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Securities & Derivative Litigation Report

2004 Second Quarter Eleventh Circuit Securities Law Update

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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 April through June 2004.

NASD Arbitration

(1) *Moeller v. D.E. Frey & Co.*, No. 4:03 MC7-SPM, 2004 WL 1173397 (N.D. Fla. May 10, 2004)

Summary: A securities broker failed to establish that an arbitration panel improperly refused to postpone the arbitration hearing, exceeded its powers, issued an arbitrary and capricious award, or lacked impartiality.

Facts: A National Association of Securities Dealers ("NASD") arbitration panel issued an award in favor of customers against a brokerage firm and a broker for churning, unsuitability, misrepresentations, and breach of fiduciary duty. The customers sought to confirm the award, and the broker sought to vacate the award on statutory and non-statutory grounds because the panel allegedly refused his postponement request, failed to enforce rules regarding the proceedings, acted in an arbitrary and capricious manner, and made statements indicating a lack of impartiality.

Holding and Reasoning: The court denied the broker's motion to vacate the award and granted the customers' motion for confirmation of the award.

The court rejected each of the broker's statutory and non-statutory vacatur arguments. First, a reasonable basis existed for the panel's refusal to postpone the arbitration hearing, and the refusal did not prejudice the broker. *Id.* at *2-*3. The broker requested the postponement because of the customers' untimely disclosure of their expert report. *Id.* at *2. After the panel and counsel for all parties reached an agreement regarding the postponement, the broker changed positions and requested a postponement of two months between the customers' direct examination of their expert and the broker's cross examination. *Id.* at *3. The court stated that the broker's action "indicate[d] a lack of

[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.

good faith on his part." *Id.* Further, the court noted that the panel allowed the broker to submit his own written expert report after the hearing, thereby affording the opportunity to address the customers' expert report and testimony. *Id.*

Second, the panel did not exceed its powers by ignoring the NASD Code of Arbitration Procedure. *Id.* at *4. The panel was not required to exclude the customers' expert report and calculations under the rule governing pre-hearing exchanges between the parties because exclusion in such situations is permissive, rather than mandatory. *Id.* Also, formal rules of evidence did not constrain the panel regarding the admission of a post-hearing affidavit and brief supporting the customers' claims. *Id.*

The court also held that the award was not arbitrary and capricious. An arbitration award may be vacated as arbitrary and capricious when "a ground for the arbitrator's decision cannot be inferred from the facts of the case." *Id.* at *5 (quoting *Raiford v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 903 F.2d 1410, 1413 (11th Cir. 1990)). In this instance, the award could be inferred from the customers' allegations of churning, unsuitability, misrepresentation, and breach of fiduciary duty. *Id.*

Finally, statements by the panel's chairperson that the broker was "being obstructionist" did not reflect a bias. *Id.* Instead, the statements simply reflected frustration with the broker's tactics regarding the requested postponement. *Id.*

Pleading Requirements

(1) *Phillips v. Scientific-Atlanta, Inc.*, No. 03-13008, 2004 WL 1382906 (11th Cir. June 22, 2004)

Summary: A plaintiff's factual allegations may be aggregated to establish the strong inference of scienter required by the Private Securities Litigation Reform Act ("PSLRA"). However, scienter must be alleged as to each individual defendant and each act or omission alleged to violate the securities laws.

Facts: Plaintiffs filed a class action against a corporation and two of its officers alleging violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5. Plaintiffs alleged that defendants falsely portrayed the corporation's financial performance and overstated demand for its products. Defendants moved to dismiss the complaint, and the district court denied the motion, holding that plaintiffs had properly pleaded fraud under Fed. R. Civ. P. 9(b) and the PSLRA because the allegations in the complaint created a strong inference of scienter when viewed collectively. The district court certified the question whether "allegations that standing alone do not give rise to a 'strong inference' of scienter under the [PSLRA] may nevertheless be aggregated to create such a finding."

Holding and Reasoning: The Eleventh Circuit answered the certified question affirmatively, thereby "readily join[ing] the courts that have interpreted the PSLRA to permit the aggregation of facts to infer scienter." *Id.* at *2. "Nothing in [the PSLRA] suggests that scienter may only be inferred from individual facts, each of which alone gives rise to a strong inference of scienter, rather than from an aggregation of particularized facts." *Id.*

The court also went beyond the certified question to address defendants' argument "that a strong inference of scienter must be found with respect to each defendant and with respect to each act or omission alleged to violate the statute." *Id.* at *3. Based on the statutory language and congressional intent, the court held that a plaintiff under the PSLRA "must allege facts sufficiently demonstrating each defendant's state of mind regarding his or her alleged violations." *Id.*

(2) *In re Eagle Bldg. Techs., Inc., Sec. Litig.*, 221 F.R.D. 582 (S.D. Fla. 2004)

Summary: Plaintiffs properly pleaded what the defendant obtained as a consequence of the alleged fraud under Fed. R. Civ. P. 9(b) by alleging that the company's auditor obtained fees and positive publicity.

