SIMPSON THACHER

SECURITIES LAW ALERT

March 2011

This month's Alert discusses the Southern District of New York's post-verdict ruling applying *Morrison* to narrow the class claims in the Vivendi litigation. The Alert also addresses: the Delaware Chancery Court's order mandating the disclosure of the contingent fee arrangement for Atheros's financial advisor in the Qualcomm-Atheros merger litigation; a Special Counsel's finding that the Nighthawk Radiology-Virtual Radiologic merger litigation settlement was not collusive; the Northern District of Illinois's dismissal of the Boeing class action following a denial by the alleged confidential source; and the Second Circuit's articulation of a post-*Merck* standard for when the statute of limitations begins to run in securities fraud actions.

The Southern District of New York Applies *Morrison* to Narrow the Class in the Vivendi Litigation

On February 17, 2011, the Southern District of New York issued a post-verdict opinion holding that under the Supreme Court's decision in *Morrison v. National Australia Bank Ltd.*, 130 S. Ct. 2869 (2010), Section 10(b) does not reach the claims of investors who purchased shares of Vivendi Universal on a foreign exchange. *See In re Vivendi Universal, S.A., Sec. Litig.*, No. 02 Civ. 05571 (HBP), 2011 WL 590915 (S.D.N.Y. Feb. 17, 2011) (Holwell, J.). Following the lead of earlier courts to consider the issue, the Southern District of New York held that Vivendi's listing of ordinary shares on the New York Stock Exchange ("NYSE") as a requisite of its American Depository Receipt ("ADR") program did not give rise to Section 10(b) liability for purchases of Vivendi ordinary shares on foreign exchanges. *Id.* at *9. The court amended the class definition to exclude purchasers of Vivendi ordinary shares, and limited the class going forward to purchasers of Vivendi ADRs. *Id.* at *12.

Additionally, the court denied Vivendi's motion for judgment as a matter of law (except as to one allegedly misleading statement at issue) and rejected the company's motion for a new trial. *Id.* at *60. The court also denied the plaintiffs' motion for entry of judgment as premature on the grounds that Vivendi is entitled to an opportunity to rebut the presumption of reliance on an individualized (as opposed to a class-wide) basis. *Id.* at *56.

Background

Shareholders brought suit against Vivendi; its former Chief Executive Officer ("CEO"), Jean-Marie Messier; and its former Chief Financial Officer ("CFO"), Guillaume Hannezo, for allegedly "conceal[ing] [Vivendi's] growing liquidity risk … by making misleading statements that touted the company's financial health and performance while failing to disclose its true liquidity position." *Id.* at *14.

This edition of the Securities Law Alert was edited by Peter E. Kazanoff (pkazanoff@stblaw.com/212-455-3525) and Jonathan K. Youngwood (jyoungwood@stblaw.com/212-455-3539).

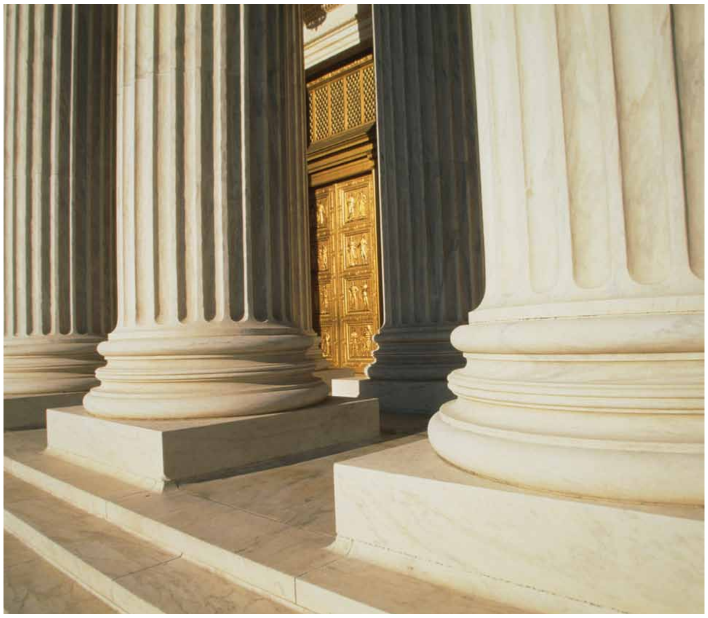
The plaintiffs claimed that this alleged "undisclosed liquidity risk began to materialize in the first half of 2002 leading the company to the brink of bankruptcy and causing a sharp decline in Vivendi's share price." *Id*.

Following a trial held from October 2009 to January 2010, the jury returned a verdict finding that "Vivendi had violated Section 10(b) … but that neither [Vivendi's former CEO nor its former CFO] had committed a primary or secondary violation of Section 10(b) or Section 20(a)." *Id*. at *1. Vivendi subsequently renewed its motion for judgment as a matter of law pursuant to Federal Rule of Civil Procedure 50(b) or, in the alternative, moved for a new trial pursuant to Rule 59. *Id*. The plaintiffs moved for, *inter alia*, the entry of judgment. *Id*.

In June 2010, the Supreme Court issued its decision in *Morrison*. As a result, the Southern District of New York requested that the parties "submit supplemental briefs addressing the impact of *Morrison* on the pending motions, and seeking such other relief as might be appropriate in light of *Morrison*." *Id*. at *4.

