Robbins Geller Rudman & Dowd LLP

Corporate Governance Bulletin

2nd Quarter 2011

IN THIS ISSUE

FEATURES

Plaintiffs Win U.S. Supreme Court Decision in *Matrixx* 1,7

Financial Crisis Inquiry Commission's Report Released 2,6

Plaintiff Prevails Over Morgan Stanley's Attempt to Dismiss 3

DEPARTMENTS

Litigation Update 4-5

Settlement Update 6

Recommended Reading 7

Calendar of Upcoming Events 8

Plaintiffs Win U.S. Supreme Court Decision in *Matrixx*

Issuing a rare unanimous decision, the United States Supreme Court upheld a plaintiffs' securities fraud complaint against pharmaceutical maker Matrixx Initiatives, Inc. The high court's ruling, issued March 22nd, affirms a 2009 holding from the Ninth Circuit Court of Appeals. Closely watched by both the business and legal communities, the matter renewed the Supreme Court's scrutiny on two hot-button issues in securities litigation: the adequate pleading of facts showing materiality and defendants' state of mind, or "scienter."

The securities fraud case had its genesis in product liability concerns about a nasal spray that some suspected was linked to the loss of the sense of smell in some users. Matrixx, an Arizona pharmaceutical corporation, marketed Zicam Cold Remedy, which contained zinc gluconate formulated in both a nasal spray and gel. Since the 1930s, intranasal application of zinc was a suspected cause of potential damage to the sense of smell, or "anosmia" – in some cases a permanent loss.

As reports began to surface suggesting a connection between Zicam nasal spray use and anosmia, Matrixx began vigorous damage-control actions. First, the drug manufacturer vehemently denied any link between Zicam and the possible loss of the sense of smell, sending chilling warning letters to the medical professionals who planned to bring up the possible Zicam-anosmia link at the 2003 annual meeting of the American Rhinologic Society. Matrixx also issued press releases blasting the allegations as "completely unfounded and misleading," reassuring investors that Zicam's safety had been "well established" in clinical trials.

Finally, concerns about the links between Zicam and olfactory damage received nationwide attention in a *Good Morning America* exposé in February 2004. The news program reported that medical experts who specialized in smelling-loss disorders had treated more than a dozen patients who had experienced anosmia shortly after using Zicam nasal products, and that several product liability suits had been filed against Matrixx. Following the revelations, Matrixx's stock price plummeted some 23% in a single day.

Responding to these stunning revelations, plaintiffs – led by **NECA-IBEW Pension Fund (The Decatur Plan)** – prosecuted a securities fraud suit in which they alleged that Matrixx did not disclose to investors that the company was keenly aware of reports from a number of Zicam users who had suffered a loss of their sense of smell after using Matrixx's product. Based upon an extensive investigation by class counsel, plaintiffs were able to plead the numerous instances in which Matrixx had been warned repeatedly over several years, both by Zicam consumers and medical specialists, that the Zicam nasal product was linked with that horrific side effect.

Still, a federal district court in Arizona ruled in favor of the *Matrixx* defendants, holding that unless plaintiffs could show that the number of anosmia complaints rose to a so-called "statistically significant" level, as a matter of law the information could not have been material. Without statistical significance, concluded the court, Matrixx had neither made any material misstatements nor acted with scienter.

Plaintiffs appealed the dismissal to the Ninth Circuit Court of Appeals, and secured a reversal of the federal district court in October 2009. The Ninth Circuit held that the district court's reliance on a "statistical significance" baseline violated the Supreme Court's rejection of "bright-line" materiality rules in the seminal *Basic Inc. v. Levinson* decision. Moreover, the Ninth Circuit ruled that plaintiffs had sufficiently pleaded a strong inference of defendants' scienter, finding that Matrixx's deliberate withholding of information relating to Zicam's adverse effects and the related lawsuits was an "extreme departure from standards of ordinary care."

Continued on p. 7

Financial Crisis Inquiry Commission's Report Released

"The financial crisis was and is a failure of governance." -Robert A.G. Monks

In the aftermath of enormous losses suffered by pension funds and institutional investors, many look to the Financial Crisis Inquiry Commission's recently released final report to shine a light on the causes of the meltdown, with a view to prudently averting or mitigating further similar financial disasters.

Nearly two years after its creation by Congress, the National Commission on the Causes of the Financial and Economic Crisis in the United States has published its findings (the "Report"), which have wide-ranging significance for investors and policymakers alike. Published both as a book and available online at www.fcic.gov, the Report summarizes the findings of the Commission's 10 appointees and 93 staff in three separate narratives, reflecting the diversity of opinion within the Commission.

"This financial crisis was avoidable."

Following numerous public hearings held in Washington, D.C., California, and Nevada, the Commission's detailed 662-page narrative is backed by findings obtained during its 19 hearings, interviews with over 700 witnesses, and from review of millions of pages of relevant documents. Supported by this evidence, the Commission's Report concludes that the crisis that led to the loss of millions of American jobs, over 4 million foreclosures, and the destruction of $11 trillion in wealth was a "result of human action and inaction."

