Robbins Geller Rudman & Dowd LLP

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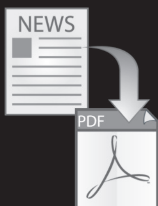

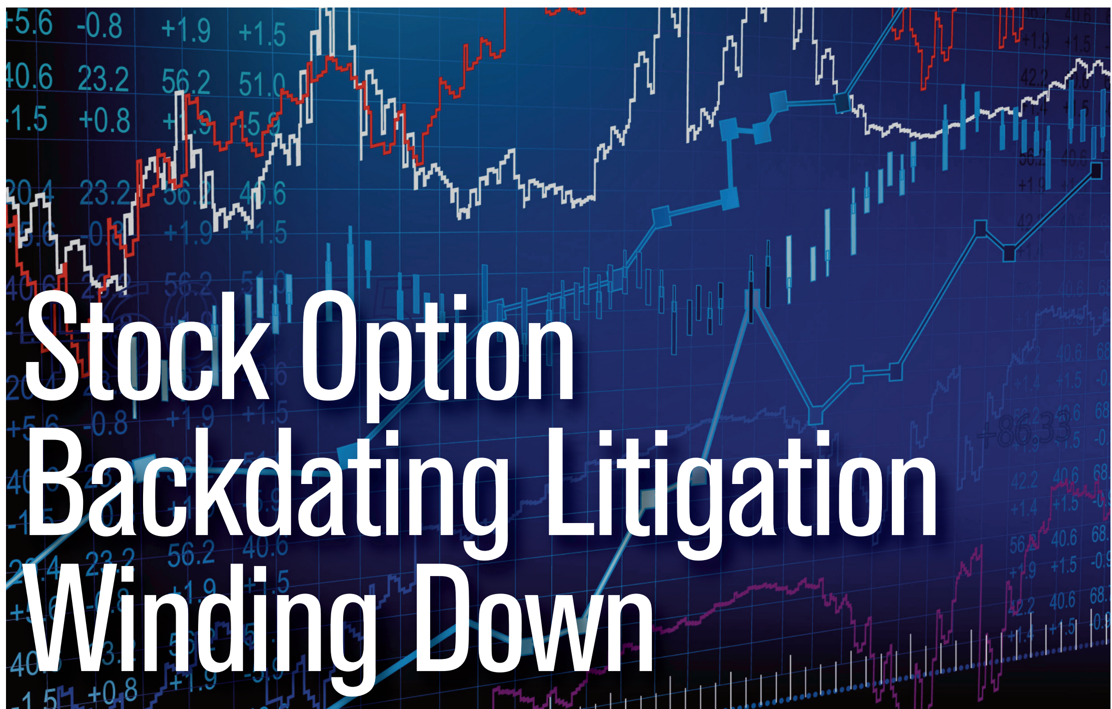

Stock Option Backdating Litigation Winding Down

In March 2006, *The Wall Street Journal* published a front-page exposé titled "The Perfect Payday." The article unmasked what had become routine in corporate boardrooms but was difficult for government regulators, stock analysts and ordinary shareholders to detect. For years, corporate executives secretly "backdated" stock options to ensure greater financial upside for the option holder – often those same executives. This ubiquitous practice was akin to betting on a horse race after the thoroughbreds crossed the finish line. Using hindsight, officers and directors wielded their control over the corporate machinery to select the most favorable "grant" date for a stock option (in other words, the winning horse). The lower the stock's trading price was on grant dates chosen by hindsight, the more profitable the option would be later when exercised to buy stock.

This deceitful conduct, however, could not be concealed forever. Soon after *The Wall Street Journal* story, more than 100 public companies became engulfed in a massive stock option backdating scandal.

Robbins Geller Rudman & Dowd LLP ("Robbins Geller") has been at the forefront of the shareholder litigation, which helps hold wayward corporate fiduciaries accountable for abusing their important positions of trust. By backdating stock options, corporate insiders benefitted personally to the tune of hundreds of millions of dollars. Option backdating also caused many companies' public disclosures and accounting statements to be false or misleading, in violation of federal and state law. Although government prosecutions of corporate wrongdoers occurred, much of the recovery was left to private litigation. Robbins Geller lawyers have recovered over $1 billion on behalf of injured companies and shareholders and have also obtained corporate governance reforms aimed at preventing future abuses.

