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Securities & Derivative Litigation Report

2004 First Quarter Eleventh Circuit Securities Law Update

Inside This Issue:

To keep our clients abreast of securities law developments in the Southeast, Carlton Fields' Securities and Derivative Litigation Practice Group provides quarterly updates of securities decisions from federal courts in the Eleventh Circuit.[1] This Update summarizes decisions of interest within the Eleventh Circuit from January through March 2004.

Class Action Settlements

(1) *AAL High Yield Bond v. Deloitte & Touche LLP,* 361 F.3d 1305 (11th Cir. 2004)

Summary: Non-parties excluded from a class may not appeal the denial of their objections to settlement of the class action without first moving to intervene, unless the non-party likely could have intervened as of right. A bar order issued pursuant to the Private Securities Litigation Reform Act of 1995 ("PSLRA"), *see* 15 U.S.C. § 78u-4(f)(7)(A), purporting to preclude claims that were truly independent of the underlying suit required support by adequate factual findings and legal reasoning about the permissible scope of such orders.

Facts: Purchasers of corporate notes brought a securities class action against the company's officers, outside auditor, and the underwriter of its note offering alleging violations of federal and Alabama securities laws. Plaintiffs and the company's officers agreed to settle, but the underwriter and two of its affiliates objected to the proposed settlement, arguing that they belonged in the class because they also purchased notes. The court overruled the objections, certified the class, approved the settlement, and entered a bar order precluding "all related present and future claims by [the underwriter and the auditor] against the Officers, and . . . any such claims against other officers and agents of [the company] who are not parties to the instant case." *Id.* at 1308, 1311. Although they had not sought to intervene pursuant to Federal Rules of Civil Procedure Rule 24, the underwriter's affiliates appealed their exclusion from the class. The underwriter and the auditor also appealed on the separate grounds that the bar order

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1 This Update is intended for the general information of readers, and is not intended as legal advice or as a substitute for research and analysis of any of these issues.

exceeded the PSLRA's scope "by precluding, without a proper 'settlement credit,' claims for contribution in other pending cases and claims that are truly independent of the settled claims." *Id.* at 1311.

Holding and Reasoning: The Eleventh Circuit held: (1) the affiliates, as "non-intervening" non-parties were not entitled to appeal the denial of their objections, and (2) the "exceedingly broad" bar order required further rationale from the district court.

First, the court held that the underwriter's affiliates, as non-parties, "could only appeal the denial of their objections to the class settlement if they had intervened in the action." *Id.* at 1309. The affiliates never moved to intervene, and accordingly, could not maintain an appeal. *Id.* at 1311. The court also noted in dicta that a non-party may have a right to appeal absent formal intervention if the non-party "would easily meet the requirements of Fed. R. Civ. P. 24(a) anyway." *Id.* at 1310 (citing *Devlin v. Scardelletti*, 536 U.S. 1, 12-13 (2002)). However, the court declined to address the issue further "[b]ecause the Objectors would not qualify as parties even under the most permissive possible reading of *Devlin*." *Id.* at 1311.

Second, the court explained that it could not "ascertain whether sufficient justification exist[ed] for the bar order" without any findings of fact or rationale from the district court. *Id.* at 1312. The court was especially concerned about whether the PSLRA authorized the district court to "bar [] claims that arise from causes of action brought by plaintiffs other than the instant plaintiffs or truly independent claims." *Id.* The court remanded for further consideration by the district court, including specific instructions to consider the PSLRA's bar order provisions.

> On remand, the district court is directed to address . . . whether the PSLRA mandates that the bar order it requires is exclusive, or whether it suggests caution with respect to broader bar orders; and if the PSLRA is not exclusive . . ., the district court should address the persuasive authorities, and the underlying reasons and policies, for and against a broader bar order which would bar claims [] arising from liability to plaintiffs other than the instant plaintiffs or would bar truly independent claims.