"[D]ramatic failures of corporate governance and risk management at many systemically important financial institutions were a key cause of this crisis."

Even prior to the stunning revelations of Enron's malfeasance, activist shareowners have demanded increased attention be paid to corporate governance practices and prudent risk management to protect assets from the short-term interest of unaccountable managers. Although the bipartisan Commission's analysis frequently divided along fairly predictable political lines, the Commission was nearly unanimous in one area: the failure of private management decisions. Restated in the words of noted shareholder activist Robert A.G. Monks, "The financial crisis was and is a failure of governance." The Report details the mind-boggling failure of management teams at systemically important financial institutions to manage risk, and of corporate boards who were ultimately responsible for management decisions. The Report drives home its conclusions with numerous examples of the reckless behavior of financial institutions that piled on staggering amounts of risk and leverage, "the equivalent of a small business with $50,000 in equity borrowing $1.6 million, with $296,750 of that due each and every day." In his commentary on the Report, Harvard Business School's Ben Heineman reiterates a core point, the "massive failure of private sector decision-making" at critical financial institutions, including Citigroup, AIG, Countrywide and Merrill Lynch, is to blame: "They, not the government, drove us to the edge of another Great Depression."

"[W]idespread failures in financial regulation and supervision proved devastating to the stability of the nation's financial markets."

What does the Commission's Report mean for regulatory reform? The perils of traveling what the late Al Meyerhoff called "the deregulation superhighway" are well-detailed, and the Report takes pains to single out the consequences of the teardown of the post-Depression financial regulatory framework, a carefully crafted structure that had provided the foundation for decades of America's steady post-War growth and expansion of the middle class. Important reforms created under FDR, including the 1933 Glass-Steagall Banking Act, had been diluted, "modernized" or repealed during the last two decades, meaning that the cops had been taken off the Wall Street beat, and "[t]he sentries were not at their posts." It gives us no reassurance that just days before the demise of Bear Stearns, SEC Chairman Christopher Cox went on the record to express his "comfort about the capital cushions" at the big investment banks. Within six months, Lehman Brothers would be receiving last rites. Incompetent regulators can be worse than none at all.

The Greenspan Doctrine – the belief that financial markets will balance themselves through self-regulation and financial innovation – appears to have been utterly repudiated by the events of the last three years. One

Continued on page 6

News Brief

The Third Annual Future of Corporate Reform Public Funds Forum

GovernanceMetrics International (formerly The Corporate Library), a leading source for independent corporate governance information and analysis, is pleased to announce its third annual **The Future of Corporate Reform Public Funds Forum**, an invitation-only educational conference. Designed to educate representatives of public pension funds with the knowledge and tools to create long-term value and shape corporate reform, the 2011 Forum will be held from September 6-8 at the Ritz-Carlton Half Moon Bay, not far from San Francisco and Silicon Valley. **Robbins Geller Rudman & Dowd LLP**, the premier securities litigation firm, and Gilardi & Co. LLC, class-action administration experts, will also be sponsoring the event.

Officials from public pension systems throughout the United States and abroad will meet to participate in panel discussions ranging from investment strategies for public funds, the use of private securities actions as remedies, and a review of new tools being used to protect assets. The keynote address will be delivered by former California Governor Arnold Schwarzenegger. Other speakers will include Arianna Huffington, founder of *The Huffington Post*; Robert A.G. Monks, founder of GovernanceMetrics International, and Ben Stein, Economist and Hollywood Personality.

In addition to educational sessions and informative panel discussions, an exciting variety of activities will allow guests ample opportunity to network and build relationships. A Taste of the Mediterranean themed dinner, dinner and dancing at Carnival, horseback riding along the California coast, a Santa Cruz wine tasting tour and golf at Half Moon Bay compliment the Forum's offerings.

For the most current information about the sessions agenda and to register, please visit: www.GMIconferences.com.

Plaintiff Prevails Over Morgan Stanley's Attempt to Dismiss

On February 25, 2011, Judge Melvin L. Schweitzer of the Supreme Court of the State of New York signed an order denying defendant Morgan Stanley's motion to dismiss a lawsuit accusing it of structuring, soliciting and selling a fraudulent $275 million collateralized debt obligation ("CDO") to Taiwan-based plaintiff China Development Industrial Bank ("CDIB").

Before the subprime disaster of 2008, Wall Street banks such as Goldman Sachs and Morgan Stanley were saddled with toxic mortgage assets, including subprime bonds. While rating agencies called the mortgage-backed securities "investment grade," the models used to obtain these ratings were flawed, and the Wall Street banks and rating agencies knew it. In the words of Raymond McDaniel, Moody's CEO, "Everything was investment grade. It didn't really matter." The insiders began to bet against the success of particular bonds (and their underlying mortgages), and began a campaign to foist these off on industry outsiders (including CDIB) before news of the souring of the subprime market became public. In Goldman's case, the infamous Abacus 2007-AC1 CDO led to a criminal probe, an SEC investigation and a $550 million settlement.

