessness by specifically alleging that the defendants "either (1) knew facts or had access to information contradicting their public statements, or (2) failed to review or check information they had a duty to monitor." *Id.*

The Southern District of New York held that the "primary defect" in the plaintiffs' attempt to plead scienter based on recklessness was "the absence of any serious effort to specify the contradictory information available to [the] [d]efendants at the time of the alleged misstatements." *Id.* at *10. "In lieu of pleading contrary facts," the court found that the plaintiffs "pen[ned] a sprawling novella on the subprime mortgage crisis, apparently relying on the metanarrative of the Wachovia collapse to infuse the alleged misstatements with an aura of fraud." *Id.* This pleading strategy "effectively require[d] the [c]ourt to reconstruct the chronology of Class Period allegations in order to decipher what [the] [d]efendants knew or should have known on the date of a particular statement." *Id.*

The Court Declines to Infer Scienter Based on the "Core Operations" Theory

As an alternative basis for pleading scienter, the plaintiffs relied on the "core operations" theory to

argue that "'scienter may be imputed to key officers who should have known facts relating to the 'core operations' of their company.'" *Id*. at *11. The Southern District of New York questioned the continued viability of the "core operations" theory after the passage of the PSLRA. Although the Second Circuit has yet to rule on this issue, the court noted that "post-PSLRA decisions in other circuits have cast doubt on the strength of the 'core operations' inference." *Wachovia*, 2011 WL 1344027, at *11 (*citing South Ferry LP, No. 2 v. Killinger*, 542 F.3d 776, 784-85 (9th Cir. 2008); *Rosenzweig v. Azurix Corp*., 332 F.3d 854, 868 (5th Cir. 2003)). "This tension is mirrored in recent cases within [the Southern District of New York], where courts have adopted a range of positions on the issue." *Id*. The court concluded that "'core operations'" allegations could, at most, "constitute supplementary but not independently sufficient means to plead scienter." *Id*.

The Court Finds That None of the Plaintiffs' Specific Factual Allegations Establish Recklessness

The court devoted several pages to an analysis of the plaintiffs' "factual allegations of recklessness," and found that none of these alleged misstatements raised an inference of scienter. *Id*. at *12. For example, the court found that "the [d]efendants' statements about their 'conservative' underwriting and risk management constitute corporate puffery rather than actionable misrepresentations." *Id*. With respect to the plaintiffs' allegations that the defendants "concealed Wachovia's exposure to subprime [collateralized debt obligations ("CDOs")] while overstating the value of its CDO holdings," the court found that the plaintiffs "alleged no contemporaneous facts regarding the 'actual' value of the particular CDOs held by Wachovia at the time of the alleged misrepresentations." *Id*. at *21-*22. Ultimately, "[d]espite the litany of alleged misrepresentations outlined" in the complaint, the court found that the plaintiffs "fail[ed] to plead access to contrary facts or breach of a duty to monitor that would support an inference of recklessness." *Id*. at *23. "Because the issue of scienter prove[d] fatal to [the] [p]laintiffs' Section 10(b) claims," the court did not address "the remaining elements of securities fraud." *Id*. at *24.

The Court Dismisses Section 11 and 12(a)(2) Claims Involving Securities the Plaintiffs Did Not Actually Purchase

In one of the four complaints at issue (the "*Bond/Notes* Complaint"), the plaintiffs brought claims under Sections 11 and 12(a)(2) involving 30 securities offerings. However, the plaintiffs failed to allege that they purchased "securities in or traceable to 16 of [those] … offerings." *Id*. at *26. The plaintiffs "attempt[ed] to manufacture standing for securities they did not purchase or acquire based on [the theory of common] shelf registration statements." *Id*. "The Southern District of New York explained that "[a]lthough the Second Circuit has yet to pass on this precise issue," it was "persuaded that the [p]laintiffs' shelf registration argument misreads the relevant statute." *Id*. at *27. Finding that the plaintiffs "have suffered no injury from [the] [d]efendants' conduct with respect to securities they did not purchase," the court dismissed for lack of standing "all claims arising from the 16 offerings in which none of the named [p]laintiffs purchased any securities." *Id*.

The Court Rules That the *American Pipe* Doctrine Tolls the Statute of Limitations for the Plaintiffs' Section 11 and 12(a)(2) Claims

In an effort to remedy their standing deficiencies, the *Bond/Notes* plaintiffs attempted to add claims brought by additional named plaintiffs after the expiration of the one-year statute of limitations for

bringing claims under Sections 11 and 12(a)(2). There was no dispute regarding the expiration of the statute of limitations. However, the parties did dispute "whether the *American Pipe* doctrine tolled the statute of limitations." *Id*. at *28.