Id. at n.13-14 (discussing 15 U.S.C. § 78u-4(f)(7)(A)).

(2) *Wisc. Inv. Bd. v. Ruttenberg*, 300 F. Supp. 2d 1210 (N.D. Ala. 2004)

Summary: The PSLRA allows a court to enter a bar order prohibiting claims other than those for contribution in the settled case, and thus authorizes a bar order extinguishing claims in related cases if the claims are sufficiently related to the settled claims.[2]

Facts: Plaintiffs filed a securities class action against an issuer, its former officers and directors, an independent auditor, and two of the auditor's employees.[3] The corporate

2 The district court issued this decision prior to the Eleventh Circuit's opinion in *AAL High Yield Bond Fund*, *see supra* p. 1. Therefore, to the extent that *Wisconsin Investment Board* discusses the PSLRA's impact on settlement bar orders and the prohibition of independent claims, it must be read in conjunction with *AAL High Yield Bond Fund* and the Eleventh Circuit's specific directions in that opinion to address similar issues on remand.

3 Several factually similar cases involving the auditor defendants are pending in other jurisdictions. The auditor defendants and corporate defendants are also co-defendants in *AAL High Yield Bond Fund*, *see supra* p. 1.

defendants and the auditors negotiated separate settlements with the plaintiffs. The auditors objected to a bar provision in the corporate defendants' settlement agreemant "that directly impacted the [auditor] defendants' ability to assert any contribution and independent claims against the [corporate] defendants in the related cases" pending in other jurisdictions. *Id.* at 1213. The district court overruled the auditor defendants' objections and adopted the bar provision. On appeal, the Eleventh Circuit remanded for reconsideration, "observ[ing] that 'although the [bar order] is exceedingly broad, there are no findings of fact or expressed rationale for barring'" the auditor defendants' possible claims. *Id.* at 1214.

Holding and Reasoning: On remand, the district court readopted the original bar order.

The court first considered whether the PSLRA provision that a court enter a bar order "bar[ring] all future claims for contribution arising out of the action" prohibited a bar order extinguishing claims other than those for contribution. *Id.* at 1216 (quoting 15 U.S.C. § 78u-4(f)(7)(A)). Noting "the absence of any statutory language or legislative history" indicating such an intent, the court held that "the PSLRA does not divest the court of the power to fashion bar orders extinguishing claims other than those for contribution in the settled case." *Id.* at 1217.

Next, the court addressed "whether a settlement bar order can extinguish contribution or so-called 'independent' claims that the [auditor] defendants may have against the [corporate] defendants in the related cases." *Id.* Concluding that the analysis turned on "the interrelatedness of the claims," the court held "any claims that the [auditor] defendants may have against the [corporate] defendants in the related cases . . . clearly satisfy the 'interrelatedness test'"and could be extinguished by a bar order. *Id.* at 1219 (citing *In re U.S. Oil & Gas Litig.*, 967 F.2d 489, 496 (11th Cir. 1992)).

Finally, the court rejected the auditors' due process argument, reasoning that "un-asserted contribution and independent claims" did not implicate substantive due process. *Id.* at 1220. Alternatively, even if the auditor defendants' "purely hypothetical claims" were "property interests protected by due process," the fairness hearing and reciprocal bar order constituted "all the process that is due." *Id.*

Derivative Suits

(1) *Klein v. FPL Group, Inc.*, No. 02-20170-CIV, 2004 WL 302292 (S.D. Fla. Feb. 5, 2004)

Summary: In multiple shareholder derivative actions, the court held that an evaluation committee that investigated and concluded that a suit was not justified was not sufficiently independent and, thus, that dismissal of the actions was not warranted.