In CDIB's case, Morgan Stanley sold CDIB $275 million in exposure to a product known as the STACK CDO in April 2007. CDIB alleged that Morgan Stanley represented that the STACK CDO was "higher than AAA in safety, 'an almost risk free asset to carry' and 'impossible' to fail." Because the instrument was so safe, CDIB was to make only 0.52% in interest on its investment. However, plaintiff alleged that the ratings given to the notes issued by the STACK CDO were meaningless: Morgan Stanley had "manipulated the rating agencies' models to create the STACK CDO's balance sheet." Morgan Stanley allegedly "paid the [r]ating [a]gencies 'three times' more to create the CDOs than traditional corporate bonds. Morgan Stanley gave them 'repeat player' payments only if the [r]ating [a]gencies gave Morgan Stanley the ratings it wanted." Plaintiff further alleged that Morgan Stanley knew that the rating agencies delayed changing their models to reflect changing conditions in the mortgage-backed asset market until "after the STACK CDO was created in June 2006, but before it sold that investment to CDIB in March 2007." Internally the rating agencies knew (and plaintiff alleged that Morgan Stanley knew) that their models did not accurately reflect the risk of the investments, and in the words of Standard & Poor's employees, a CDO "could be structured by cows and we would rate it," and "How many millions does Morgan Stanley pay us in the greater scheme of things?" With respect to Morgan Stanley insisting on the use of an old rating methodology, an S&P employee wrote in an email, "Lord help our [expletive deleted] scam."

The supposed safety of the STACK CDO, which meant ideally CDIB eked out a meager 0.52%, came crashing down in short order after CDIB entered into the transaction. Morgan Stanley's old subprime assets now in the STACK CDO began to default, and Morgan Stanley began to call CDIB for funds to cover the impairment of the assets. CDIB made payments of over $150 million by April 2008 and over $190 million by the end of 2008. In response to CDIB's outrage over a "safe" investment turning into a financial calamity, "Morgan Stanley threatened to label CDIB with 'default' should it fail to make payments" – adversely affecting CDIB's other business efforts. CDIB lost $228 million in total in the STACK CDO due to Morgan Stanley's continuing margin calls. In light of news of Goldman's Abacus deal and resulting investigations, and how similar deals were structured to rid banks of toxic assets, CDIB refused to pay a $12 million demand and then filed suit in New York in July of 2010.

Morgan Stanley first moved to dismiss CDIB's complaint contending that there were no actionable statements made against it. Judge Schweitzer disagreed, stating that CDIB's allegations of a troubled investment with flawed ratings due to Morgan Stanley's influence were sufficiently detailed. The judge added that in denying Morgan Stanley's motion to dismiss plaintiff's allegation of fraudulent concealment, "Morgan Stanley had a duty to disclose relevant facts, including the 'grandfathering' of rating methodologies and the payment of extraordinarily high performance fees, regarding its own involvement in the ratings process because of its sole knowledge of those facts."

Judge Schweitzer also agreed with CDIB that its complaint sufficiently alleged that Morgan Stanley participated in, or knew about, the fraud. These allegations of scienter included the description of "Morgan Stanley's close relationship with, and alleged influence over" the agencies giving ratings that Morgan Stanley knew did not reflect the true, flawed nature of the assets underlying the STACK CDO deal and the risk it presented to CDIB.

Morgan Stanley's motion to dismiss also claimed that CDIB could not claim to have justifiably relied on its statements and marketing materials because CDIB had signed the transaction agreement stating that it relied on its own judgment and acknowledging that defendant made no guarantee as to the expected results. The judge declined to take Morgan Stanley's position, pointing out its "pitch admitted that the CDO had no employees or operating history and advised that requests for additional information be made to Morgan Stanley." The judge further wrote that CDIB had adequately alleged "a set of circumstances constituting fraud, with respect to the investment here, that could not have been discovered by any degree of due diligence or analysis performed by the most sophisticated of investors."

Robbins Geller Rudman & Dowd LLP attorneys **Samuel H. Rudman**, **Spencer A. Burkholz**, **Robert M. Rothman**, **Jason C. Davis**, **Mark T. Millkey** and **Maureen E. Mueller** successfully opposed Morgan Stanley's motion to dismiss on behalf of CDIB.

China Development Industrial Bank v. Morgan Stanley & Co. Inc., No. 650957/2010, Decision and Order (N.Y. Sup. Ct. Feb. 25, 2011).