Now, five years after the scandal broke, Robbins Geller continues to pursue the last remaining stock option backdating suits on behalf of institutional investors and other clients. Robbins Geller recently obtained a significant appellate decision in the shareholder derivative action on behalf of Finisar Corporation based in Silicon Valley. In September 2009, the United States District Court for the Northern District of California dismissed the shareholder derivative complaint in *In re Finisar Corp. Derivative Litigation*, No. C-06-07660-RMW. The judge believed the complaint failed to allege sufficient facts excusing a presuit demand for action on Finisar's Board of Directors. Disagreeing with this ruling, the plaintiffs appealed. The United States Court of Appeals for the Ninth Circuit recently reversed the dismissal. The appellate panel held that a presuit demand would have been futile under Delaware law and therefore was excused. *See Lynch v. Rawls*, No. 09-17379, Memorandum (9th Cir. Apr. 26, 2011). A team of Robbins Geller attorneys expects to prosecute this derivative action when it returns to the Northern District of California later this year.

Additionally, the derivative suit on behalf of F5 Networks, Inc. was resolved after a unanimous Washington Supreme Court opinion in favor of the investors who brought the case. *See In re F5 Networks, Inc. Derivative Litigation*, 207 P.3d 433 (Wash. 2009). In March 2011, the United States District Court for the District of Arizona dismissed a shareholder class action involving stock option backdating in *Teamsters Local 617 Pension & Welfare Funds v. Apollo Group, Inc.*, No. CIV 06-02674-PHX-RCB. Believing this dismissal was error, Robbins Geller on behalf of the lead plaintiff has moved the judge to reconsider. If reconsideration is denied, an appeal to the United States Court of Appeals for the Ninth Circuit (the same court that recently decided *Lynch v. Rawls*) appears likely. And, at the state level, a trial judge for the Circuit Court of Jasper County, Missouri recently dismissed a strong stock option backdating complaint in *New England Carpenters Pension Fund v. Haffner*, No. 10AO-CC00284. Robbins Geller attorneys are now prosecuting an appeal to the Missouri Court of Appeals for the Southern District. After recovering more than $1 billion in damages caused by backdating frauds, Robbins Geller attorneys are gearing up for the final legal battles. ■

Elizabeth Warren: Profile of a Consumer Protection Advocate

Elizabeth Warren

> "Responsibility is not just about blame. Responsibility is about making sure we fix this and it will not happen again."
> - Elizabeth Warren

The financial crisis has brought forth a narrative replete with a sturdy cast of villains (mainly from Wall Street, investment banks and hedge funds) and a modest handful of unlikely heroes. Or, more accurately, heroines. One of the trio of women a *TIME* magazine cover labeled "The New Sheriffs of Wall Street" is Elizabeth Warren, a Harvard Law School professor whose nomination to run a new congressionally mandated consumer protection agency focused on financial products has caused shockwaves of concern to ripple across the Wall Street/lobbyist industrial complex.

Signed into law on July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act establishes the Consumer Financial Protection Bureau (CFPB), whose central mission is "to make markets for consumer financial products and services work for Americans." Ms. Warren had a strong hand in designing the agency, noting that whereas Americans had fought for and won consumer protections for products as simple as toasters, no such protections extended to consumer financial products like mortgages and credit cards, despite their much greater potential hazards. The new Bureau's reach will include banks, securities firms, payday lenders, mortgage-servicing operations, and other financial companies. The new agency will be housed in the Federal Reserve and independently funded, with hopes that this will save it from the fate of the underfunded SEC. However, the new agency still doesn't have a Senate-confirmed director, and time is running out for the President to nominate one. A bevy of consumer protection and Wall Street reform advocates are loudly calling for Elizabeth Warren herself to be the CFPB's first director.