The *Vivendi* Court Rejects the "Listing Theory" of Section 10(b) Liability

While the parties agreed that "*Morrison* has no impact on the claims of ADR purchasers since Vivendi's ADRs were listed and traded on the NYSE," the parties differed on the decision's effect on "the claims of foreign and American purchasers of ordinary shares, transactions that necessarily took place on foreign exchanges." *Id*. at *7. At issue was the significance of Vivendi's listing of ordinary shares with the NYSE and its registration of ordinary shares with the Securities and Exchange Commission ("SEC"), both requisites of the company's ADR program. (Because Vivendi sold its ADRs in the United States through a public offering, the company was "required to register under the '33 Act a corresponding number of its ordinary shares with the SEC." *Id*.)



The plaintiffs argued that "the registration [with the SEC] of the ordinary shares underlying Vivendi's ADR issuance caused the *entire class* of Vivendi's ordinary shares (including those ordinary shares that did not underlie any ADRs[]) to be registered with the SEC." *Id*. "Consequently," the plaintiffs contended, "*all* of Vivendi's ordinary shares were registered or listed—plaintiffs claim the terms are interchangeable—on a U.S. exchange." *Id*. In the plaintiffs' view, "all purchasers of [Vivendi] ordinary shares (whether foreign or American) [could therefore] bring Section 10(b) claims under the test announced in *Morrison* even though their shares were traded" abroad. *Id*.

Vivendi responded that "while some ordinary shares were listed on the NYSE, they were not listed for trading purposes and served only as backup to the ADRs that were traded domestically." *Id*. at *4. "[A]ctual transactions in Vivendi ordinary shares only took place on foreign exchanges, such as the Bourse, on which the shares were listed for trading." *Id*. Vivendi contended that "[i]f anything is clear, … it is that *Morrison* excludes from Section 10(b) 'transactions conducted upon foreign exchanges.'" *Id*.

The Southern District of New York found that the central question in dispute was this: "do 'foreign cubed' transactions actually survive *Morrison* where ordinary shares are listed but not traded on a domestic exchange as a result of a foreign issuer's ADR program"? *Id.* at *8. The court answered this question in the negative, finding that:

> There is no indication that the *Morrison* majority read Section 10(b) as applying to securities that may be cross-listed on domestic and foreign exchanges, but where the purchase and sale does not arise from the domestic listing, particularly where (as here) the domestic listing is not even for trading purposes.

Id. at *9. The court also explained that "registration with the SEC is not the same as listing (registering) on an exchange." *Id.* at *8.

Turning to the language of the *Morrison* decision, the court raised the possibility that "Justice Scalia simply made a mistake" when "[h]e stated the test [for the application of Section 10(b)] as … whether the alleged fraud concerned the purchase or sale of a security 'listed on an American stock exchange.'" *Id.* at *9 (*quoting Morrison*, 130 S.Ct. at 2888). The *Vivendi* court suggested that perhaps Justice Scalia "really meant to say a security 'listed and *traded*' on a domestic exchange." *Id.* (emphasis added).

In ruling in Vivendi's favor, the Southern District of New York noted that "[a]ll the courts who have directly or indirectly addressed this issue have dismissed the ['listing theory'] argument as a technical one that is contrary to the 'spirit' of *Morrison*." *Id.* at *8. Earlier this year, in *In re Royal Bank of Scotland ("RBS") Group PLC Securities Litigation*, No. 09 Civ. 300, 2011 WL 167749 (S.D.N.Y. Jan 11, 2011) (Batts, J.), the Southern District of New York held that "[t]he idea that a foreign company is subject to U.S. Securities laws everywhere it conducts foreign transactions merely because it has 'listed' some securities in the United States is simply contrary to the spirit of *Morrison*." *Id.* at *7. (To read our discussion of the *RBS* decision in the January edition of the Alert, please click here.) And last fall, the Southern District of New York in *In re Alstom SA Securities Litigation*, No. 03 Civ. 6595, 2010 WL 3718863 (S.D.N.Y. Sept. 14, 2010) (Marrero, J.) rejected the plaintiffs' "listing theory" argument as "a selective … reading of *Morrison* that ignores the larger point of the decision." *Id.* at *2.

Unlike earlier courts to consider the "listing theory" of Section 10(b) liability post-*Morrison*, however, the *Vivendi* court expressed some hesitation about its decision. The *Vivendi* court noted that although the defendant in *Morrison* had ADRs listed on the NYSE, the Supreme Court "was never presented with and did not consider the argument[ ] … that the listing of [National Australia Bank's ("NAB's")] ADRs on the NYSE required the simultaneous listing of its ordinary shares … and, therefore, that NAB's ordinary shares actually met the test enunciated." *Vivendi*, 2011 WL 590915, at *6. Moreover, the *Vivendi* court suggested that the plaintiffs' "listing theory" argument was "not unmoored from all policy considerations" because "[w]hen a foreign issuer decides to access U.S. capital markets by listing and trading ADRs, … it would not be illogical to subject that company to the antifraud provisions of the Exchange Act at least where there is a sufficient nexus to the United States." *Id.* at *7.

The court concluded its analysis by noting that the "listing theory" question is far from black-and-white: "This is not to say that this Court's reading of *Morrison* is free from doubt, or that *Morrison*'s reading of Section 10(b) is free of potential inconsistency, only that resolution of these issues is fairly the province of the Supreme Court or Congress." *Id.* at *9.

