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Welcome to the March 2014 issue of the Securities Litigation & Enforcement Newsletter. This publication is distributed by the Securities Litigation & Enforcement practice of Baker & McKenzie LLP's North American Litigation Group to highlight significant recent decisions and developments in private securities litigation and SEC enforcement.

If you have questions about any of the matters discussed, or other current topics of particular interest on which you would like more information, please feel free to contact any of us.

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Baker & McKenzie Client Prevails in SEC Lawsuit

Elizabeth Yingling

In February, an Austin, Texas federal jury ruled in favor of Baker & McKenzie client Life Partners Holdings, Inc., as well as its CEO and General Counsel, finding that none of the defendants engaged in securities fraud or insider trading, as the Securities and Exchange Commission had alleged.

After a four-day trial in U.S. District Court, the jury found for the defendants on eight of the twelve claims. The securities fraud and insider trading claims, on which the jury found in favor of the defendants, represented the "heart and soul" of the government's case, said Elizabeth Yingling, who led Baker & McKenzie's trial team along with Laura O'Rourke, Will Daugherty and Meghan Hausler.

Of the four claims on which the jury found liability, Life Partners obtained a post-verdict victory on the Section 17(a) claim. The Section 17(a) claim was based upon the SEC's allegations that the defendants had committed securities fraud due to the manner in which Life Partners had disclosed its revenue recognition policies in early 2007. The federal court agreed with Life Partners that there was no evidence to support the jury's verdict on that claim and, consequently, on March 12, 2014, entered a verdict in favor of Life Partners on that claim. As a result, the defendants were exonerated of all fraud claims asserted by the SEC.

Life Partners, headquartered in Waco, Texas, is a specialty financial services company and the parent company of Life Partners, Inc. ("LPI"). LPI, incorporated in 1991, is engaged in the secondary market for life insurance policies known generally as "life settlements." LPI facilitates the sale of life settlements between sellers and purchasers. The purchasers acquire the life insurance policies at a discount to their face value for investment purposes.

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"We are very pleased with both the jury verdict and [the Court's] ruling, " Life Partners CEO Brian Pardo said in a statement. "Now that we have moved past these accusations of fraud, we can move forward as a company bringing value to both senior Americans and our shareholders."

The trial victory attracted national media attention as a notable win against the SEC, which has been aggressive in its enforcement of insider trading claims in recent years.

The United States Supreme Court Revisits "Fraud on the Market" Reliance

Colin H. Murray and Christina Wong

On March 5, 2014, the Supreme Court heard oral arguments in the landmark securities class action case, *Halliburton v. Erica P. John Fund, Inc.*, to decide whether the Court should overrule or modify its previous ruling in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988). The *Basic* decision recognizes a presumption of class-wide reliance based on "fraud-on-the-market," as opposed to specific reliance on fraudulent misrepresentations or omissions. The Supreme Court also considered whether a company may rebut a presumption of reliance (to prevent class certification) by introducing evidence that the alleged misrepresentations had no impact on the market price of its stock.

The Supreme Court's line of questioning over the hour-long oral argument suggests that the Court remains largely divided whether to overrule, modify or uphold the over 25-year-old precedent announced in *Basic*. In *Basic*, the Court recognized a "fraud on the market" theory, which presumes that an efficient market incorporates all public information about a company in determining the company's stock price, including allegedly misleading statements. This presumption allows investors to satisfy the reliance requirement of a Section 10(b) (of the Securities Exchange Act) and SEC Rule 10b 5 in a securities fraud class action without demonstrating actual reliance upon any specific misrepresentations. In practical effect, the Court's "fraud on the market" theory has allowed plaintiffs to satisfy the requirements for class certification easily, leading to large class action settlements.

At least four of the justices on the liberal wing of the Court expressed varying degrees of support *Basic*. Justice Kagan pointed out that Congress had enacted securities reforms yet declined to overrule *Basic*. Justice Kennedy, a frequent swing vote, seemed interested in exploring a compromise short of overturning *Basic*, namely, adopting a requirement that plaintiffs submit economic "event studies" at the class certification stage to demonstrate that the alleged misrepresentations substantially affected the stock price.

With the Court apparently split, the future of *Basic* is unclear. While overruling *Basic* would have a profound impact on the future of securities class action suits (vastly reducing them) the practical impact of a compromise decision is uncertain.

Canadian Domiciled Companies Await the US Supreme Court's Ruling in *Halliburton Co. v. Erica P. John Fund Inc*.

John J. Pirie and David Gadsden

The U.S. Supreme Court's approval of the fraud on the market theory in *Basic v. Levinson* expanded securities class actions in the US from 1988 to date, and the theory has found its way into securities litigation in neighboring jurisdictions, most notably in Canada. Currently, in Canada, it remains unclear as to whether there exists a fraud on the market presumption of reliance at common law (although provincial statutory liability in Canada exempts plaintiffs from the need to prove reliance where there has been secondary market misrepresentation, but with express liability ceilings).

Canadian domiciled companies are watching the *Halliburton* case with particular interest. These issuers are increasingly facing the fraud on the market presumption as the increasing trend toward parallel US/Canada filings continues. According to a recent report issued by Mark Berenblut and Bradley Heys of NERA Economic Consulting ("Trends in Canadian Securities Class Actions: 2013 Update") as of December 2013, there were 54 Canadian securities class actions pending, representing more than $19 billion in claims. In 2013 alone, there were 10 new securities class actions filed in Canada. Eight of the actions involved securities listed on the Toronto Stock Exchange (TSX), with six of these issuers also being cross-listed on US exchanges. Each of these companies faces significant, parallel securities class actions filed in the US.