The *American Pipe* doctrine provides that "the filing of a class action suit toll[s] the statute of limitations for class members who [seek] to intervene" after the denial of a motion for class certification. *Id*. (*citing Am. Pipe & Construction Co. v. Utah*, 414 U.S. 538, 553 (1974)). "Here, the relevant question [was] whether *American Pipe* tolling also extends to cases where a class action complaint or particular class action claims are dismissed for lack of standing." *Id*. at *29.

The court found that "[a]lthough the law of the Second Circuit is far from settled on this issue, the failure to apply *American Pipe* tolling to this case would undermine the policies of 'efficiency and economy of litigation' that underlie Rule 23." *Id*. Explaining that "the additional [p]laintiffs should not be punished for their failure to anticipate or timely remedy the standing deficiencies of the original *Bond/Notes* Complaint," the court "applie[d] the *American Pipe* tolling doctrine and conclude[d] that the claims of the additional [p]laintiffs are not time-barred." *Id*.

In addition to the applicable one-year statute of limitations, claims under Sections 11 and 12(a)(2) are also subject to a three-year statute of repose. *See* 15 U.S.C.A. § 77m. Two recent Southern District of New York decisions have held that *American Pipe* tolling does not apply to this three-year statute of repose. *See Footbridge Ltd. Trust v. Countrywide Fin. Corp*., 2011 WL 907121, at *4 (S.D.N.Y. Mar. 16, 2011) (Castel, J.); *In re Lehman Bros. Sec. and ERISA Litig*., No. 09 MD 02017, at 8-9 (S.D.N.Y. Apr. 13, 2011) (Mem.) (Kaplan, J.). We are following the evolving law on the application of *American Pipe* tolling in the context of claims under Sections 11 and 12(a)(2), and will report any developments in future issues of the Alert.

The Southern District of New York Challenges SEC Settlement Language Providing That Defendants Neither Admit Nor Deny Liability

On March 21, 2011, the Southern District of New York approved proposed consent judgments by the SEC against Vitesse Semiconductor Corporation and two of its executives. *See SEC v. Vitesse Semiconductor Corp*., 2011 WL 976578 (S.D.N.Y. Mar. 21, 2011) (Rakoff, J.). However, the court found that "[t]he proposal raises difficult questions of whether the [SEC]'s practice of accepting settlements in which the defendants neither admit nor deny the [SEC]'s allegations meets the standards necessary for approval by a district court." *Id*. at *1.

The *Vitesse* court recognized that this approach is "nothing new," given that the SEC has "'a longstanding policy'" dating back more than forty years "'of settling cases on the basis of neither requiring an admission nor permitting a denial by the defendant.'" *Id*. at *3. For defendants, the inclusion of this language ensures that "their agreement to the [SEC]'s settlements [will] not have collateral estoppel consequences for parallel civil actions, in

which [they] frequently face[] potential monetary judgments far greater than anything the [SEC] [is] likely to impose." *Id.* But the court observed that the practice of including "neither admit nor deny" language has "benefits for the [SEC] as well," by making it "much easier" for the SEC to settle cases. *Id.*

While this approach offers clear benefits for the parties to SEC settlements, the Southern District of New York expressed concern that the "neither admit nor deny" language has the effect of leaving the investing public in the dark: "[T]he public will never know whether the [SEC]'s charges are true, at least not in a way that they can take as established by these proceedings." *Id.* at *4. These settlements leave the defendant "free to proclaim that he has never remotely admitted the terrible wrongs alleged by the [SEC]" but at the same time, "he had better be careful not to deny them either." *Id.* Notwithstanding settlement language prohibiting defendants from "'mak[ing] any public statement' denying the allegations," defendants somehow still manage to "get[] the word out there that they are … denying the allegations" by issuing "equivocal press releases." *Id.* at *5. "The [end] result is a stew of confusion and hypocrisy unworthy of such a proud agency as the [SEC]." *Id.* at *4.