The Court Dismisses Claims Brought by American Purchasers of Vivendi Ordinary Shares

The *Vivendi* court held that American purchasers of Vivendi ordinary shares could not bring Section 10(b) claims "in the wake of *Morrison*." *Id.* at *10. "Though the Supreme Court in *Morrison* did not explicitly define the phrase 'domestic transactions,'" the *Vivendi* court found that:

> [T]here can be little doubt that the phrase was intended to be a reference to the location *of the transaction*, not to the location of the purchaser and that the Supreme Court clearly sought to bar claims based on purchases and sales of foreign securities on foreign exchanges, even though the purchasers were American.

Id. In so holding, the *Vivendi* court "join[ed] other lower courts that have rejected the argument that a transaction qualifies as a 'domestic transaction' under *Morrison* whenever the purchaser or seller resides in the United States, even if the transaction itself takes place entirely over a foreign exchange." *Id*.

The Southern District of New York Denies in Near-Entirety Vivendi's Motion for Judgment as a Matter of Law

The court denied Vivendi's motion for judgment as a matter of law almost in its entirety, holding that the plaintiffs had presented sufficient evidence of, among other things, materially misleading statements, scienter and loss causation. *Id*. at *13.

As to the 39 allegedly misleading statements publicly attributed to Vivendi's former CEO and/or former CFO, Vivendi argued that "a jury finding that [the individual defendants] did not act with scienter precludes a finding of scienter against the company" because "Vivendi's scienter necessarily depends on the state of mind of the individuals who made the statements." *Id*. at *21. The Southern District of New York rejected this contention, explaining that a court's "task on a Rule 50 motion is not to examine different aspects of the jury's verdict to determine whether they can be logically reconciled with one another." *Id*. at *24. The court stated that "[t]he fact that the jury absolved [the former CEO and the former CFO] of liability does not negate the fact that there was sufficient evidence in the record in the first instance to enable a reasonable jury to find against all three defendants on the issue of scienter." *Id*.

Notably, the court held that the jury's verdict was not inconsistent as "it is possible to reconcile the jury's finding that Vivendi was liable but [the individual defendants] were not based on the different evidence admissible against each of the three defendants." *Id*. at *29. The court found it significant that "[o]ver half of the documents at trial were admitted against Vivendi but not against [the individual defendants], or were admitted against Vivendi for all purposes but against [the individual defendants] only for limited purposes." *Id*.

The Court Rules That Vivendi Is Entitled to Rebut the Presumption of Individual Reliance

Denying the plaintiffs' motion for the entry of final judgment as premature, the court held that "Vivendi is entitled to [an opportunity to] rebut the presumption of reliance on an individual basis." *Id*. at *56. The court explained that "[i]t is well-established that the presumption of reliance on the market price of a security under the fraud-on-the-market theory is rebuttable." *Id*. at *57. Although "some of the means of rebutting the presumption of reliance can be proven on a class-wide basis," others "require an individualized inquiry into the buying and selling decisions of particular class members." *Id.* at *57-*58. Thus, "issues of individual reliance can and should be addressed after a class-wide trial, through separate jury trials if necessary." *Id.* at *58.

The Southern District of New York found that the record "does not support [the plaintiffs'] contention" that "Vivendi already used its opportunity to rebut the presumption of reliance." *Id.* at *59. "While Vivendi attempted to rebut the presumption of reliance on a class-wide basis at trial by showing that the allegedly omitted information was immaterial," the court explained that "Vivendi did not challenge the individual reliance of each class member at trial—indeed, Vivendi could not have done so, as Vivendi does not yet know the identity of most class members." *Id.*

The Delaware Chancery Court Mandates Disclosure of the Contingency Fee for Atheros's Financial Advisor in the Qualcomm-Atheros Merger Litigation

On March 4, 2011, the Delaware Chancery Court preliminarily enjoined the shareholder vote on Atheros Communications, Inc.'s $3.1 billion all-cash acquisition by Qualcomm Inc., pending the disclosure of: (1) the precise compensation terms for Atheros's financial advisor, Qatalyst Partners LP; and (2) and the details of when Qualcomm informed Atheros's Chief Executive Officer ("CEO") of its plans to employ him post-merger. *See In re Atheros Commc'ns, Inc. S'holder Litig.*, No. 6124-VCN, 2011 WL 864928 (Del. Ch. Mar. 4, 2011).

The court found meritless the plaintiffs' price and process claims, finding that "there is nothing in the record to indicate that the Board acted unreasonably." *Id.* at *8. The court also rejected the plaintiffs' remaining disclosure claims with respect to the methodology employed by Qatalyst and the specifics of the price negotiations between the parties. *Id.* at *10-*11.

The Court Finds Insufficient Atheros's Disclosure That a "Substantial Portion" of Qatalyst's Fee Is Contingent upon Closing

While the Proxy Statement "informed Atheros's shareholders that Qatalyst would 'be paid a customary fee, a portion of which is payable in connection with the rendering of its opinion and a substantial portion of which will be paid upon completion of the Merger,'" the Proxy Statement did not disclose that approximately 98% of Qatalyst's fee is contingent upon closing. *Id.* at *8.