Facts: Plaintiffs filed derivative actions against a corporation and its individual officers and directors challenging the corporation's long-term incentive plan and certain payments made under that plan. Plaintiffs alleged that change-of-control payments under the long-term incentive plan were improperly made to high-level executives upon shareholder approval of a merger although the merger itself was not ultimately consummated. After the corporation's Evaluation Committee recommended that the derivative suits were not in the best interests of the corporation or its shareholders, defendants moved to dismiss under Florida Statutes § 607.07401(3).

Holding and Reasoning: The court denied the motion to dismiss, holding that defendants did not meet their "burden of proving the independence and good faith of the group making the determination and the reasonableness of the investigation." *Id.* at *15 (quoting Fla. Stat. § 607.07401(3)).

Applying a totality of the circumstances test, the court carefully limited its inquiry to the issue of independence. The court specifically noted that its ultimate holding should "not disparage the integrity of the members of the Evaluation Committee or the Board. The issue is not their integrity but their objectivity and impartiality, both in fact and in perception." *Id.* at *20.

The court identified several reasons why defendants failed to establish the Evaluation Committee's independence. First, the members recommending and determining not to pursue the derivative claim had previously approved the change-of-control payments and were potentially subject to liability in the action. *Id.* Second, the formation of the Evaluation Committee was not sufficiently independent because a defendant's "involvement in the selection process at all raises obvious concerns about the appearance of potential bias and control." *Id.* at *22. Third, public statements issued by management regarding the legality of the plan and payments at issue did "not create an atmosphere conducive to an independent review." *Id.* at *24.

Falsity, Materiality, and Reliance

(1) *In re World Access, Inc. Sec. Litig.*, No. CIV.A. 1:99-CV-43-OD, 2004 WL 547535 (N.D. Ga. Mar. 16, 2004)

Summary: Plaintiffs failed to create a genuine issue of material fact regarding defendants' alleged misstatements or omissions, including whether such statements were indeed false, whether such statements were material when the market did not react to the statements, and whether plaintiffs relied on the statements.

Facts: Plaintiffs filed a securities fraud suit against defendants alleging violations of Sections 11, 12, and 15 of the Securities Act, and Sections 10(b) and 20(a) of the Securities Exchange Act and Rule 10b-5. Plaintiffs alleged that defendants falsely represented the performance of one of their products. Defendants moved for summary judgment.

Holding and Reasoning: The court granted summary judgment for defendants, holding that no genuine issue of material fact existed regarding falsity, materiality, and reliance.

No evidence in the record indicated that defendants' generalized statements were false. *Id.* at *14. The statements featured "measured descriptions" of the product at issue and noted that the corporation "could not offer assurance that the new product would ultimately be a success." *Id.* Accordingly, because the corporation "gave a description of the product as well as a warning, it did not have the duty to do more." *Id.*

Further, defendants' statements regarding the product were not material because the plaintiffs could not establish any evidence, other than their own expert's report,[4] showing the statements' effect on the stock price. *Id.* at *16.

4 The court noted that plaintiffs' expert focused primarily on the decline in stock price after the negative announcements, while defendants' expert "looked at the allegedly false and misleading disclosures and found no statistically significant positive price reaction to any [product]-related disclosure." *Id.* The court reasoned that, despite "inconsistent" case law, "in this case both would be important to the reasonable investor." *Id.*

> If the public statements surrounding development of the [product] and its importance to [the corporation] were material to investors, the market would have accordingly reacted in a positive manner when the announcements were made. Similarly, the market would have reacted in a negative manner when announcements were made that the [product] was not performing as expected.