The *Vitesse* court compared the SEC's "pervasive" practice of "permitting defendants to neither admit nor deny the charges against them" with the Department of Justice's refusal to permit defendants, "except in the very most unusual circumstances," to "enter into pleas of *nolo contendere*, by which a defendant accepts a guilty plea to a criminal charge without admitting or denying the allegations." *Id.* at *4-*5. Underlying the Department of Justice's approach is a recognition that the public views *nolo contendere* pleas as inherently suspect: "'[T]he public regards consent to such a plea by the Government as an admission that it has only a technical case at most and that the whole proceeding was just a fiasco.'" *Id.* at *5.

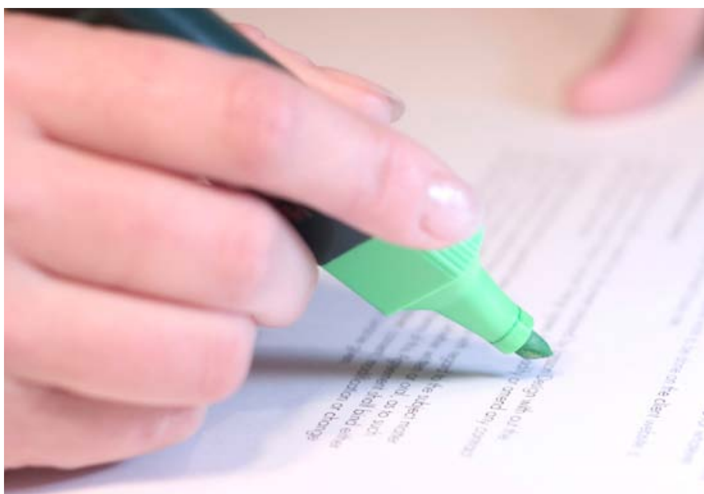
While the Southern District of New York recognized that it "must give substantial deference to the [SEC]'s views, even if only embodied in a practice rather than in a fully articulated policy," the court maintained that it was "obliged to determine whether such a practice renders any given proposed Consent Judgment so unreasonable or contrary to the public interest as to warrant its disapproval." *Id.* at *5. In this case, the court determined that the issue of including the "neither admit nor deny" language was minimally significant, since Vitesse's executives had already "admitted their guilt in the parallel criminal proceedings" and Vitesse had agreed to pay more than $5 million in damages and penalty payments. *Id.* Given this backdrop, the Southern District of New York found that "[n]o reasonable observer … could doubt that the company has effectively admitted the allegations of the complaint." *Id.* However, the court reserved judgment "for the future" on the "substantial questions of whether the Court can approve other settlements that involve the practice of 'neither admitting nor denying.'" *Id.*

The Third Circuit Adopts the Bright-Line Attribution Rule for Secondary Actor Liability under Section 10(b)

In a March 29, 2011 ruling, the Third Circuit held that "in order for a plaintiff to invoke the fraud-on-the-market presumption of reliance against a secondary actor in a scheme liability action under § 10(b), the plaintiff must show the deceptive conduct was publicly attributed to that secondary actor." *In re DVI, Inc. Sec. Litig.*, 2011 WL 1125926, at *16 (3d Cir. Mar. 29, 2011).

The Third Circuit's decision widened an existing circuit split on whether attribution is required for secondary actor liability under Section 10(b). To date, four circuits (the Second, Third, Fifth, and Eleventh Circuits) have adopted a bright-line attribution rule for secondary actor liability, and the First Circuit has signaled its approval of that rule. *See Affco Invs. 2001*

LLC v. Proskauer Rose LLP, 625 F.3d 185, 194 (5th Cir. 2010); *Pac. Inv. Mgmt. Co. v. Mayer Brown LLP*, 603 F.3d 144, 148 (2d Cir. 2010); *S.E.C. v. Tambone*, 550 F.3d 106, 139 (1st Cir. 2008); *Ziemba v. Cascade Int'l, Inc.*, 256 F.3d 1194, 1205 (11th Cir. 2001). However, the Fourth and Ninth Circuits have ruled that secondary actors can be held liable even for statements that are not directly attributed to those actors at the time the statements are made. *In re Mut. Funds Inv. Litig.*, 566 F.3d 111, 123-124 (4th Cir. 2009); *Howard v. Everex Sys., Inc.*, 228 F.3d 1057, 1061 n.5 (9th Cir. 2000). The Supreme Court is expected to resolve this circuit split in its upcoming decision in the case of *Janus Capital Group, Inc. v. First Der. Traders*, No. 09-525 (U.S. argued Dec. 7, 2010).