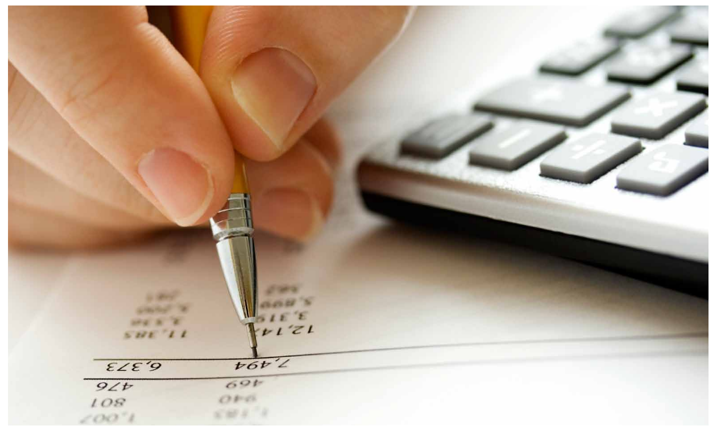
The Chancery Court found that though "[c]ontingency fees are undoubtedly routine," "the percentage of the fee that is contingent [in this case] exceeds both common practice and common understanding of what constitutes 'substantial.'" *Id.* Here, "the compensation that Qatalyst will receive if the Transaction closes is nearly fifty times the fee that it would receive if there is no closing." *Id.* This fee structure "can readily be seen as providing an extraordinary incentive for Qatalyst to support the [t]ransaction." *Id.*

The court agreed with the defendants that "there is no magic contingent percentage that mandates something more than a disclosure that a 'substantial portion' of the fee is contingent." *Id.* at *9. Nonetheless, the court held that "it is clear that an approximately 50:1 contingency ratio requires disclosure to generate an informed judgment by the shareholders as they determine whether to rely upon the fairness opinion in making their decision to vote for or against the [t]ransaction." *Id*. The court explained that "[s]tockholders should know that their financial advisor, upon whom they are being asked to rely, stands to reap a large reward only if the transaction closes and, as a practical matter, only if the financial advisor renders a fairness opinion in favor of the transaction." *Id*. at *8. "Before shareholders can have confidence in a fairness opinion or rely upon it to an appropriate extent, the conflicts and … incentives that may influence the financial advisor in the exercise of its judgment and discretion must be fully and fairly disclosed." *Id*. at *8.

With respect to the question of whether it is sufficient simply to disclose that a financial advisor's fee is "customary" (without providing the precise dollar figure), the court declined to "resolve that general debate here." *Id*. at *9. The court ruled that in the context of the "late agreement between Atheros and Qatalyst as to financial advisor compensation, coupled with the contingent fee concerns …, the stockholders should be afforded an opportunity to understand fully the nature and means by which Atheros will compensate Qatalyst … includ[ing] the [exact] amount of the fee." *Id*.

The Court Requires Additional Disclosures regarding Qualcomm's Employment-Related Discussions with Atheros's CEO

Although the Proxy Statement included "robust disclosures regarding the terms of [Atheros CEO Craig H. Barratt's] post-closing employment" with Qualcomm, *id*. at *11, the plaintiffs charged that the Proxy Statement "inaccurately describes the negotiations over the compensation Barratt would receive when he joined Qualcomm after consummation of the [t]ransaction." *Id*. Specifically, the plaintiffs challenged as "materially misleading" the Proxy Statement disclosure that "Dr. Barratt had not had any discussions with Qualcomm regarding the terms of his potential employment" prior to December 14, 2010. *Id*. (Preliminary merger discussions began in March 2010, and the merger agreement was signed on January



5, 2011.) The plaintiffs contended that "Barratt's future with Qualcomm … could have influenced him, in his role as Atheros's lead negotiator, to take a less aggressive stance on behalf of its stockholders." *Id*.

The Chancery Court found that "[t]he record indicates that, as of a date earlier than December 14, 2010, Barratt had overwhelming reason to believe he would be employed by Qualcomm after the [t]ransaction closed." *Id*. "[E]ven though specific terms were not elicited until later in the process," the court stated that the fact that "Barratt was aware that he would receive an offer of employment from Qualcomm at the same time he was negotiating, for example, the [t]ransaction's offer price, would be important to a reasonable shareholder's decision regarding the [t]ransaction." *Id*. at *12.

The court ruled that "[b]ecause the Proxy Statement partially addresses the process by which Barratt negotiated his future employment with Qualcomm, the Board must provide a full and fair characterization of that process." *Id*. at *11. Specifically, the court held that "the date on which Barratt learned from Qualcomm that it intended to employ him after the [t]ransaction closed should be disclosed." *Id*. at *12.

The Southern District of New York Reaffirms the Principle of Martin Act Preemption of Most Common Law Claims

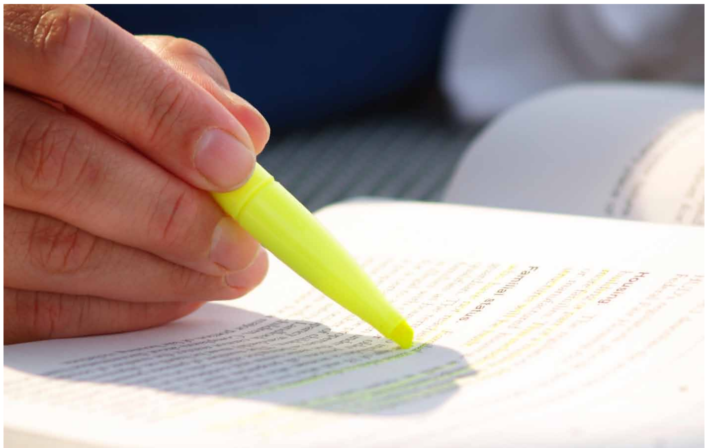
For years, many New York federal and state courts have interpreted the Martin Act—New York's blue sky law—to preempt all common law claims (except for fraud actions) arising out of New York securities transactions. Two recent decisions, one from the Southern District of New York and another from the First Department, have rejected this long-held view. *See Anwar v. Fairfield Greenwich Ltd.*, 728 F. Supp. 2d 354 (S.D.N.Y. 2010) (Marrero, J.); *Assured Guar. (UK) Ltd. v. J.P. Morgan Inv. Mgmt. Inc.*, 915 N.Y.S.2d 7 (1st Dep't 2010). (To read our discussions of these cases in earlier editions of the Alert, please click here and here.)