Litigation Update

Motion to Dismiss MBIA Can't Get Away

On February 28, 2011, the United States Court of Appeals for the Second Circuit vacated a Southern District of New York court's order dismissing lead plaintiffs (and appellants) **City of Pontiac General Employees' Retirement System** and **Southwest Carpenters Pension Trust's** class action complaint against MBIA, Inc. In its dismissal order, the district court ruled that plaintiffs' claims were barred by the statute of limitations. Citing a recent decision of the U.S. Supreme Court, the Second Circuit reinstated the proposed class action and observed that under current federal law, the statute of limitations could not have run as early as the lower court (and defendants) had contended.

MBIA's primary business is insuring bonds issued by its clients. MBIA's "Triple-A" rating reduces the clients' interest costs when issuing debt, allowing MBIA to charge a premium for its services. However, in 1998, a medical group insured by MBIA went into bankruptcy and their bonds became worthless, leaving MBIA facing a $170 million loss on the deal. Plaintiffs alleged that, rather than post their first-ever quarterly loss, senior executives of MBIA caused the bond insuring company to enter into retroactive sham transactions with three reinsurers to cover up the $170 million loss in exchange for agreeing to retain the reinsurers for three years on future top-rated bond reinsurance deals that had virtually no risk, thus allowing the reinsurers to profit from the deal despite the initial outlay. This would allegedly allow MBIA to avoid recognizing a loss in 1998 (sullying their "Triple-A" rating) and instead offset the loss with "insurance proceeds" and overstate their reported income from 1998 to 2003.

In 2004, MBIA revealed that the Securities and Exchange Commission ("SEC") and the New York Attorney General's ("NYAG") office had issued subpoenas to the company regarding MBIA's insurance products. In March 2005, MBIA acknowledged the impropriety of $70 million in reinsurance agreements with one of the three reinsurers and restated its financial statements for 1998 to 2003. A day after this announcement, MBIA revealed that it had received an NYAG subpoena for information on the ill-fated $170 million bond insurance deal and the reinsurance agreements resulting from it. A few weeks later, MBIA revealed that the previously announced government investigations had broadened and that it had received more requests for information from the NYAG and SEC. Plaintiffs filed their suit shortly thereafter, in April 2005. In November 2005, MBIA restated the remaining $100 million of the reinsurance deals. In 2007, MBIA settled with the SEC and the NYAG over the matter, confirming the restatements and paying $75 million in penalties and disgorgement.

In moving to dismiss plaintiffs' complaint, defendants claimed that plaintiffs had filed their proposed class action too late, and that the statute of limitations had started by 2002, when the transaction was discussed in trade press and analyst reports. Although MBIA's chairman denied the 2002 reports of accounting impropriety on the reinsurance deal, calling them "patently wrong," the district court ruled in September 2009 that the reports were sufficient to put the proposed class of MBIA investors on "inquiry notice" by December of 2002. In so holding, the court ruled that the statute of limitations started when a reasonable investor would begin to investigate the possibility of a fraud. Because plaintiffs did not file until 2005, the judge ruled that the statute had run, and the complaint was dismissed.

Plaintiffs appealed the ruling to the Second Circuit in November 2009, and the case was argued in November 2010. After the district court dismissal, but prior to the oral argument, the U.S. Supreme Court decided a case that was to have a significant effect in the *MBIA* matter. The Supreme Court case, *Merck & Co. v. Reynolds*, 130 S. Ct. 1784 (2010), overruled the "inquiry notice" standard previously used in the Second Circuit. Instead of the statute of limitations running from the date the court determined a reasonable investor should have begun investigating a fraud, *Merck* held that, in the Second Circuit's words, the limitations period begins "when such a reasonable investor conducting such a timely investigation would have uncovered the facts constituting a violation."

In its analysis of *Merck's* application to the *MBIA* case, the Second Circuit observed that a plaintiff would need to be able to show the elements of a violation of securities law, including scienter (defendant's state of mind, or whether defendant has acted with fraudulent intent), sufficiently enough to survive a motion to dismiss: "Only after a plaintiff can adequately plead his claim can that claim be said to have accrued, and only after a claim has accrued can the statute of limitations on that claim begin to run." When considering inquiry notice, in the district court's dismissal order, the statute of limitations was considered to have begun in December 2002. However, plaintiffs' proposed class period did not begin until August 2003: "This means (under the district court's analysis) that the statute of limitations period began to run more than six months before the first stock purchase giving rise to the class's claims. That cannot be." The dismissal was vacated and the case remanded to the district court.

The litigation team at Robbins Geller Rudman & Dowd LLP, consisting of **Samuel H. Rudman**, **Sandy Svetcov**, **David Rosenfeld**, **Susan K. Alexander** and **Mario Alba**, was responsible for this win.

City of Pontiac General Employees' Ret. Sys. v. MBIA, Inc., No. 09-4609-cv, 2011 U.S. App. LEXIS 3813 (2d Cir. Feb. 28, 2011).

Second Circuit Overturns Blackstone Dismissal

On February 10, 2011, the United States Court of Appeals for the Second Circuit reversed the decision of a New York District Court judge dismissing a securities class action against the Blackstone Group, L.P. and certain executives of the company. The suit alleges negligent misrepresentations and omissions in the Registration Statement and Prospectus (the "Offering Materials") for Blackstone's June 21, 2007 initial public offering (the "IPO"), and asserts claims under Sections 11, 12(a)(2), and 15 of the Securities Act of 1933.