This is not Warren's first trip to the rodeo. Congress tapped Warren in November 2008 to chair the Congressional Oversight Committee monitoring the banking sector bailout programs formerly called TARP. Warren's stewardship of the oversight panel produced monthly reports on issues from small business lending and foreclosure mitigation to banking stress tests. Testifying frequently before House and Senate committees, Warren's style is to cut through the Gordian knot of complexity surrounding financial issues with pithy and understandable calls to action. In a late 2009 interview with *Newsweek*, Warren laid out her vision: "To restore some basic sanity to the financial system, we need two central changes: fix broken consumer-credit markets and end guarantees for the big players that threaten our entire economic system." Other proposed regulatory measures could be dialed up or down as needed, but, in Warren's view, "if we don't get those two right, I think the game is over." Warren had been critical of the lack of criminal investigation and accountability on Wall Street, stating in regards to the recent wealth-destruction event, "Responsibility is not just about blame. Responsibility is about making sure we fix this and it will not happen again."

Warren's background is as unassuming as they come. The daughter of a janitor, Warren didn't attend an Ivy League law school, she went to Rutgers. She did, however, work her way up to become Editor of the *Rutgers Law Review*. Her ideas about forming a consumer financial products protection agency developed while Warren was researching a book about how middle class families who formerly got by on one income now struggled to make ends meet with two working parents. *The Two-Income Trap*, which Warren co-wrote with her daughter, found that middle class families were under financial stress not because of reckless personal spending, but due to combined pressures of flat wage growth mixed with large increases in the cost of housing, education, and health care, and exacerbated by the "tricks and traps" of fine-print complex loan and credit card contracts. These tricks led to high profit margins for banks and nonbank lenders, at the expense of families. "They shouldn't be in debt because hidden tricks in their credit card agreements increased their balances or bounced up their interest rates," Warren told *The Wall Street Journal*, which has called Warren a "scourge of Wall Street."

The consumer protection standards that Warren advocates are linked to her stance on major financial institutions – in fact, her calls for transparency for consumer products go hand in hand with reforms she proposes to correct the "too big to fail" implicit guarantee for reckless banks. Without the deceptive and predatory lending practices of the last decade fueling the boom in mortgage-backed securities, the large financial centers and investment banks could not have created the hundreds of billions of dollars of collateralized debt obligations that came crashing down in 2008, taking the greater economy with them, and decimating public fund and pension assets worldwide. Thus, a second key feature of reform according to Warren is ending the implicit guarantees of the federal government to bail out reckless financial institutions, because this creates a vast subsidy for these investment banks, resulting in market distortions and an unbalanced playing field.

A Warren nomination to head the new consumer protection agency that she helped midwife has faced harsh opposition from both of the Wall Street-funded parties in Congress, and their deep-pocketed lobbying allies like the Financial Services Roundtable. Deeply worried about the prospect of having the public observe the nomination process, Senate minority leadership has promised (and delivered) a filibuster threat to a Warren nomination, and is actively seeking to undermine the entire idea of the CFPB itself through a sustained lobbying and media campaign. If a Warren nomination were to be debated on the Senate floor, many believe that the dirty financial laundry aired in the nomination proceedings alone (regardless of the outcome) might result in heightened public attention or anger, leaving Wall Street and its gang of lobbyists with their "blood and teeth" on the floor. Given the near-impossibility of a Warren nomination being heard in the Senate, Warren's supporters urge the President to nominate her through a recess appointment – an undesirable option, but perhaps the only one left.

Unfazed by her critics and the bright lights of media attention, Warren has continued to make the case for strong consumer financial protection in op-ed columns and appearances as a guest on major networks. At this time, it remains unclear if she will be nominated, appointed, or simply left on the sidelines. In the meantime, the position of the CFPB director remains unfilled, with the nomination clock set to expire in July. No matter the outcome, Warren's poise, tenacity and smarts have earned her ample respect from across the political spectrum, and we will undoubtedly hear more from her in the future.

Michael Copass graduated from Harvard University in 2002 with a master's degree in Microbiology. He writes on issues affecting institutional investors, including advances in shareholder litigation, and reviews recent books of interest to the corporate governance community. ■

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Déjà Vu: The Sixth Circuit Again Reverses the District Court's Dismissal of the *Dana Corporation* Case

For the second time in three years in the *Frank v. Dana Corporation* case, the Sixth Circuit Court of Appeals in Cincinnati has reversed the district court's dismissal of the action. The first time around, a Sixth Circuit panel held that the district court had applied an incorrect pleading standard to plaintiffs' allegations, and sent the case back for a renewed look under the correct standard; this time, following the complaint's dismissal, a new three-judge panel held that plaintiffs had sufficiently alleged the defendants' "scienter," or state of mind, in connection with misstatements that inflated Dana Corporation's stock price.