Id. Plaintiffs conceded that the market had not reacted "in a statistically significant manner" to earlier positive product-related statements. *Id.* "Thus Plaintiffs have not demonstrated what value the market placed on the [product] up to the point of the negative news." *Id.* Even when the market reacted negatively to later announcements, those negative "announcements did not solely concern the [product]." *Id.* Rather, the negative announcements preceding stock price declines also referenced other products, special merger-related charges, additional one-time charges, and plans to sell non-core businesses. *Id.*

Therefore, plaintiffs failed to "show [] that a reasonable investor would have considered the information in the [earlier product-related disclosures] to be material." *Id.* Plaintiffs also failed to identify "evidence sufficient to show that the [later product]-related disclosures . . . were what made the stock price drop so drastically." *Id.* Accordingly, no "genuine issue of material fact . . . exist[ed] as to the materiality element." *Id.*

Finally, plaintiffs could not establish reliance when they continued to purchase stock after learning of the alleged misrepresentations. *Id.* at *17. "Due to the timing of his purchases, the only thing that [plaintiff] appears to have relied upon is that [the] stock would eventually go back up. Specifically, [plaintiff] testified that he decided to invest in [the corporation] because he believed that it would be acquired by another company." *Id.* Such actions directly countered the fraud-on-the-market presumption, and accordingly, summary judgment was proper. *Id.*

Insider Trading

(1) *S.E.C. v. Ginsburg*, No. 03-10848, 2004 WL 541181 (11th Cir. Mar.19, 2004)

Summary: The SEC needs to raise only a reasonable inference that defendant communicated material nonpublic information to sustain a jury verdict finding liability for insider trading.

Facts: The SEC brought a civil enforcement action against the defendant under Sections 10(b) and 14(e) of the Securities Exchange Act and Rules 10b-5 and 14e-3. The SEC alleged that defendant, the chairman and CEO of one corporation, transmitted material nonpublic information to his father and brother regarding two other companies that the corporation was interested in acquiring. The SEC also alleged that defendant's father and brother traded in the target companies' stock based on that information. The jury found the defendant liable for insider trading, and the district court, although denying the SEC's request to enjoin further violations, imposed a $1,000,000 penalty. Later, the district court granted defendant's renewed motion for judgment as a matter of law, holding "that the evidence was insufficient to permit a reasonable jury to find that [defendant] had tipped off his brother or father about inside information." *Id.* at *1.

Holding and Reasoning: The Eleventh Circuit reversed the district court's grant of judgment as a matter of law and remanded with instructions to reinstate the civil penalty and enjoin the defendant from future securities violations.

The court held that "[t]he SEC did not have the burden of putting in evidence that compelled the inference [that defendant] conveyed nonpublic information . . . . All it was required to do was put in evidence that *reasonably permitted* that inference." *Id.* at *7 (emphasis added). While defendant's "credible and innocent explanation for the timing of calls and sales can rebut" such an inference and create an issue of fact, "it [is] up to the jury to choose between those competing plausible theories of fact." *Id.* The district court should have followed *S.E.C. v. Adler*, 137 F.3d 1325 (11th Cir. 1989), regarding the sufficiency of the evidence and permissible inferences in insider trading cases, and erred in overturning the verdict when the jury was simply "free to disbelieve" the defendant's evidence. *Id.* at *3, *7.

The court rejected defendant's alternate arguments, holding that information regarding a merger met Rule 10b-5's materiality requirement. *Id.* at *8. "A merger is an event of considerable magnitude to an investor, and preliminary merger negotiations constitute concrete steps indicating an increasing possibility of a merger occurring." Id. When considered with the proposed mergers' confidentiality agreements, "[t]he jury could reasonably infer that the information was material and nonpublic." *Id.*

The court also rejected defendant's Rule 14e-3 arguments, explaining that an executive meeting, due diligence procedures, and a confidentiality agreement were "substantial steps" toward a tender offer for purposes of Rule 14e-3. *Id.* at *9. "Rule 14e-3, by its terms, does not require that the offender know or have reason to know that the information relates to a tender offer, so long as the information in fact does relate to a tender offer and the offender knows or has reason to know the information is nonpublic and was acquired by a person with the required status." *Id.* at *10.

NASD Arbitration

(1) *Isenhower v. Morgan Keegan & Co.*, No. 03-F-566-N, 2004 WL 633207 (M.D. Ala. Mar. 11, 2004)

Summary: Plaintiffs failed to establish that an arbitration panel's refusal to award a claimant attorneys' fees, costs, and interest lacked any rational basis, displayed a manifest disregard of the law, or violated public policy.