Blackstone is a leading global alternative asset manager and provider of financial advisory services. As of May 1, 2007, Blackstone had more than $88 billion under management. Plaintiffs allege that at the time of the IPO, two of Blackstone's portfolio companies, as well

as its real estate fund investments, were experiencing problems that would materially affect the Company's future revenues, and that should have been disclosed in the Offering Materials.

Specifically, plaintiffs allege that the Offering Materials failed to disclose: (1) that FGIC Corporation, a financial guarantor in which Blackstone held a $331 million equity interest, was exposed to billions of dollars in non-prime mortgages; (2) that Freescale Semiconductor, Inc., a semiconductor designer and manufacturer in which Blackstone invested $3.1 billion, had recently lost an exclusive agreement with its largest customer; and (3) that the downward trend in the real estate market would have a foreseeable impact on Blackstone's ability to generate performance fees. In addition, plaintiffs allege that the Offering Materials affirmatively misrepresented the strength of the real estate industry.

On September 22, 2009, the New York District Court granted defendants' motion to dismiss, concluding that plaintiffs had not sufficiently alleged one of the elements of their claims – the materiality of misrepresentations and omissions at issue. The District Court did not give plaintiffs permission to amend their complaint.

In reversing the dismissal on appeal, the Second Circuit elucidated both the disclosure requirements and the materiality standard of the federal securities laws. First, the court endorsed plaintiffs' argument that defendants had a disclosure obligation under SEC Regulation S-K (17 C.F.R. §229.303(a)(3)(ii)), which requires a registrant to "[d]escribe any known trends or uncertainties . . . that the registrant reasonably expects will have a material . . . unfavorable impact on . . . revenues or income from continuing operations."

Specifically, the court stated: "Plaintiffs allege that the downward trend in the real estate market was already known and existing at the time of the IPO, and that the trend or uncertainty in the market was reasonably likely to have a material impact on Blackstone's financial condition. Therefore, plaintiffs have adequately pleaded a presently existing trend, event, or uncertainty, and the sole remaining issue is whether the effect of the 'known' information was 'reasonably likely' to be material for the purpose of Item 303 and, in turn, for the purpose of Sections 11 and 12(a)(2)." In so holding, the court rejected the "sweeping proposition," advocated by the defendants, "that an issuer of securities is never required to disclose publicly available information."

The court then turned to the question of materiality, which it characterized as "inherently fact-specific." For a statement or omission to be material, there must be a "substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." In concluding that the statements and omissions before it were material, the court articulated a number of important principles that should aid plaintiffs in attempting to assert similar claims in the future.

For example, although there is a five percent numerical threshold for materiality, that threshold is merely a "starting place" for analysis. Courts must consider both quantitative and qualitative factors in assessing an item's materiality.

Moreover, a defendant "is not permitted, in assessing materiality, to aggregate negative and positive effects on its [financial performance] in order to avoid disclosure of a particular material negative event. . . . Even where a misstatement or omission may be quantitatively small compared to a registrant's firm-wide financial results, its significance to a particularly important segment of a registrant's business tends to show its materiality."

Finally, a plaintiff cannot be penalized for not alleging the very information the defendants failed to disclose – here, Blackstone's at-risk real estate holdings.

Applying these and other principles, the Second Circuit concluded that plaintiffs had plausibly alleged both omissions of material information and material misstatements relating to FGIC, Freescale, and the company's real estate fund investments. Thus, the court overturned the dismissal and remanded the case to Judge Harold Baer, Jr., of the Southern District of New York, for further proceedings.

Robbins Geller Rudman & Dowd LLP partners **Samuel H. Rudman** and **David A. Rosenfeld**, as well as of counsel **Mark T. Millkey**, handled the appeal. Lead plaintiffs in the action are Martin Litwin, Max Poulter, and Francis Brady.

Litwin, et al. v. The Blackstone Group, L.P., et al., No. 09-4426-cv (2d Cir. Feb. 10, 2011). ■

For more information on these and other cases, please visit: www.rgrdlaw.com

EYE ON WALL STREET

John Paulson

John Paulson's name rocketed to prominence during the 2008 economic crisis when he was heralded as one of the investors who was said to have foreseen the mortgage-backed securities collapse and shrewdly bet accordingly. It appears that Paulson's fortune, however, may be owed more to the insights of others and his insider access to Goldman Sachs's CDO production machine than to his own insights.

A complaint filed by the SEC last year notes that a Paulson & Co. hedge fund advised Goldman Sachs in 2007 about structuring a synthetic collateralized debt obligation (CDO) called "Abacus 2007-AC1." This complicated CDO, which referenced many different mortgage-backed securities, was sold to investors hungry for its high returns and good credit rating. What investors in the Abacus CDO were not told is that Paulson, who played a role in hand-picking certain high risk assets concealed inside the CDO, had bought "short positions" and stood to win big if certain securities included in Abacus were to drop – which they did, right on schedule, generating billions for Paulson & Co.