The Delaware Chancery Court Addresses the Apportionment of Plaintiffs' Counsel Fees in the Allion Healthcare-H.I.G. Capital Merger Litigation

On March 29, 2011, the Delaware Chancery Court addressed the allocation of attorneys' fees between counsel for the Delaware plaintiffs and counsel for the New York plaintiffs in connection with multi-district litigation arising out of a going-private transaction in which Allion Healthcare, Inc. merged with affiliates of H.I.G. Capital, LLC and a group of Allion stockholders. *See In re Allion Healthcare Inc. Shareholders Litig.*, 2011 WL 1135016 (Del. Ch. Mar. 29, 2011) (Chandler, C.).

In approving the settlement of the Delaware action in January 2011, the court awarded a $1 million fee award and "left it to plaintiffs' counsel in the first instance to try to work out a fee-splitting solution…." *Id.* at *4. Plaintiffs' counsel, failing to reach agreement, asked the court to determine how the award should be allocated. Observing that "this fee-splitting issue is yet another byproduct of the rise of multi-forum deal litigation," the court ruled that New York plaintiffs' counsel were entitled to half of the $250,000 fee award for the disclosure benefits negotiated by both Delaware and New York plaintiffs' counsel. *Id.* However, the court held that New York plaintiffs' counsel were not entitled to any portion of the $750,000 fee award for the $4 million increase in share price negotiated as part of the settlement of the Delaware action.

The Court Rules That Counsel for New York Plaintiffs Are Entitled to Half of the Disclosure Fee Award

Finding that "[b]oth New York plaintiffs and Delaware plaintiffs negotiated independently with defendants for [the] improved disclosures, and each played an important role," the Chancery Court ruled that "[counsel for the] New York plaintiffs and [counsel for the] Delaware plaintiffs are both entitled to share [equally] in the [$250,000] disclosure fee." *Id.* at *7. The court held that although New York plaintiffs' counsel challenged the adequacy of these disclosures at the January 2011 settlement hearing, "they did … negotiate for those disclosures at the time" and "directly contributed to the benefit achieved by those disclosures…." *Id.*

The Court Holds That New York Plaintiffs' Counsel Are Not Entitled to Any Portion of the Increased Share Price Award

Rejecting the claim that "the prosecution of [the New York] action created 'the atmosphere in which the [Delaware] cash settlement could be achieved,'" the Chancery Court held that "the New York litigation in no way caused any of the benefit achieved by Delaware plaintiffs in the settlement." *Id.* at *8. The court therefore ruled that Delaware plaintiffs' counsel was entitled to the entirety of the increased share price award.

The court explained that "out-of-state counsel [are] only 'entitled to a share of attorneys' fees in a settlement of a Delaware action *if their efforts elsewhere conferred a benefit realized as part of the Delaware settlement.*" *Id.* at *7. Furthermore, "out-of-state counsel must actually 'substantiate their contribution to the result achieved.'" *Id.*

Here, it was "undisputed" that the New York plaintiffs were not parties to the Delaware settlement. *Id.* at *8. They "did not negotiate any benefit or contribute to the settlement whatsoever." *Id.* As to the argument that the New York action "'encouraged the [d]efendants to settle the Delaware action," the court found that an earlier Chancery Court decision had rejected a similar assertion as "a matter of conjecture." *Id.* (*citing In re Cablevision/Rainbow Media Group Tracking Stock Litig.*, 2009 WL 1514925, at *2 n.10 (Del. Ch. May 22, 2009)). The *Cablevision* court ruled that "in the absence of a sufficient evidentiary basis to the contrary," the settlement of a Delaware action "should be taken at face value for what it purports to be—a settlement achieved by counsel for the Delaware [p]laintiffs." *Id.*

Because the Chancery Court found no "sufficient evidentiary basis" for holding that New York plaintiffs' counsel contributed to the Delaware settlement, the court awarded the full amount of the increased share price fee to Delaware plaintiffs' counsel. *Id.* at *8.

The Southern District of Texas Dismisses the Franklin Bank Subprime Suit, Holding That a Desire to Maintain High Stock Prices Is Not Evidence of Scienter

In a March 21, 2011 decision, the Southern District of Texas granted the defendants' motions to dismiss a securities fraud class action suit arising out of the fall 2008 collapse and subsequent state shutdown of Franklin Bank Corporation. *See In re Franklin Bank Corp. Sec. Litig.*, 2011 WL 1100272 (S.D. Tex. Mar. 21, 2011). The court expressed "full sensitivity to the losses suffered by the investors" in Franklin Bank, but determined that "[t]he investors were … [simply] part of a much larger economic paradigm, one that is unprecedented in the lives of all the relevant players." *Id.* at *50.