Facts: Plaintiffs instituted an arbitration proceeding through the National Association of Securities Dealers ("NASD") against their brokerage firm alleging claims of securities fraud, unsuitability, churning, breach of fiduciary duty, and negligent supervision. The NASD arbitration panel found defendant liable on the unauthorized trading and failure to supervise claims, and awarded plaintiffs $20,000 in compensatory damages. The panel declined plaintiffs' request for attorneys' fees, interest, and punitive damages, and assessed costs between the parties. Plaintiffs filed a motion with the court to modify the arbitration award to provide for attorneys' fees, costs, and interest.

Holding and Reasoning: The court denied plaintiffs' motion to modify the arbitration award.

The court initially held that plaintiffs failed to argue properly under any of the Federal Arbitration Act's exclusive statutory grounds for modifying an arbitration award.[5] *Id.* at

[5] The court also noted that, contrary to plaintiffs' claim, the Federal Arbitration Act did not convey federal subject matter jurisdiction. *Id.* at *1. Instead, either the parties' diversity or the fact that one of plaintiffs' claims arose under the Securities Exchange Act provided subject matter jurisdiction. *Id.*

*3. Although plaintiffs' motion was styled as a motion for *modification*, plaintiffs' arguments were based instead on non-statutory grounds for vacating an arbitration award. *Id.* at *4. Noting the "problematic" nature of such an argument, the court proceeded to hold "for purposes of argument, without deciding the issue," that plaintiffs' application was without merit. *Id.*

First, the court held that plaintiffs failed to meet their burden of "refut[ing] every rational basis upon which the arbitration panel could have relied" in determining the award. *Id.* at *5. Thus, a proper basis for the award existed and plaintiffs were limited to the statutory grounds for relief that they failed to assert. *Id.*

Second, assuming that plaintiffs' non-statutory arguments warranted analysis, plaintiffs also failed to "satisf[y] their burden of establishing either that the arbitration panel acted with 'manifest disregard' for the law or contrary to public policy." *Id.* The manifest disregard of the law standard required that "the arbitration panel appreciated the existence of a clearly governing legal principle but consciously decided to ignore it at the urging of [d]efendant's counsel." *Id.* at *6. Even if, as plaintiffs argued, the Alabama Securities Act mandated the award of attorneys' fees, interest, and costs, "[p]laintiffs never informed the arbitration panel of [this] fact." *Id.* Further, plaintiffs' public policy argument based on similar grounds was "'no more than a complaint that the Panel failed to interpret the law correctly.' Such an argument does not support a finding that an arbitration award must be vacated on public policy grounds." *Id.* at *7.

NASD Immunity

(1) Rubin v. Fahnestock & Co., No. 03-61468-CIV-ALTONAGA/BANDSTRA (S.D. Fla. Mar. 24, 2004)

Summary: The NASD enjoys absolute immunity from state law liability arising out of its processing of registration applications.

Facts: Plaintiffs sued their former employer and the NASD for failure to properly register one of the plaintiffs as a broker alleging, among other things, negligence by the NASD in failing to properly process a registration application. Plaintiffs alleged the NASD received the application but failed to process it because of an internal error. The NASD moved for dismissal.

Holding and Reasoning: The court dismissed the negligence claim against the NASD.

Noting that "it is well established that the NASD is absolutely immune from state law liability" for claims arising out of its regulatory duties, the court's analysis focused on "whether the NASD's allegedly negligent acts occurred while the NASD was performing its regulatory duties under the [Securities] Exchange Act." *Id.* at 5. Although plaintiffs couched their claim as a state law negligence action, the court stated that when "determin[ing] the NASD's entitlement to immunity, the Court must look not 'at the manner in which [plaintiffs] cast [] [their] claims… but rather to the alleged misconduct of the [defendant] as detailed in the complaint.'" *Id.* at 6. In this instance, the alleged actions were "intertwined with [the NASD's] actions taken in furtherance of its regulatory duty to maintain records," and accordingly, the NASD was entitled to immunity. *Id.* at 7.