The Financial Crisis Inquiry Commission subpoenaed millions of documents and collected evidence revealing that Abacus may have actually been designed to fail. Since Paulson did not specifically mislead investors himself, neither Paulson nor his fund were named as a defendant in the SEC investigation.

Although his investment strategy was largely borrowed from others (*See* Recommended Reading, *The Big Short*), no one can argue that Paulson's hedge fund bets against subprime and other mortgage security instruments were not profitable – as investors lost trillions and foreclosures soared into the millions, Paulson's huge "shorts" tripled his hedge fund value to $21 billion in 2007. Forbes's 2010 Billionaires List credits Paulson with a personal net worth of $12 billion.

Settlement Update

Midland
Annuity Deceptions Exposed

On February 28, 2011, United States District Judge Christina A. Snyder granted final approval of a nationwide settlement that provides substantial economic relief to more than 70,000 senior citizens who purchased a deferred annuity from Midland National Life Insurance Company between January 25, 2001 and June 30, 2007.

Plaintiffs alleged that, for the past decade, Midland National Life Insurance Company and its marketing organizations and agents have targeted senior citizens for the sale of long-term deferred annuity products and misrepresented and otherwise failed to disclose the annuities' illiquidity and extremely high costs. Among other features, plaintiffs asserted that Midland did not disclose to senior policyholders material facts concerning the costs associated with its annuities, the interest credited to the annuities, the bonus features of certain of its annuities, the surrender penalties and withdrawal provisions of the annuities, and the fixed maturity dates of the annuities. Midland's annuities and their high costs are particularly harmful to seniors because they do not mature for 15 or 20 years, often beyond the elderly person's life expectancy. Attorneys general and insurance regulators in several states had expressed concern over and even launched inquiries into the marketing and sales practices being challenged by plaintiffs.

Based on these allegations, plaintiffs brought claims for violations of the federal civil RICO statute, 18 U.S.C. §1962, and certain California consumer protection laws, including §§17200 and 17500 of the California Business and Professions Code, and California's Financial Elder Abuse Act (Welf. & Inst. Code §15610.30, *et seq.*).

The litigation began in both California and Iowa courts, and all actions were eventually consolidated in California. The court denied multiple attempts by Midland to dismiss plaintiffs' claims. Plaintiffs' counsel aggressively pursued discovery, taking numerous depositions of Midland officers, employees, and independent agents, reviewing over 450,000 pages of documents, and analyzing extensive electronic data produced by Midland. When the nationwide settlement was reached, various motions, including plaintiffs' motion for class certification and Midland's summary judgment motion, were pending before the court.

The court's order approving the settlement concludes over five years of hard-fought litigation between the parties. By virtue of the settlement, class members will be entitled to receive an annuitization bonus, enhanced annuity payments, or a reduction in the past or future surrender charges for their annuities. The relief made available to class members is valued at approximately $80 million.

Attorneys **Theodore J. Pintar**, **John J. Stoia, Jr.**, **Steven M. Jodlowski** and **Phong L. Tran** of Robbins Geller Rudman & Dowd LLP were responsible for litigating the case and obtaining this victorious ruling.

In re Midland National Life Insurance Co. Annuity Sales Practices Litigation, No. 2:07-ml-1825 (C.D. Cal.). ■

Financial Crisis Inquiry Report continued from page 2

such example is shown by the behavior of credit ratings agencies. The Report notes that these institutions were adept at making money in customized deals with Wall Street underwriters, but failed dismally in the performance of the sole task entrusted to them: to provide trustworthy evaluations of creditworthiness. When tranches of BBB-rated subprime bonds can be repackaged into CDOs that receive "investment grade" credit ratings from Moody's or Standard & Poor's, something is very wrong with finance.

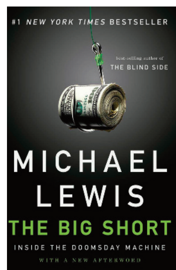
"Compensation systems … rewarded the quick deal ... without proper consideration of long-term consequences."

The Report noted how Wall Street's pay schemes added gasoline to the fire, exacerbating the short-term bonus culture rampant within the financial services industry. Risks assumed by individual trading desks taking on multi-billion dollar positions, such as occurred at Morgan Stanley, Bear Stearns and AIG-FP, generated massive fees for the banks, and enormous personal enrichment for traders and executives. However, the schemes lacked a counterbalance and means of accountability. Gains were privatized; risks and massive losses were socialized.