Background

Defendants Lewis S. Ranieri and Anthony Nocella purchased Franklin Bank, a state-chartered savings and loan institution, in April 2002, and immediately "initiated a rapid growth strategy for the Bank[.]" *Id.* at *2. Franklin Bank "operated without significant financial difficulties until 2007, when real estate, mortgage, and financial markets nationwide were showing sharp downturns." *Id.* By August 2008, the bank announced a proposed restatement of its financials dating back as far as 2006. Ultimately, the bank's securities became "essentially worthless" when state banking authorities shut down Franklin Bank in November 2008. *Id.* A report commissioned by the Federal Deposit Insurance Corporation ("FDIC") through the Office of the Inspector General (the "OIG Report") concluded that "[Franklin] Bank's failure was due, at least in part, to bank management's high-risk business strategy and weak risk management practices

and controls." *Id*. The report also attributed the bank's collapse to "a declining economic environment and ineffective FDIC supervision." *Id*.

Purchasers of Franklin Bank common stock asserted Section 10(b) and Section 20(a) claims against Ranieri, Nocella, and Franklin Bank's Chief Financial Officer, Russell McCann. Purchasers of preferred stock brought these claims as well as: Section 10(b) claims against the remaining directors of Franklin Bank's board and the bank's outside auditor, Deloitte & Touche; a Section 11 claim against the bank's underwriter, RBC Capital Markets Corporation; and Section 11 and Section 15 claims against Ranieri, Nocella, McCann, and the remaining directors. None of these claims survived dismissal.

The Court Holds That the Plaintiffs Failed to Establish Material Misrepresentations by Ranieri, Nocella and McCann

Rather than specifying how each alleged misstatement was false or misleading, the plaintiffs "group[ed] together all of the defendants' [allegedly] false statements … and allege[d] collective reasons why the statements were materially false and misleading." *Id*. at *16. Upon review, the court found that a number of the alleged material misrepresentations at issue were "nothing more than the type of corporate 'cheerleading' recognized as non-actionable puffery." *Id*. at *24. Statements such as Ranieri's expression of "his belief that they could 'shepherd' the Bank through the then-current downward market cycle" were "so vague and lacking in specificity that no reasonable investor could find them important in the total mix of information." *Id*. at *16. With respect to Ranieri's assertion that the bank had adequate reserves, the court found that there was no evidence that these statements were false or misleading at the time they were made. As to claims that Nocella failed to disclose certain information regarding Franklin Bank's loan concentrations and Countrywide Financial's default on a warehouse line of credit with the bank, the court explained that "[a]n individual does not commit securities fraud merely by failing to disclose all nonpublic information in his possession." *Id*. at *28.

The Court Finds That the Plaintiffs Failed to Establish Scienter as to Ranieri, Nocella and McCann

The plaintiffs attempted to establish scienter by alleging that the defendants "intended to inflate the Bank's stock prices [and] then sell the bank…." *Id*. at *20. Rejecting this effort, the Southern District of Texas explained that "'[s]cienter in a particular case may not be footed solely on motives universal to corporate executives,' such as the desire to maintain the company's credit ratings or maintain high stock prices to increase its value." *Id*. at *6 (*quoting Indiana Elec. Workers' Pension Trust Fund IBEW v. Shaw Group, Inc.*, 537 F.3d 527, 544 (5th Cir. 2008)). "[T]he desire to keep stock values high is a universal goal among corporations and their executives and consequently does not contribute significantly to

an inference of scienter." *Id.* at *20. The court also declined to infer scienter based on the fact that the company restated its financials in August 2008. "The nature of accounting problems that lead to restatement of a company's financials, for instance, can 'easily arise from negligence, oversight, or simply mismanagement, none of which rise to the standard necessary to support a securities fraud action.'" *Id.* at *7 (*quoting Abrams v. Baker Hughes, Inc.*, 292 F.3d 424, 433 (5th Cir. 2002)).

With respect to the plaintiffs' scienter allegations based on findings in the OIG Report that "'bank management … pursue[d] a high-risk business strategy without adequate risk management practices and controls,'" the court found that "goals for achieving fast growth and profitability are well-recognized corporate goals, and show neither an intent to deceive, manipulate, or defraud." *Id.* at *18. "Section 10(b) and Rule 10b-5 do not protect investors against negligence or corporate mismanagement…." *Id.* at *5 (*citing Shaw Group, Inc.*, 537 F.3d at 535).