Pleading Requirements

(1) *Grippo v. Perazzo*, 357 F.3d 1218 (11th Cir. 2004)

Summary: A plaintiff need not allege the specific identity of the security purchased to state a claim for securities fraud under Section 10b of the Securities Exchange Act, Rule 10b-5, and Fla. Stat. § 517.301.

Facts: Plaintiff sued his broker and related investment firms under both federal and Florida securities laws alleging that he was deceived into providing money to a broker to invest in securities that the broker never delivered. The district court dismissed plaintiff's federal and state claims because (1) the plaintiff failed to allege the purchase of a specific security and (2) the plaintiff failed to plead his claims with the particularity required by the PSLRA and Fed. R. Civ. P. 9(b). The district court also dismissed the federal claims as barred by the statute of limitations.

Holding and Reasoning: The Eleventh Circuit affirmed in part and reversed in part.

Concluding that the district court erred in holding that the federal and state claims were defective for failure to allege the purchase or sale of a specific security, the Eleventh Circuit reasoned that the Supreme Court's decision in *S.E.C. v. Zandford*, 535 U.S. 813, 819-21 (2002), required a broad interpretation of the "in connection with" requirement of the federal and state securities laws. *Id*. at 1223-24. The phrase "in connection with," under Section 10b, Rule 10b-5, and Fla. Stat. § 517.301, encompassed the situation where a broker accepts and deposits an investor's money as a supposed payment for securities. *Id*. The broker's subsequent failure to deliver any securities does not render the investor unable to plead fraud based on an "inability to prove that his money was actually used to purchase any security." *Id*. at 1224.

The court also reversed the dismissal of the Florida state securities claims for lack of particularity. *Id*. at 1224-25. Although federal law requires a plaintiff to plead facts giving rise to a strong inference of intent or recklessness, Florida securities law would be satisfied by allegations of fact showing mere negligence. *Id*. at 1225 (citing *In re Sahlen & Assocs. Inc. Sec. Litig.*, 773 F. Supp. 342, 371 (S.D. Fla. 1991)).

The court affirmed the dismissal of the federal securities claims on statute of limitations grounds because the plaintiff had inquiry notice of the fraud more than one year prior to the filing of his complaint (the limitations period in effect at that time).[6] *Id*. at 1224.

(2) *Fidel v. Pearlman*, No. 02-61258-CIV-MARRA (S.D. Fla. Mar. 4, 2004)

Summary: Plaintiffs failed to plead with particularity sufficient facts to establish scienter as required under the PSLRA.

Facts: Plaintiffs filed a class action against two senior executives of Unapix, Inc., alleging violations of Sections 10(b) and 20(a) of the Securities Exchange Act. The plaintiffs claimed that defendants misled investors regarding the value of Unapix's film library and that the library was later sold at a forced bankruptcy sale for a fraction of its represented value. Defendants moved for dismissal.

Holding and Reasoning: The court dismissed the complaint, without prejudice, for failure to adequately plead scienter. The court held that plaintiffs' allegations regarding the magnitude of the alleged overstatement, defendants' executive positions, and defendants' personal financial motives were insufficient to plead scienter under the PSLRA. *Id*. at 5-7. Plaintiffs failed to allege "any contemporaneous information casting doubt upon the Defendants' statements regarding

6 *See infra* p. 10, Statute of Limitations.

the market value of the library. Even if there was such information, there is no allegation that Defendants were privy to it." *Id.* at 6. Further, "[a]part from their experience in the industry, Plaintiffs allege no facts as to why Defendants should have known that the market value of the library was worth less than stated." *Id.* at n.4. The court limited any inference drawn from the difference in the library's value, citing the two to three-year interval between the alleged misrepresentations and the forced sale, and the fact that "the market value of an asset is difficult to compare to a value obtained in a forced sale." *Id.* at 6.

