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Securities Litigation Trends

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LITIGATION UPDATE: RECENT TRENDS IN SECURITIES LITIGATION

RECENT DECISIONS

Supreme Court Grants Certiorari to Resolve Circuit Split Regarding Scope of SLUSA Preemption

CERTIORARI GRANTED IN MERRILL, LYNCH, PIERCE, FENNER & SMITH, INC. V. DABIT, 2005 U.S. LEXIS 5414 (SEPT. 27, 2005)

The United States Supreme Court has agreed to resolve a split among the Circuit Courts of Appeals concerning the scope of preemption under the Securities Litigation Uniform Standards Act ("SLUSA"). Among other things, SLUSA preempts certain state-law class action claims based on alleged misrepresentations or omissions "in connection with the purchase or sale" of nationally traded securities. *See* 15 U.S.C. §§ 77p, 78bb(f). The purpose of this provision of SLUSA is to prevent plaintiffs from circumventing federal pleading and other rules governing securities litigation by filing state-law class action securities claims.

Earlier this year, the Seventh Circuit held in *Kircher v. Putnam Funds Trust*, 2005 U.S. App. LEXIS 7914 (7th Cir. May 2, 2005), that the "in connection with" language in SLUSA is not limited to purchasers and sellers of securities but, rather, extends to state-law class actions brought on behalf of plaintiffs who refrain from purchasing or selling securities (so-called "holder claims") based on the alleged misrepresentations and omissions. By contrast, the Second Circuit ruled in *Dabit v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 395 F.3d 25 (2d Cir. 2005), that SLUSA does not preempt such actions. In reaching its conclusion, the Second Circuit noted that SLUSA does not define "in connection with." Thus, the court reasoned that it should apply the definition applicable to private claims under Section 10(b) of the Exchange Act and Securities and Exchange Commission Rule 10b-5, as delineated by the Supreme Court in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975). Unlike the Seventh Circuit, the Second Circuit held that SLUSA preemption is limited to state-law class actions brought by plaintiffs alleging they purchased or sold securities in reliance on alleged misrepresentation or omissions, and not to holder claims.

The Supreme Court is set to resolve the split next term. The question as framed for the court is "[w]hether, as the Seventh Circuit held earlier this month and in direct conflict with the [Second Circuit's] decision below, SLUSA preempts state law class action claims based upon allegedly fraudulent statements or omissions brought solely on behalf of persons who were influenced thereby to hold or retain (and not purchase or sell) securities?"

Failure to Properly Allege a Violation of Section 10(b), and Securities and Exchange Commission Rule 10b-5, Does Not Preclude A Claim for Controlling-Person Liability Under Section 20(a)

IN RE STONE WEBSTER, INC., SEC. LITIG., 2005 U.S. APP. LEXIS 19718 (1ST CIR. SEPT. 13, 2005)

The First Circuit declined to rehear its prior decision affirming the dismissal of claims against defendants for violations of Section 10(b) of the Securities Exchange Act ("Act") and Rule 10b-5 promulgated thereunder, while reversing dismissal of claims against them for controlling-person liability under Section 20(a) of the Act. The plaintiffs brought Rule 10b-5 claims against engineering firm Stone & Webster, Inc. ("S&W") and S&W officers Kerner Smith and Thomas Langford ("Smith & Langford"), as well as controlling-person claims against Smith & Langford under Section 20(a) of the Act. The controlling-person claims were predicated on the alleged Rule 10b-5 violations by S&W. After staying the matter as it pertained to S&W when the company filed for bankruptcy protection, the district court dismissed all claims against Smith & Langford because the plaintiffs' complaint did not allege facts supporting a strong inference of *scienter* on the part of either of them.

The First Circuit affirmed the dismissal of the Rule 10b-5 claims against Smith & Langford, but reversed the dismissal of the controlling-person claims. In denying the defendants' petition for rehearing, the First Circuit noted that in order to state a Section 20(a) controlling-person claim, a plaintiff must allege a Rule 10b-5 violation *by the controlled entity*. Because the plaintiffs' complaint included controlling-person claims against Smith & Langford predicated on Rule 10b-5 violations by S&W that were not dismissed, the First Circuit stated that its decision affirming dismissal of the Rule 10b-5 claims against Smith & Langford was "in no way incompatible" with its decision to allow the plaintiffs' controlling-person claims against them to proceed.

Maryland District Court Finds Attorney Memoranda From Internal Audit Investigation Discoverable in Securities Litigation

IN RE ROYAL AHOLD N.V. SEC. & ERISA LITIG., 2005 U.S. DIST LEXIS 19489 (D. MD. SEPT. 8, 2005).

The District Court of Maryland compelled defendants in a class action securities fraud case to produce attorney notes and memoranda reflecting witness interviews conducted as part of a pre-suit investigation into accounting irregularities and fraud. The defendants had employed outside accountants to complete work necessary to issue its audited 2002 financial statements, which were critical to the defendants' receipt of €3.1 billion in financing. The audit was later suspended when accounting irregularities were discovered, and an internal investigation ensued. As part of a subsequent securities fraud class action, the plaintiffs sought to compel the production of memoranda created by counsel during witness interviews taken as part of the investigation.

In granting the plaintiffs' motion, the district court held that the documents were not immune from discovery under the work product immunity doctrine. The court noted that although the defendants were also preparing for litigation at the time of the investigation, the investigation would have been undertaken even without the prospect of defending a civil suit. The court also found that the defendants had waived any protections that may have been afforded to the documents. In making its finding, the court pointed out that the defendants: (1) had disclosed information contained in the witness interview memoranda in the defendants' Form 20-F filed with the Securities and Exchange Commission; (2) had turned over to the lead plaintiffs several key investigative reports that quoted from memoranda; and (3) had disclosed several of the memoranda to the Securities and Exchange Commission ("SEC") pursuant to a protective order that granted the SEC substantial discretion to later use the memoranda.

The court also rejected defendants' attempt to apply, on a blanket basis, opinion work product protection to the memoranda. The court noted that while such a theory would protect memoranda reflecting the mental impressions or legal theories of the defendants' counsel, an *in camera* inspection of certain of the memoranda revealed that they merely contained recitals of witness statements. Thus, the court compelled the defendants to produce the memoranda, except as to those portions that the defendants could specifically demonstrate revealed the mental impressions or legal theories of counsel.

VEDDER, PRICE, KAUFMAN & KAMMHOLZ, P.C.

About Vedder Price

Vedder, Price, Kaufman & Kammholz, P.C. is a national, full-service law firm with approximately 225 attorneys in Chicago, New York City and New Jersey.

The firm has actively engaged in the litigation and arbitration of numerous securities cases including the prosecution or defense of companies and individuals, including corporate directors and officers, in connection with claims involving the sale of unregistered securities, fraud in connection with the purchase or sale of securities, broker-dealer responsibilities, and insider trading and include the precedent setting case before the U.S. Supreme Court, *Gustafson*, holding that Section 12(a)(2) liability cannot attach unless there is an obligation to distribute the prospectus.

If you have any questions regarding material in this issue of *Securities Litigation Trends* or suggestions for a specific topic you would like addressed in a future issue, please contact the editor, **Thomas P. Cimino, Jr., at 312/609-7784** or at tcimino@vedderprice.com, or **Jon P. McCarty** (312/609-7572 or jmccarty@vedderprice.com). **Ursula Taylor** (312/609-7635 or utaylor@vedderprice.com) assisted in the publication of this issue.

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