The Court Dismisses Claims Against Deloitte & Touche

To state a claim of securities fraud against an outside auditor, "[i]t must be established not merely that there was a deviation from accounting principles, but that the accounting practices were so deficient that the audit amounted to no audit at all, or there was an egregious refusal to see the obvious, or to investigate the doubtful…." *Id.* at *32. Here, the court found that the plaintiffs' "allegations of scienter reveal little more than their assertions that Deloitte's statements were false when made because the Bank later announced a need to restate certain financial information in 2008." *Id.* There were no allegations that "Deloitte knew that the statements were false when made, or that it was severely reckless in not knowing that the statements were false when made." *Id.*

The Court Dismisses Section 11 Claims against RBC Capital Markets Corporation

As to the merits of plaintiffs' Section 11 claims against RBC Capital Markets Corporation, the underwriter for Franklin Bank's May 2006 preferred stock offering, the court considered allegations that RBC "made untrue statements or material omissions in the registration statement of May 5, 2006…." *Id.* at *36. The court held, *inter alia*, that "[t]he fact that the Bank announced a need to file a restatement in August 2008 is insufficient to plead a Section 11 violation as to RBC's participation in the 2006 preferred stock offering." *Id.* "Even assuming there were an error in the Bank's … financial statements," the court held that "no materiality is alleged as a matter of law … [since] the proposed restatement reduced total interest income by only 0.46%, net interest income by 1.4%, and interest income after provision for credit losses by 1.78%…." *Id.* at *38.

Notably, the court did reject the defendants' statute of limitations arguments with respect to the Section 11 claims. The court held that the plaintiffs were not on notice of "potential claims against RBC as to the 2006 registration statement" until the Bank indicated in a proposed restatement announcement in August 2008 "that the accounting problems might go back as far as 2006." *Id.* at *40.

The Court Dismisses Claims against the Remaining Directors

The court dismissed all claims against the other members of Franklin Bank's board of directors, finding that "[n]either the announced [August 2008] restatement nor the OIG Report support the … allegations of scienter or severe recklessness…." *Id.*

The Southern District of New York Dismisses a Derivative Suit Alleging Securities Fraud and Fiduciary Duty Claims Arising out of Morgan Stanley's Subprime Mortgage Trading

On March 31, 2011, the Southern District of New York dismissed a shareholder derivative suit brought against current and former directors and officers of Morgan Stanley for alleged wrongdoing arising out of Morgan Stanley's U.S. subprime mortgage trading, on the grounds that the plaintiff failed to adequately allege that a pre-suit demand on Morgan Stanley's board of directors would have been futile. *See Staehr v. Mack*, 2011 WL 1330856 (S.D.N.Y. Mar. 31, 2011) (Batts, J.).[1]

Background

The plaintiff, a purported Morgan Stanley shareholder, brought three categories of claims against the Morgan Stanley defendants. *First*, the plaintiff alleged that the defendants committed securities fraud and breached their fiduciary duties in connection with Morgan Stanley's purported "failure to disclose its exposure to the subprime mortgage market and the [allegedly] false statements it provided to the market about the company's financial prospects." *Id*. at *3. *Second*, the plaintiff alleged that the defendants "committed waste by causing Morgan Stanley to repurchase $3.8 billion of the company's stock at an inflated price despite their knowledge that the subprime crisis would negatively impact the stock price in the future." *Id*. *Third*, the plaintiff alleged that "certain directors and officers sold their personally-held shares of Morgan Stanley stock on the basis of undisclosed information about the company's subprime exposure." *Id*. The plaintiff did not make a pre-suit demand on Morgan Stanley's board of directors and instead alleged that such a demand would have been futile because Morgan Stanley's directors, who were named defendants, faced a substantial likelihood of liability under the alleged claims.

The Plaintiff Failed to Show That a Majority of Morgan Stanley's Directors Faced a Substantial Likelihood of Liability for Allegedly Failing to Disclose Morgan Stanley's Subprime Exposure

Applying Delaware law, the court examined the futility of a pre-suit demand relating to the plaintiff's inadequate disclosure claims under the disinterestedness and independence test set forth in *Rales v. Blasband*, 634 A.2d 927, 933-34 (Del. 1993).