Although it dismissed on scienter grounds, the court also held that plaintiffs pleaded fraud with sufficient particularity by alleging the reasons why defendants' statements were false and that defendants stood to gain increased profitability in their stock options by making the statements. *Id.* at 8. Additionally, the court rejected defendants' argument that the market value estimates were forward-looking statements because they were based on "soft" information such as appraisals of the library. *Id.* at 8-9. "This Court concludes that just because a statement regarding current assets is 'soft' or subjective in nature, does not mean that such statement is forward-looking." *Id.* at 9.

(3) *Druskin v. Answerthink, Inc.*, 299 F. Supp. 2d 1307 (S.D. Fla. 2004)

Summary: Plaintiffs failed to plead scienter as required under the PSLRA and failed to plead loss causation. Accordingly, defendants' motion to dismiss was granted, with leave to amend.

Facts: Plaintiffs filed a class action alleging violations of Sections 10(b) and 20(a) of the Securities Exchange Act. The plaintiffs claimed defendants improperly recognized revenue from accounts they knew were uncollectible, failed to establish sufficient reserves for uncollectible accounts, and failed to disclose related-party transactions. Defendants moved for dismissal.

Holding and Reasoning: The court dismissed the complaint, without prejudice, holding that plaintiffs failed to allege scienter with the particularity required under the PSLRA and also failed to adequately allege loss causation.

Regarding scienter, the court held the group pleading doctrine inapplicable to the PSLRA's scienter requirement. *Id.* at 1322. Therefore, "[p]laintiffs must allege specific facts showing that each [d]efendant acted with severe recklessness." *Id.* at 1323. The court dismissed plaintiffs' allegations of improper revenue recognition for several reasons. First, the allegedly uncollectible accounts actually made payments to defendants during the class period. *Id.* at 1326. Second, "the fact that a company is incurring a loss, running out of money, or even near-bankrupt, 'does not mean that it necessarily [lacks the] ability to generate revenues or make future payments to its creditors from such revenues.'" *Id.* (quoting *In re Smith Gardner Sec. Litig.*, 214 F. Supp. 2d 1291, 1303 (S.D. Fla. 2002)).

The court also dismissed plaintiffs' claims concerning the sufficiency of the company's loss reserves, pointing out that defendants actually maintained significant reserves and adjusted that amount annually. *Id.* at 1328. Accordingly, plaintiffs failed to establish that defendants' reserve levels were fraudulent or "reflect[ed] an extreme departure from the standards of ordinary care." *Id.*

Plaintiffs' allegations of undisclosed related-party transactions lacked materiality because the transactions at issue represented an extremely small percentage of defendants' revenues during the class period. *Id*. at 1329. Although plaintiffs claimed that defendants used the related parties to recycle revenue, plaintiffs failed to allege such transactions specifically. *Id*. at 1330.

The court dismissed plaintiffs' further scienter allegations involving aging reports, a project report, and confidential witnesses because the plaintiffs failed to allege knowledge by the defendants that statements were false when made. *Id*. at *1330-33. Further, plaintiffs' claims regarding defendants' stock trades failed to establish scienter because the defendants either lost money, made small trades, or were forced to sell to meet margin calls. *Id*. at 1335-37.

Turning to loss causation, plaintiffs "failed to allege with specificity that [d]efendants' fraud, as opposed to general market conditions, caused the stock price to decline." *Id.* at 1339. Defendants' stock price had already plunged significantly before the disclosure that allegedly revealed the earlier fraud. *Id*. Also, while defendants' earlier partial disclosures negatively impacted the stock price, the stock price quickly rebounded. *Id*. Accordingly, plaintiffs "failed to adequately allege that [d]efendants' false statements were in some reasonably direct way responsible for their loss." *Id*.