When disaster occurs, one useful response is to study what went wrong in order to create a rational program of action to mitigate or prevent further meltdowns. Judged by this standard, the Commission was an unqualified success. Those who have clamored for higher standards of corporate governance in U.S. financial firms and rating agencies will find some vindication in this Report, as well as grudging acknowledgment that the work of active and alert investors is far from over. Still, many remain dissatisfied. Even in the face of stunning fraud and deceit revealed on Wall Street, and painful losses affecting every state in the union, not a single trader or CEO from a large firm has yet been sent to jail, as noted by Charles Ferguson, the director of the acclaimed financial meltdown documentary "Inside Job."

Despite the Commission's painstaking exposure of abysmal corporate governance and compensation practices, little voluntary change has occurred. In fact, the top five Wall Street banks, recapitalized by taxpayer bailouts, have continued to rake in near-record profits, setting aside $90 billion for bonuses in 2010 alone. It's clear that the work is not yet done. Still, the Report informs the urgency of the ongoing tasks of strengthening investor protections and improving governance practices so that the wealth-creating engine of private enterprise can be harnessed to work for everyone – business, institutional investors, and the public. ■

Recommended Reading



The Big Short: Inside the Doomsday Machine

Michael Lewis

W. W. Norton & Company, 2010

The recent financial crisis has spurred a large number of fine books detailing the stories and narratives behind it. If you only have time to read one, pick up Michael Lewis's latest production, *The Big Short*. Hailed by fellow author Malcolm Gladwell as "the finest storyteller of our generation," Lewis has created a compelling narrative worthy of his landmark *Liar's Poker*, about high-flying Salomon Brothers during the 1980s, a morality tale which launched the Wall Street genre.

The Big Short tells its story from the perspective of a handful of men who bet against Wall Street's conventional wisdom, and won – yet little changed. These contrarian investors were smart enough to anticipate in hard-number terms just how the Wall Street mortgage securitization machine and CDO factory was doomed to crash, as well as bold enough to invest large sums to back up their words – in other words, "shorting" Wall Street. The characters are complex and entertaining; along the way we meet the brilliant but utterly tactless bond trader named Steve Eisman, an extremely introverted neurologist named Dr. Mike Burry, and two rookies with a "garage band hedge fund" in Berkeley. Along with the oily Deutsche Bank insider Greg Lippman, these "shorts" tried to shake the investor community by the lapels, hollering in its ear that the Emperor has no clothes, that the securitization-driven subprime mortgage market – "the most powerful engine of profits and employment on Wall Street" – was simply a glorified Ponzi scheme that Wall Street, with the connivance of the credit rating agencies, manipulated into the illusion of finance.

Telling the story from the point of view of this band of characters makes Lewis's narrative readable, and allows the reader to cheer for the little guy. One cannot miss the main point: that the Wall Street financial edifice of the 2000s, built on opaque derivatized mortgage securities, had become a towering sandcastle – with a large wave on the way. Why didn't the rest of Wall Street see the collapse coming? The answer takes a book to tell, but suffice it to say, the creation of the CDO as "investor" – one of those "financial innovations" – made it more profitable to keep the game going. *The Big Short* cements Michael Lewis's reputation as one of the greatest modern storytellers and is a book worth picking up.

Matrixx continued from page 1

Stung by this setback, defendants petitioned the Supreme Court to grant certiorari and reverse the Ninth Circuit's decision – pointing out that other circuit courts applied the "statistical significance" requirement, and claiming that the adverse reports Matrixx had received about Zicam and anosmia were scattered and merely anecdotal. In what came as a surprise to many interested observers, the Supreme Court not only chose to review the *Matrixx* case, but also, in its 9-0 decision authored by Justice Sotomayor, rejected the "statistically significant" standard for assessing materiality and scienter that had been urged by the *Matrixx* defendants and their many supporters filing *amicus* briefs – including a number of Big Pharma interests and the United States Chamber of Commerce.

In addressing materiality, the Supreme Court reaffirmed *Basic's* holding that any approach "that designates a single fact or occurrence as always determinative of an inherently fact-specific finding such as materiality, must necessarily be overinclusive or underinclusive." The Court explained that any "categorical rule" requiring allegations of statistical significance would artificially exclude information that reasonable investors might otherwise consider significant to their trading decisions, noting that doctors and the FDA do not require statistical significance before acting on particularly troubling inferences. "Given that medical professionals and regulators act on the basis of evidence of causation that is not statistically significant, it stands to reason that in certain cases reasonable investors would as well." In sum, concluded the Court, Matrixx's materiality argument "is flawed."