The *Staehr* court concluded that Morgan Stanley's statements about its business prospects and risk controls "fall well within the bounds of non-actionable puffery," and that Morgan Stanley's alleged lack of detailed disclosures about its subprime exposure was not actionable because the company had no obligation to divulge anything beyond its general exposure to subprime mortgage products, which it had publicly disclosed. *Id*. at *6.

The court found that the plaintiffs failed to allege that the directors faced a substantial likelihood of liability in connection with these disclosures, noting that the "[p]laintiff faces a difficult burden here, [both] because directors 'are entitled to a presumption that they were faithful to their fiduciary duties,'" and because "Morgan Stanley's certificate of incorporation exculpate[d] the [d]irectors from personal liability for violations of the duty of care." *Id*. (citations omitted). The court found that the complaint was "entirely

1. Simpson Thacher represents the outside directors of Morgan Stanley in this matter.

devoid" of allegations required to support an inference that the directors acted knowingly or in bad faith, or that the eleven outside directors were involved in the operation of the company. *Id*. at *7.

The Plaintiff Failed to Show That a Majority of the Morgan Stanley Directors Faced a Substantial Likelihood of Liability for the Decision to Repurchase Morgan Stanley Stock

On the question of demand futility with respect to the corporate waste claim, the court applied the test set forth in *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984), which requires plaintiffs to plead particularized facts showing, *inter alia*, that the "the challenged transaction [did not constitute] a valid exercise of [the directors'] business judgment." *Id*. at *8. Here, the plaintiff argued that the board approved the $3.8 billion share repurchase, signaling to the market that the stock was undervalued, in an effort to hide the company's exposure to the subprime market. However, the court found that plaintiffs had not alleged that "any [d]irector was in possession of adverse non-public information" about the company's financial prospects and subprime exposure, and that "there is no basis to infer that [the stock repurchase] was not a legitimate exercise of the [d]irectors' business judgment." *Id*. at *9. The court also concluded that the plaintiff failed to satisfy his burden in showing that the stock repurchase was "so egregious or irrational that it could not have been based on a valid assessment of [Morgan Stanley's] best interests." *Id*. (citations omitted).

The Plaintiff Failed to Show That a Majority of Morgan Stanley's Directors Faced a Substantial Likelihood of Liability for the Alleged Insider Trading of Morgan Stanley Shares

The court also found no grounds for the plaintiff's allegation of demand futility on the basis of alleged insider trading. Given that two of the alleged "red flags" put forth by the plaintiff involved public information, and the other two "purport[ed] to show that the general subprime mortgage market was troubled," the court held that "[t]his is hardly the level of inside information that would support an insider trading claim[.]" *Id*. Nor did the court find persuasive the plaintiff's claims involving the directors' access to internal corporate documents, or the plaintiff's allegation that the directors' stock sales were "'especially suspicious'" because they were executed during the company's stock repurchase and before the stock price began to drop. *Id*. at *11. Because the plaintiff failed to allege any facts regarding the timing or amount of any unusual sales by the directors, the court held that "there is no basis [to] infer that the directors were acting on the basis of insider information." *Id*. at *10-11.

The Northern District of California Rejects the "Listing Theory" of Section 10(b) Liability Post-*Morrison*

A recurring argument advanced by plaintiffs' lawyers in the wake of the Supreme Court's decision

in *Morrison v. National Australia Bank Ltd.*, 130 S. Ct. 2869 (2010) is the "listing theory." Under this theory, plaintiffs argue that corporations who choose to list American Depositary Shares on the New York Stock Exchange can also be held liable under Section 10(b) for purchases and sales of their shares on foreign exchanges. To date, courts in the Southern District of New York have rejected the "listing theory" as inconsistent with *Morrison*. (To read our discussion of the *Vivendi* decision addressing the "listing theory" of liability, please click here.)

On March 17, 2011, the Northern District of California rejected the "listing theory" of liability in *In re Infineon Technologies AG Sec. Litig.*, (N.D. Cal. Mar. 17, 2011) (Ware, J.) The plaintiffs attempted to bring Section 10(b) claims in connection with Infineon stock purchases on the Frankfurt Stock Exchange, on the grounds that "Infineon has American Depositary Shares which are listed and actively traded on the New York Stock Exchange…." *Id.* at 6.