On February 9, 2011, the Southern District of New York "reaffirm[ed] its recognition of Martin Act preemption" of common law claims. *In re Merrill Lynch Auction Rate Sec. Litig.*, No. 09 MD 2030, 2011 WL 536437, at *12 n.6 (S.D.N.Y. Feb. 9, 2011) (Preska, J.). The court found that the plaintiff's negligent misrepresentation claims against certain rating agencies were "preempted by the Martin Act." *Id.* Although the court acknowledged that "there has been some unsettling of these waters recently," the Southern District of New York nonetheless concluded that "the weight of opposing authority, including Second Circuit Court of Appeals precedent, compels this Court" to hold that the principle of Martin Act preemption of most common law claims still applies. *Id.* (internal citations and quotations omitted); *see also Castellano v. Young & Rubicam, Inc.*, 257 F.3d 171, 190 (2d Cir. 2001) (affirming the dismissal of a breach of fiduciary duty claim on Martin Act grounds based on "principles of federalism and respect for state courts' interpretation of their own laws").

A week later, on February 15, 2011, the Southern District of New York again held that the Martin Act preempts common law negligent misrepresentation claims. *See Horvath v. Banco Comercial Portugues, S.A.*, No. 10 Civ. 4697, 2011 WL 666410 (S.D.N.Y. Feb. 15, 2011) (Daniels, J.). The *Horvath* court noted that "the Second Circuit and many courts within this district have found that non-fraud related common law securities claims are precluded by the Martin Act because sustaining such common law actions would effectively create an end-run around the New York Attorney General's exclusive enforcement authority." *Id.* at *7. Finding that "alleged events that took place in New York" were "central" to the plaintiff's negligent misrepresentation claims, the Southern District of New York ruled that the claims were "within the ambit of the Martin Act and [we]re therefore precluded." *Id.* at *8.

Special Counsel Finds No Collusion in the Nighthawk Radiology-Virtual Radiologic Merger Litigation Settlement

In last month's edition of the Alert, we reported on the Delaware Chancery Court's finding of potential collusion in the settlement of multi-district litigation arising out of the $170 million merger of Nighthawk Radiology with Virtual Radiologic Corporation. (To



read that article, please click here.) The court appointed Gregory P. Williams of Richards, Layton & Finger, P.A. as Special Counsel to advise on the Nighthawk-Virtual Radiologic settlement specifically, and to address forum shopping and collusive settlements in multi-jurisdictional deal litigation more generally.

On March 11, 2011, Special Counsel submitted a briefing to the court reflecting his finding that the Nighthawk-Virtual Radiologic settlement was *not* collusive. *See* Brief of Special Counsel at 28, *Scully v. Nighthawk Radiology Holdings, Inc.*, No. 5890-VCL (Del. Ch. Mar. 11, 2011). Special Counsel found that:

> [A] collusive settlement in the context of stockholder deal litigation appears to involve, at its core, an explicit or implicit agreement between counsel for plaintiffs and counsel for defendants to require less consideration for the settling class in exchange for (1) exclusive dealings with particular plaintiffs' counsel and/or (2) more consideration for plaintiffs' counsel.

Id. at 26. In Special Counsel's view, the following factors should "give rise to heightened scrutiny for collusiveness:"

- "[D]isproportionately weak" settlement consideration "in comparison to the strength of the claims asserted;"
- "[S]ettlement with a plaintiff's firm that typically does not litigate aggressively when other, more formidable, firms are involved in the litigation;" and
- "[A]n agreement to pay attorneys' fees significantly higher than are typical given the settlement consideration."

Id. at 26-27.

Applying these standards, Special Counsel concluded that the Nighthawk-Virtual Radiologic settlement was not collusive. He explained that "[s]ettlements in multi-jurisdictional deal litigation are nearly always reached quickly" and found that "[t]he timing of settlement here was consistent with similar cases," "[t]he amount of fees ultimately agreed to was within the range of fees generally awarded in disclosure settlements," and "[t]he amount of discovery provided to plaintiffs was similarly within the bounds of discovery often shared by defendants before settling these types of cases." *Id.* at 28.

With respect to the issue of "forum-shopping for purposes of securing an advantageous settlement," Special Counsel advised the court that strategic forum selection is "not an independent wrong under existing Delaware law" and "should not be equated with a collusive settlement." *Id.* at 17. "[D]efendants can … attempt to advance one jurisdiction over another by allowing or resisting expedition, providing or withholding document production, or even taking or avoiding telephone calls." *Id.* at 3-4. "These actions are rarely driven by a desire to settle with the 'weakest' plaintiff" but are instead "driven by, among other things, perceptions of which judge or jurisdiction may be more favorable to defendants." *Id.* at 4. Special Counsel explained that "'[f]orum shopping' in this context is often merely a description of a rational and good-faith pursuit of the client's best interests." *Id.* at 4.