The Supreme Court also rejected defendants' argument that without a statistically significant number of reports linking Zicam with anosmia, Matrixx and its top executives could not have acted with scienter – *i.e.*, that they had not acted intentionally or recklessly. "Matrixx's proposed bright-line rule requiring an allegation of statistical significance to establish a strong inference of scienter is just as flawed as its approach to materiality," held the Court. The complaint's numerous allegations raised an inference that Matrixx was keenly aware of the link between Zicam and anosmia and acted accordingly, concluded the Court, noting the company's contacts with various medical professionals concerning the side effect and numerous other attempts to intervene. "Most significantly," explained the Court, "Matrixx issued a press release that suggested that studies had confirmed that Zicam does not cause anosmia when, in fact, it had not conducted any studies relating to anosmia and the scientific evidence at that time, according to the panel of scientists, was insufficient to determine whether Zicam did or did not cause anosmia." Considered together, held the Court, plaintiffs' allegations raised a strong inference of defendants' scienter: "These allegations … give rise to a 'cogent and compelling' inference that Matrixx elected not to disclose the reports of adverse events not because it believed they were meaningless but because it understood their likely effect on the market."

The Supreme Court victory was truly a team effort, representing the culmination of nearly seven years of hard-fought litigation. Robbins Geller Rudman & Dowd LLP partner **Scott Saham** and associate **Lucas Olts** prosecuted the case in the district court; Appellate Department partner **Joseph Daley** briefed and argued the successful appeal before the Ninth Circuit; and Mr. Daley and his Appellate Department partner **Eric Alan Isaacson** worked extensively on the Supreme Court briefing in conjunction with Supreme Court specialist **David Frederick**.

Matrixx Initiatives, Inc. v. Siracusano, No. 09-1156, 2011 U.S. LEXIS 2416 (U.S. Mar. 22, 2011). ■

Calendar of Upcoming Events

May 3, 2011

Institutional Investor
The UAE Global Investment Forum

Emirates Palace
Abu Dhabi, United Arab Emirates

Featured Speaker: **Patrick W. Daniels**, Robbins Geller Rudman & Dowd LLP

This forum brings together international and regional investors with industry leaders, financial intermediaries and high-profile government officials. Sessions will highlight the range of investment opportunities available in the UAE and bring to light the progress being made in Abu Dhabi's ambitious diversification program. Speakers will also discuss the outlook for emerging markets globally and debate the strength of international and local financial markets.

For more information, visit: www.iiconferences.com

May 20-22, 2011

American Bar Association
15th National Appellate Practice Institute

Northwestern University School of Law
Chicago, Illinois

Featured Speaker: **Sandy Svetcov**, Robbins Geller Rudman & Dowd LLP

This event is designed for both public and private practitioners who currently appear in federal and state appellate courts and attorneys who want to prepare themselves for appellate practice. The program will focus on appellate writing, oral advocacy skills, and common mistakes and pitfalls in the appellate process. The program will also provide valuable insight into perspectives from the bench.

For more information, visit: www.abanet.org/jd/ajc

May 22-25, 2011

International Pension & Employee Benefits Lawyers Association (IPEBLA) 2011 Conference

Berlin Marriott Hotel
Berlin, Germany

Featured Speaker: **Darren J. Robbins**, Robbins Geller Rudman & Dowd LLP

This conference will give common and civil law lawyers from different countries the opportunity to discuss current domestic and international issues affecting their practice and pension, executive compensation and related employee benefit fields. The event provides unique networking opportunities for lawyers practicing or interested in this area of the law.

For more information, visit: ipebla.org

May 22-26, 2011

National Conference on Public Employee Retirement Systems (NCPERS)
NCPERS 2011 Annual Conference and Exhibition

Fontainebleau Hotel
Miami, Florida

Join 1,000 trustees, administrators, state and local officials, investment, financial and union officers, pension staff and regulators at this annual event. Benefit from the comprehensive educational programming, dynamic speakers, and networking opportunities with money managers, investment service providers and public fund colleagues from across the nation.

For more information, visit: www.ncpers.org

June 9-10, 2011

American Conference Institute and Responsible-Investor.com
National Summit on the Future of Fiduciary Responsibility

Millennium UN Plaza Hotel
New York, New York

Featured Speaker: **Patrick W. Daniels**, Robbins Geller Rudman & Dowd LLP

This conference will feature key insights and advice for the following: assessing the role of shareholders and institutional investors in corporate governance reform measures; understanding the best examples of activism that resulted from the financial crisis; mortgage-backed securities: the collapse, today's litigation landscape and tomorrow's potential liabilities; dissecting the impact of Dodd-Frank's new corporate governance rules, regulations and limitations on investors; preserving shareholder value by keeping companies honest, deterring misconduct, achieving "pay for performance" compensation and developing independent boards; and screening your portfolio companies and recognizing the warning signs that may lead to litigation.

For more information, visit: www.americanconference.com

June 13-15, 2011

International Foundation
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The Mirage
Las Vegas, Nevada

This premier educational conference is for all multiemployer trust fund members. With three separate institutes – new trustees, advanced trustees and administrators – attendees will have the opportunity to focus their education to the role and experience level that fits their needs. Topics discussed will include timely, relevant and balanced education concerning the trends, issues and future direction of the industry.

For more information, visit: www.ifebp.org

June 20-21, 2011

IIR and IBC Events
The 12th Annual Multi Pensions Global Pensions Forum

NH Krasnapolsky Hotel
Amsterdam, The Netherlands

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