Declining to adopt the "listing theory," the Northern District of California held that the "[p]laintiffs' reliance on the fact that Infineon shares were 'listed and registered' on the New York Stock Exchange to overcome *Morrison* is misplaced." *Id.* The court ruled that the plaintiffs "cannot state claims on behalf of individuals who purchased Infineon shares on the Frankfurt Stock Exchange." *Id.*

The Delaware Court of Chancery Finds that There Was No Collusion in the Nighthawk Radiology-Virtual Radiologic Merger

In the February edition of the Alert, we reported on the Delaware Chancery Court's finding of potential collusion in the settlement of multi-district litigation arising from the Nighthawk Radiology-Virtual Radiologic Corporation merger. Last month, we discussed the findings of court-appointed special counsel, who advised the court that the settlement was *not* collusive.

The Delaware Chancery Court has now adopted the special counsel's findings. On April 12, 2011, the court informed the parties by letter that it "agree[d] with special counsel's analysis of the law and assessment of what took place." Letter from Vice Chancellor J. Travis Laster, *Scully v. Nighthawk Radiology Holdings, Inc.*, No. 5890-VCL, at 1 (Apr. 12, 2011). The court stated that it had no remaining "concerns about the conduct of any attorney involved in this matter." *Id.* at 2.

The Northern District of Texas Dismisses the MetroPCS Class Action in its Entirety without Granting Leave to Amend

On March 25, 2011, the Northern District of Texas dismissed, without granting leave to amend, a purported securities fraud class action against MetroPCS Communications, Inc., and three of its executives for "fail[ing] to allege facts sufficient to support a strong inference of scienter." *Hopson v. MetroPCS Communications, Inc.*, 2011 WL 1119727, at *21 (N.D. Tex. Mar. 25, 2011).[2] The court also held that "[e]ven if it is assumed *arguendo* that he properly pleaded scienter, the plaintiff has failed to state a claim for securities fraud because his amended complaint lacks the particularity necessary to state a plausible fraud claim and adequately put the defendants on notice of the charges against them, and the statements alleged to be false or misleading are either forward-looking statements protected by the PSLRA or immaterial puffery." *Id.*

2. Simpson Thacher represents the defendants in this action.

The Court Finds That the Complaint Fails to Raise an Inference of Scienter

Finding that the plaintiff failed to plead scienter with particularity for each individual defendant, the court rejected the plaintiff's three scienter allegations individually and *in toto*. Specifically, the court held that: (1) "sales … made pursuant to preexisting Rule 10b5-1 trading plans … cuts against an inference of suspiciousness"; (2) the senior "executives['] compensation structure tying compensation to corporate profits" did not create a strong inference of scienter; and (3) "the defendants' alleged access to information that might have contradicted their representations" was unsupported by any factual allegations that could suffice to raise a strong inference of scienter. *Id*. at *14. The court concluded that "the plaintiff's allegations … depict commonplace non-fraudulent business practices." *Id*.

The Court Further Finds That the Plaintiffs Failed to Allege Material Misstatements or Omissions

The court also held that the complaint failed to allege any material misstatement or omission in each of the three categories previously identified. *Id*. at *15. *First*, the court noted that even the most substantial of the plaintiff's claims, the churn allegations, "lack the specificity and particularity that Rule 9(b) and the PSLRA demand." *Id*. Consistent with precedent, the court found insufficient general allegations of reports with unidentified information. Indeed, the court refused "to speculate whether all—or none—of the defendants reviewed the information allegedly provided … whether and when that information verily indicated an increase in churn due to the handset promotion, and how that information comports with the representations about churn made by the defendants individually and collectively." *Id*.

Second, the court found many statements, including those related to the 2009 guidance, to be non-actionable forward-looking statements or immaterial puffery. "[E]ach of the statements made by the defendants in the company's earnings announcements and press releases are forward-looking statements … accompanied by meaningful cautionary language." *Id*. at *17. The opinion stressed that the "cautionary language is not just a boilerplate litany of risk factors generally applicable to all businesses; it identifies risks that are specific to MetroPCS as a prepaid wireless service provider…." *Id*. And, the court rejected the plaintiff's argument that the defendants had actual knowledge that their statements were false because they were based on the same non-specific reports rejected in the churn analysis. *Id*. at *18.

Third, as to statements "that allegedly misled the investing public regarding the company's strength in light of the recessionary economy and increased competition," the court concluded "that these statements are not actionable either because they are not pleaded with particularity or because they are immaterial puffery." *Id*. at *19.

Finding that the plaintiff failed to allege facts sufficient to support a strong inference of scienter or state a claim for securities fraud, the court dismissed the Section 10(b) and Rule 10b-5 fraud claims without granting leave to amend, and also dismissed the plaintiff's Section 20(a) claim.

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