For parties engaged in multi-district litigation pending in part in Delaware state courts, Special Counsel noted that "all counsel should be aware that this Court will play some role, either in reviewing a potential settlement or in dismissing a case following a settlement approved by another court." *Id.* at 30. "[B]est practice for counsel negotiating a settlement of such litigation in a jurisdiction outside of Delaware … would be to substantively involve Delaware counsel in the negotiations." *Id.*

The Northern District of Illinois Dismisses the Boeing Class Action Following a Denial by the Alleged Confidential Source

On March 7, 2011, the Northern District of Illinois dismissed with prejudice a purported securities fraud class action against The Boeing Company and two of its executives on the grounds that the alleged "confidential source … denies the information attributed to him in plaintiffs' pleadings and in their representations to the court." *City of Livonia Employees' Ret. Sys. v. The Boeing Co.*, No. 09 C 7143, 2011 WL 824604, at *1 (N.D. Ill. Mar. 7, 2011). The court held that "[t]he information attributed to the confidential source … should not only have been steeply discounted, it should not have been considered at all." *Id.* at *5.

The case concerns allegations that Boeing and its executives "intentionally deceiv[ed] investors about the testing and delivery schedule for the much-anticipated 787 Dreamliner commercial aircraft." *Id.* at *1. In May 2010, the court dismissed the plaintiffs' amended complaint without prejudice. The court found that the "[p]laintiffs' generalized reliance on confidential source information was insufficient to establish Boeing's scienter … because the amended complaint lacked particularized information concerning how any anonymous source was in a

position to know about defendants' knowledge and intent, and reasons were not provided to establish that any specific undisclosed source should be credited." *Id.*

The plaintiffs subsequently filed a second amended complaint containing three new paragraphs that pled "details about only one confidential source and the basis for his knowledge." *Id.* at *2. In denying the defendants' motions to dismiss the second amended complaint, the Northern District of Illinois "expressly relied on the new allegations … concerning the confidential source's insider position at Boeing and representations by plaintiffs' counsel that the confidential source had firsthand knowledge about the 787's test results in documents circulated to top executives." *Id.*

The plaintiffs later disclosed that Bishnujee Singh was the confidential source, and defense counsel first interviewed and then deposed him. *Id.* Singh has since "consistently denied that he was the source of the information attributed to him in the second amended complaint" and even denies being employed by Boeing, claiming instead that "he worked for an outside contractor at Boeing starting in late August 2009, months after the events at issue in this suit." *Id.* Singh also "denies personal knowledge of the 787-8 testing documents or their circulation to Boeing executives," "claims he never met plaintiffs' counsel until his deposition on November 17, 2010," and states that he was never "shown the allegations attributed to him in the second amended complaint until he met with defense counsel." *Id*. The plaintiffs assert that Singh is "presently lying," while Singh claims that "it is plaintiffs' investigators [who interviewed Singh prior to the filing of the second amended complaint] who are the liars." *Id*. at *1.

Armed with a signed declaration from Singh, the Boeing defendants moved for reconsideration of the denials of their motions to dismiss the second amended complaint pursuant to Rule 54(b), and to dismiss the case with prejudice for "fraud on the court." *Id*. at *3. "Under Rule 54(b), the court may consider evidence of manifest factual errors for the limited purpose of determining whether its dismissal orders were procured by fraud, carelessness by counsel, or by the court's own misperception of the facts." *Id*. at *4. Here, the court determined that "Singh's deposition testimony and affidavit stand unrebutted; he was not a Boeing engineer, chief or otherwise, and he did not have access to the 787-8 test files." *Id*. The court also found that "[i]t is undisputed that plaintiffs' counsel never disclosed paragraphs 139-142 to Singh; rather it was defense counsel who first showed Singh the allegations attributed to him *six months after the second amended complaint was proffered to the court*." *Id*. at *2 (emphasis added).

"Without verifying the facts, plaintiffs' counsel represented to the court that the confidential source was a former Boeing senior structural analyst and chief engineer who worked on the 787 team." *Id*. at *3. The plaintiffs "led the court to believe that the confidential source had direct access to and firsthand knowledge about the 787 test files and the distribution of the information to [the] defendants." *Id*. "[T]his unseemly conflict between [the] plaintiffs' confidential source and [the] plaintiffs' investigators could have been avoided by reasonable inquiry on the part of plaintiffs' counsel before filing the second amended complaint." *Id*. at *4.

The Northern District of Illinois ruled that "[i]t matters not whether … Singh told [plaintiffs'] investigators the truth, but he is lying now for ulterior motives." *Id*. "The reality is that the informational basis for [the confidential source paragraphs of the second amended complaint] is at best unreliable and at worst fraudulent, whether it is Singh or [the] plaintiffs' investigators who are lying." *Id*.

The court held that it was "manifest factual error" to rely on purported confidential source information that "should not have been considered at all." *Id*. at *5. Accordingly, the court granted the defendants' motion for reconsideration and dismissed the action with prejudice.

The Second Circuit Articulates a Post-*Merck* Standard for When the Statute of Limitations Begins to Run in Securities Fraud Actions

In *Merck & Co., Inc. v. Reynolds*, 130 S. Ct. 1784 (2010), the Supreme Court ruled that "the limitations period does not begin to run" in a securities fraud action "until the plaintiff … discovers or a reasonably diligent plaintiff would have discovered 'the facts constituting the violation,' including scienter." *Id*. at 1798. (To read our brief recap of the *Merck* decision in the January edition of the Alert, please click here.)