Statute of Limitations [7]

(1) *La Grasta v. First Union Sec., Inc.*, 358 F.3d 840 (11th Cir. 2004)

Summary: A sharp decrease in stock price, standing alone, is insufficient to place plaintiffs on inquiry notice of fraud for purposes of a motion to dismiss.

Facts: Purchasers of Ask Jeeves, Inc. stock brought a securities fraud class action against defendant, alleging that its research analyst inflated the price of Ask Jeeves stock through "strong buy" recommendations while defendant simultaneously sought investment banking business from Ask Jeeves. The district court dismissed the complaint, holding that the statute of limitations had expired because plaintiffs possessed inquiry notice of securities fraud when Ask Jeeves' stock price experienced a "steady and profound decrease."

Holding and Reasoning: The Eleventh Circuit reversed, holding that plaintiffs were not on inquiry notice of the possibility of fraud until the publication of a magazine article revealing defendant's conflict of interest.

The court adopted the reasoning of *Summer v. Land & Leisure, Inc.*, 664 F.2d 965, 969 (5th Cir. Unit B 1981), holding "that we could 'conceive of several factual situations

7 The Eleventh Circuit is currently considering a limitations issue - whether the Sarbanes-Oxley Act of 2002 ("SOX") may retroactively apply to revive time-barred claims. Effective July 30, 2002, SOX lengthened the limitations period for federal securities claims involving "fraud, deceit, manipulation, or contrivance" to the earlier of two years after the date of discovery or five years after the date of the violation. *See* 28 U.S.C. § 1658(b). The Eleventh Circuit heard argument on November 21, 2003 in *Roberts v. Dean Witter Reynolds, Inc.*, No. 8:02-CV-2115-T-26EAJ, 2003 WL 1936116, *4 (M.D. Fla. Mar. 31, 2003), in which the district court held that "Congress intended for the extended statute of limitations to apply retroactively." Several district courts in other Circuits have held otherwise. *See Newby v. Enron Corp.*, No. MDL-1446, Civ.A. H-01-3624, 2004 WL 405886, *17 (S.D. Tex. Feb. 25, 2004) (SOX's "extended limitations period cannot revive stale claims."); *In re Enter. Mortgage Acceptance Co., Sec. Litig.*, 295 F. Supp. 2d 307, 312 (S.D.N.Y. 2003) (same); *Glaser v. Enzo Biochem, Inc.*, 303 F. Supp. 2d 724, 734 (E.D. Va. 2003) (same); *In re Heritage Bond Litig.*, 289 F. Supp. 2d 1132, 1148 (C.D. Cal. 2003) (same).

in which a price decline, under the circumstances here, would not be indicative of fraud in the least.'" *Id.* at 846. "There may be numerous reasons, other than fraud, for a stock to decline (even steeply) in price." *Id.* at 847.

Among the reasons analyzed were the stock market's inherent risk, the high volatility of Ask Jeeves' stock price, as yet undiscovered reasons other than fraud for the price drop, the plaintiffs' undisclosed investment profiles, and the fact that plaintiffs were suing the defendant and not Ask Jeeves. *Id.* at 847-48. " It may be that even if the price drop alerted them to possible fraud on the part of Ask Jeeves, it would not necessarily have alerted them to misconduct by [defendant]." *Id.* at 848. The court noted that defendant, with the benefit of further discovery, might still be able to establish inquiry notice on the plaintiffs' part at the summary judgment stage. *Id.* The court also rejected defendant's actual notice argument based on disclaimers in the analyst reports and brokerage customer agreements. *Id.* at 850-51.

The court remanded the case with a "suggestion" to the district court to consider several loss causation issues on remand, namely, whether the PSLRA warranted a change in the Eleventh Circuit's loss causation analysis or traditional pleading standards for loss causation. *Id.* at 851.

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