When considered against this backdrop, the upcoming decision in *Halliburton* will be very important for both US and Canadian companies that are exposed to Rule 10b-5 liability. The decision is also expected to play a key role in shaping Canadian common and civil law with respect to the principle of reliance in securities class actions.

Supreme Court Watch: The Sarbanes-Oxley Act of 2002 Shields Both Employees of a Public Company and Employees of its Privately Held Contractors and Subcontractors

Teresa H. Michaud

On March 4, 2014, the Supreme Court held that a provision of the Sarbanes-Oxley Act of 2002, 116 Stat. 745, shields not only employees of a public company from retaliation for whistleblowing, but also shields the employees of privately held contractors and subcontractors who report violations to the SEC from retaliation by their privately held employers. *Lawson v. FMR LLC*, No. 12-3, 2014 U.S. LEXIS 1783 (March 4, 2014) (interpreting 18 U.S.C. § 1514A). Justice Ginsburg noted in her opinion for the Court that this interpretation of 18 U.S.C. § 1514A, sheltering accountants, lawyers and other consultants to the

public company, was both consistent with the text of the statute and "common sense."

The petitioners in *Lawson* included two former employees of privately held companies that had provided advisory and management services to the Fidelity family of mutual funds. Notably, the Fidelity funds themselves have no employees, which is common in the mutual fund industry. Petitioner Lawson alleged that, after she raised concerns about certain cost accounting methodologies, believing operating expenses of the mutual funds had been overstated, she suffered a number of adverse employment actions and was constructively discharged. Petitioner Zang alleged that he was fired in retaliation for raising concerns about inaccuracies in a draft SEC registration statement. Because the FMR subsidiaries were privately held, FMR maintained that § 1514A was meant to protect only employees of public companies--i.e., companies that either have a class of securities registered under section 12 of the Securities Exchange Act of 1934 or that are required to file reports under section 15(d) of that Act.

The District Court in Massachusetts rejected FMR's argument, but a divided panel of the First Circuit Court of Appeals reversed the decision in an interlocutory appeal. Several months later, the Department of Labor's Administrative Review Board issued a decision in an unrelated case disagreeing with the Court of Appeals' interpretation of § 1514A. The Supreme Court then granted certiorari to resolve the differences in opinion and rejected FMR's interpretation.

The Supreme Court's opinion in *Lawson* discussed both the context and purpose of the Sarbanes-Oxley Act, noting that during its investigations following Enron, Congress learned that when employees of Enron and its accounting firm, Arthur Anderson, attempted to report corporate misconduct, they faced retaliation, including discharge. Justice Ginsberg further noted that, because of these findings, the Sarbanes-Oxley Act contains numerous provisions aimed at controlling the conduct of accountants, auditors, and lawyers who work with the company. "Given Congress' concern about contractor conduct of the kind that contributed to the Enron collapse, [the Court regards] with suspicion construction of § 1514A to protect whistleblowers only when they are employed in a public company and not when they work for the public company's contractor." Ultimately, therefore, the Court determined that § 1514A must be read to protect employees of private contractors to the public company from retaliation for whistleblowing in order to fulfill Congress' purpose for the Act.

Supreme Court Watch: Interpretation of the "In Connection With" Requirement of SLUSA

Meghan E. Hausler

On February 26, 2014, the Supreme Court, in a 7-2 ruling, held that the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), which forbids plaintiffs from bringing securities class actions for violations of state law where the plaintiffs allege "a misrepresentation or omission of a material fact *in connection with* the purchase or sale of a *covered*

security,” does not prevent plaintiffs from bringing class actions based on state law where plaintiffs allege that they purchased *uncovered* securities (in this case, certificates of deposit sold by Stanford Bank) based on defendants’ misrepresentation that the uncovered securities were backed by covered securities. *Chadbourne & Parke LLP v. Troice,* 571 U.S. ___ (2014). The Court specifically held that “[a] fraudulent misrepresentation is not made ‘in connection with’ such a ‘purchase or sale of a covered security’ unless it is material to a decision by one or more individuals (other than the fraudster) to buy or to sell a ‘covered security.’” In other words, the Court held that SLUSA does not prohibit state law claims “when the fraud bears so remote a connection to [a covered security] that no person actually believed he was taking an ownership position in [a covered security].”

In so holding, the Court pointed to the narrow scope of “covered securities,” which SLUSA defines to include only securities traded on a national exchange or issued by investment companies, and noted that SLUSA “expresses no concern” regarding the purchase or sale of uncovered securities. The Court found that its interpretation of the “in connection with” requirement supported Congress’s goals in enacting SLUSA—reduction of abusive class-action lawsuits and mitigation of legal costs for firms and investment professionals that participate in the market for nationally traded securities. The Court also noted that its interpretation of SLUSA’s “in connection with” requirement is consistent with the same requirements in the Securities Act of 1933 and the Securities Exchange Act of 1934, which apply to a much broader definition of “securities,” including any note, stock, treasury stock, security future, security-based swap, bond, debenture, or certificate of deposit for a security.

The dissent and an amicus brief filed by the SEC expressed concern that a narrow interpretation of “in connection with” could limit the Commission’s authority, but the Court dismissed these concerns by noting that SLUSA is inapplicable to the government, whose authority extends to all “securities” and is not limited to “covered securities.” The Court also noted that neither the SEC nor the dissent had identified a single enforcement action that the Court’s decision would have prevented the SEC from bringing. Indeed, all of the proceedings identified by the SEC involved defrauded investors who had tried to take an ownership interest in the relevant securities and would thus satisfy the Court’s interpretation of the “in connection with” requirement.

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