Facts: Plaintiffs filed a securities fraud class action against a corporation, two of its officers, and the auditor of the corporation's financial statements. The court granted the auditor's motion to dismiss because, although plaintiffs adequately pleaded scienter under the PSLRA, plaintiffs failed to allege properly "what the [auditor] obtained as a consequence of the fraud" as required by Rule 9(b). Plaintiffs filed an amended complaint elaborating on what the auditor received as a result of the alleged fraud. The auditor moved to dismiss this complaint, again arguing that plaintiffs failed to satisfy Rule 9(b).

Holding and Reasoning: The court denied the auditor's motion, holding that plaintiffs satisfactorily alleged what the auditor obtained as a result of the fraud.

The amended complaint alleged that the auditor gained the "receipt of tens of thousands of dollars in fees as well as the enhancement to [its] reputation as a nationally based accounting firm." *Id.* at 584. The court rejected the auditor's argument that the new allegations stated only what the firm gained from its engagement by the corporation, rather than what the firm received from the alleged fraud.

> Here, [the auditor] seems to miss the point; it appears that Plaintiffs claim that, without the continued fraud, there would no longer have been an engagement. Thus, as a consequence of the fraud, [the auditor] received its fees because it was still engaged as [the corporation's] auditor.

Id. at 586. The court also rejected the auditor's argument that "it is counterintuitive to assert that a professional firm, hired to perform professional services for a business entity, would participate in fraud for the mere fees it earned or the possible prestige from its engagement." *Id.* Such an argument "cannot be the basis of a motion to dismiss, as it falls far short of demonstrating beyond doubt that a plaintiff can prove no set of facts in support of its claim." *Id.*

Securities Litigation Uniform Standards Act

(1) *Steamfitters Local 449 Pension & Ret. Sec. Funds v. Quality Distribution, Inc.*, No. 8:04-cv-961-T-26MAP (M.D. Fla. June 25, 2004) (Unpublished Decision)

Summary: A class action filed in state court alleging exclusively violations of the Securities Act of 1933 is not removable under the Securities Litigation Uniform Standards Act of 1998 ("SLUSA").

Facts: Plaintiffs filed a state court class action against a corporation, certain officers and directors, and the underwriters of the corporation's initial public offering alleging violations of only the Securities Act and alleging no state law claims. Defendants removed to federal court under SLUSA's removal provisions. Plaintiffs moved for remand, arguing that SLUSA prohibits the removal of a class action securities case alleging only federal claims.

Holding and Reasoning: The court granted plaintiffs' motion for remand.

The court acknowledged that district court opinions were divided on this issue, but sided with those courts disapproving removal and holding that "the plain language of the Securities Act, as amended by SLUSA, clearly and unambiguously permits the removal of only those covered class action complaints that are based on State statutory or common law." *Id.* at 3 (quoting *Nauheim v. Interpublic Group of Cos., Inc.*, No. 02-C-9211, 2003 WL 1888843, *4 (N.D. Ill. 2003)). The court also relied upon an Eleventh Circuit decision concerning SLUSA's applicability to certain state law claims in which the court explained that a party removing an action under SLUSA must show "that . . . (2) the plaintiffs' claims are based on state law . . ." *Id.* (quoting *Riley v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 292 F.3d 1334, 1342 (11th Cir. 2002)).

Further, the court reasoned that SLUSA's language dictated the result. "[A] class action lawsuit filed in state court founded only on claimed violations of the Securities Act of 1933 cannot be removed to federal court because of the unmistakable intent of Congress . . . that the only type of class action lawsuit subject to removal is one alleging violations of a state's statutory or common law." *Id.* at 4. Although "recogniz[ing] the anomaly of deciding that a class action lawsuit filed in state court alleging federal claims cannot be removed to federal court," the court noted that it was bound to apply the statute as it found it. *Id.* at 5.

For more information about this issue of *Securities & Derivative Litigation Report,* to receive it via mail, or for information about Carlton Fields' Securities & Derivative Litigation Practice Group, contact Carlton Fields either by telephone: 888.223.9191, Ext. 4256 or 813.229.4256; by email: gsasso@carltonfields.com; by mail: Corporate Center Three at International Plaza, 4221 West Boy Scout Boulevard, Tampa, Florida 33607; or visit **www.carltonfields.com**.

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