A few weeks ago, the Second Circuit applied *Merck* for the first time. *See City of Pontiac Gen. Employees' Ret. Sys. v. MBIA, Inc.*, No. 09-4609-cv, 2011 WL 677404 (2d Cir. Feb. 28, 2011) ("*Pontiac II*"). In April 2005, the plaintiffs filed a proposed securities fraud class action against MBIA, Inc. in connection with a 1998 transaction involving a policyholder-default on an MBIA-insured bond issue. *Id.* at *1. Following investigations by the SEC and the New York Attorney General, MBIA restated its financials for the years 1998 through 2003 to treat the 1998 transaction as a loan rather than income. *Id.*

The district court dismissed the securities fraud action on the grounds that "trade press discussions of the 1998 transaction put the proposed class on inquiry notice by December 2002"—more than two years prior to the commencement of the action. *Id.* at *2; *see also* 28 U.S.C. § 1658(b) (2006) (providing that private securities fraud suits must be filed within the earlier of "2 years after the discovery of the facts constituting the violation" or "5 years after such violation"). On appeal, the Second Circuit affirmed the district court's ruling, but permitted the plaintiffs to amend the record with additional trade press reports and refile the complaint. *See City of Pontiac Gen. Employees' Ret. Sys. v. MBIA, Inc.*, 300 F. App'x 33 (2d Cir. 2008). The district court dismissed the suit again on statute of limitations grounds, and the plaintiffs appealed once

more. *Pontiac II*, 2011 WL 677404, at *2. Prior to oral argument on appeal, the Supreme Court issued its decision in *Merck*.

Given the "'intervening change of controlling law," the Second Circuit in *Pontiac II* held that its prior determination that "the original unamended record put the class on inquiry notice by December 2002" was no longer "binding as the 'law of the case.'" *Id.* The *Pontiac II* court reexamined the statute of limitations question under *Merck*.

Pre-*Merck*, Second Circuit law "provided that a plaintiff was on 'inquiry notice' when public information would lead a reasonable investor to investigate the possibility of fraud." *Id.* at *3. The statute of limitations began to run "on the day the plaintiff should have been investigating." *Id.* The *Pontiac II* court, however, found that "*Merck* overruled this analysis." *Id.* Under *Merck*, "the limitations period commences not when a reasonable investor would have begun investigating, but when such a reasonable investor conducting such a timely investigation would have *uncovered the facts constituting a violation*." *Id.* (emphasis added).

The Second Circuit in *Pontiac II* found that "two questions remain unresolved" under *Merck*:

A. What are the facts that together constitute a securities fraud violation for purposes of commencing the statute of limitations?

B. With regard to any particular one of these facts, how much information does the reasonable investor need to have about it before it is deemed 'discovered' for purposes of commencing the statute of limitations?

Id. "To apply *Merck* with consistency," the *Pontiac II* court determined that "a standard is needed to assess how much information a reasonably diligent investor must have about the facts constituting a securities fraud violation before those facts are deemed 'discovered' and the statute of limitations begins to run." *Id.* For example, are the facts "discovered" when a reasonable investor would (a) "suspect a violation," (b) "become absolutely convinced that the violation occurred," or (c) be able to "prove in a courtroom that the violation occurred?" *Id.*

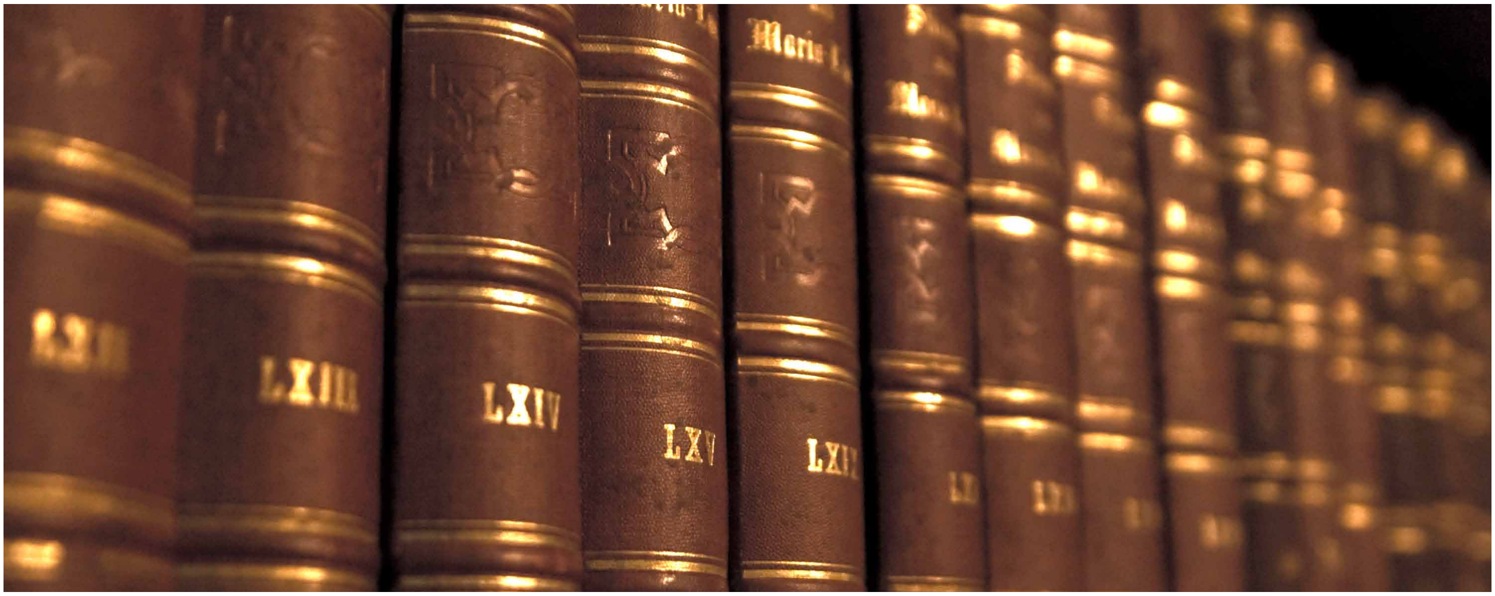
The Second Circuit looked first to the *Merck* decision for guidance. Because the ruling "cast[ ] discovery of scienter in terms of what information and evidence a plaintiff would need to survive a motion to dismiss," the *Pontiac II* court found that the Supreme Court "thought about the requirements for 'discovering' a fact in terms of what was required to adequately plead that fact and survive a motion to dismiss." *Id.* at *4. The Second Circuit also considered "the basic purpose of a statute of limitations." *Id.* "Since the purpose is to prevent stale claims," the court concluded that "it would make no sense for a statute of limitations to begin to run before the plaintiff … can adequately plead his claim." *Id.*

"Based on this analysis," the Second Circuit held that "a fact is not deemed 'discovered' until a reasonably diligent plaintiff … can plead that fact with sufficient detail and particularity to survive a 12(b)(6) motion to dismiss." *Id.* The *Pontiac II* court remanded the case to the district court to evaluate "when the [plaintiffs] had enough information about MBIA's scienter to plead it with sufficient particularity to survive a motion to dismiss under the heightened pleading requirements for scienter." *Id.* at *5. The Second Circuit emphasized that "[t]he two-year statute of limitations cannot commence before that point." *Id.*

The Supreme Court Denies the Petition for *Certiorari* in the Apollo Litigation

In the January edition, we discussed the petition for *certiorari* in *Apollo Group, Inc. v. Policemen's Annuity and Benefit Fund of Chicago*, No. 10-649. (Please click here to read the complete article.) The petition sought (1) the Court's guidance on the amount of time that may elapse between an alleged corrective disclosure and a subsequent price drop for purposes of loss causation and (2) whether a recharacterization or analysis of previously disclosed facts can constitute a corrective disclosure.

On March 7, 2011, the Court denied Apollo's petition for *certiorari*. The Ninth Circuit's ruling reinstating the $277.5 million verdict against Apollo will therefore stand.



NEW YORK

Bruce D. Angiolillo
212-455-3735
bangiolillo@stblaw.com

Michael J. Chepiga
212-455-2598
mchepiga@stblaw.com

Mark G. Cunha
212-455-3475
mcunha@stblaw.com

Paul C. Curnin
212-455-2519
pcurnin@stblaw.com

Michael J. Garvey
212-455-7358
mgarvey@stblaw.com

Paul C. Gluckow
212-455-2653
pgluckow@stblaw.com

David W. Ichel
212-455-2563
dichel@stblaw.com

Peter E. Kazanoff
212-455-3525
pkazanoff@stblaw.com

Joshua A. Levine
212-455-7694
jlevine@stblaw.com

Linda H. Martin
212-455-7722
lmartin@stblaw.com

Mary Elizabeth McGarry
212-455-2574
mmcgarry@stblaw.com

Joseph M. McLaughlin
212-455-3242
jmclaughlin@stblaw.com

Lynn K. Neuner
212-455-2696
lneuner@stblaw.com

Barry R. Ostrager
212-455-2655
bostrager@stblaw.com

Thomas C. Rice
212-455-3040
trice@stblaw.com

Mark J. Stein
212-455-2310
mstein@stblaw.com

Alan C. Turner
212-455-2472
aturner@stblaw.com

George S. Wang
212-455-2228
gwang@stblaw.com

David J. Woll
212-455-3136
dwoll@stblaw.com

Jonathan K. Youngwood
212-455-3539
jyoungwood@stblaw.com

LOS ANGELES

Michael D. Kibler
310-407-7515
mkibler@stblaw.com

Chet A. Kronenberg
310-407-7557
ckronenberg@stblaw.com

PALO ALTO

Alexis S. Coll-Very
650-251-5201
acoll-very@stblaw.com

James G. Kreissman
650-251-5080
jkreissman@stblaw.com

WASHINGTON, D.C.

Peter H. Bresnan
202-636-5569
pbresnan@stblaw.com

Peter C. Thomas
202-636-5535
pthomas@stblaw.com

> "The firm's securities litigators are 'excellent at strategy of judgment in this area of law.'"
>
> *—THE LEGAL 500 UNITED STATES 2010*

UNITED STATES

New York
425 Lexington Avenue
New York, NY 10017
+1-212-455-2000

Los Angeles
1999 Avenue of the Stars
Los Angeles, CA 90067
+1-310-407-7500

Palo Alto
2550 Hanover Street
Palo Alto, CA 94304
+1-650-251-5000

Washington, D.C.
1155 F Street, N.W.
Washington, D.C. 20004
+1-202-636-5500

EUROPE

London
CityPoint
One Ropemaker Street
London EC2Y 9HU
England
+44-(0)20-7275-6500

ASIA

Beijing
3119 China World Office 1
1 Jianguomenwai Avenue
Beijing 100004
China
+86-10-5965-2999

Hong Kong
ICBC Tower
3 Garden Road, Central
Hong Kong
+852-2514-7600

Tokyo
Gaikokuho Jimu Bengoshi Jimusho
Ark Mori Building
12-32, Akasaka 1-Chome
Minato-Ku, Tokyo 107-6037
Japan
+81-3-5562-6200

SOUTH AMERICA

São Paulo
Av. Presidente Juscelino Kubitschek, 1455
São Paulo, SP 04543-011
Brazil
+55-11-3546-1000