Led by a trio of institutional investors (**SEIU Pension Plans Master Trust**, **West Virginia Laborers' Pension Trust Fund**, and **Plumbers and Pipefitters National Pension Fund**), plaintiffs alleged that Dana's Chief Executive Officer Michael Burns and its Chief Financial Officer Robert Richter had continually (and falsely) reassured investors that the automotive parts maker was prospering, even in the face of rising material costs and market conditions that were negatively impacting its industry peers.

Barely two months after reaffirming strong earnings guidance and reporting fantastic financial results, however, the defendants stunned the market by drastically lowering Dana's earnings guidance and conceding the likelihood of financial restatements. Skeptical analysts described the admissions as a "significant body blow" to Dana's management team "that already had credibility issues." Two weeks later, the other shoe dropped: Defendants announced that Dana's reported financials for the past six quarters were unreliable and would have to be restated, and that the company was going to write off nearly $1 billion in deferred tax assets. Dana soon plunged into bankruptcy, and CFO Richter abruptly retired.

In the district court the lead plaintiffs pleaded a litany of facts that they believed combined to show the two Dana executives' scienter during the class period. Among them were: (a) weekly, monthly, and quarterly periodic reports generated by numerous company plants that showed Dana's financial distress; (b) the CEO's statements that he and the CFO had evaluated Dana's accounting systems and found them to be sound; (c) the "magnitude" of the false accounting, in light of the dramatic financial restatements and nearly $1 billion in write-downs; (d) the close temporal proximity between defendants' false reassurances and the contradictory disclosures that stunned the market; (e) the two executives' motivation to earn bonuses tied to Dana's reported financial results; (f) Richter's sudden "retirement"; (g) the two men's false certifications of Dana's financial results; and (h) a Securities and Exchange Commission investigation into Dana's accounting practices. None of these allegations swayed the district court, however, which dismissed the complaint with prejudice after dispatching each of the scienter allegations in turn.

That method of individual analysis was error, according to the Sixth Circuit. In light of recent Supreme Court pleading authority like the *Tellabs* and *Matrixx Initiatives* decisions, the panel held that the "only appropriate" method was to use a scienter pleading analysis "based on the collective view of the facts, not the facts individually." Without employing this holistic approach, observed the panel, anyone considering a securities fraud complaint's allegations "risks losing the forest for the trees."

Applying that collective analysis to the facts alleged in *Dana Corporation*, the panel easily concluded that the complaint raised a strong inference that Burns and Richter had acted with scienter in making false statements. The two men were the "top two executives" at the auto parts maker, and they reported supposedly "gangbuster earnings during a period of time when the entire auto industry was spiraling toward bankruptcy." They made the bullish reports and asserted the veracity of Dana's reported financials "all while one of their key product lines was operating at fifty percent of earnings," the price of steel was rising, and multiple Dana factories were failing to meet their budgets. "It is difficult," the panel noted, "to grasp the thought that Burns and Richter really had no idea that Dana was on the road to bankruptcy." Indeed, from the first (false) public statement of Dana's supposed health to its demise was a "matter of nine months." And the two men appeared only more culpable given that Dana was able to secure a much-needed cash infusion during the class period by selling $450 million in company debt – an infusion "which almost surely would have been denied if the company's true financial status was publicly reported."

Beyond its scienter holding, the Sixth Circuit issued another favorable holding in the case – this one having to do with the alleged "control person" status of Burns and Richter. Under the federal securities laws, a defendant may be liable for "controlling," either directly or indirectly, any other person or entity that commits a securities law violation. The controlling person can escape liability, however, if he shows – among other things – that he acted in good faith.

The district court had dismissed plaintiffs' control-person claims against Burns and Richter on two grounds: (1) that because of the dismissal on scienter grounds there was no predicate, underlying securities violation; and (2) plaintiffs failed to carry their burden of alleging that the two men hadn't acted in good faith.

The panel rejected both holdings. First, because it had already overturned the district court's scienter holding, the panel noted that there *was* an underlying securities violation. Nor was the district court's second rationale correct – for the panel agreed with plaintiffs' argument that they did not have to establish a defendant's "state of mind" in order to plead a control-person claim; whether defendants acted in good faith was actually "an affirmative defense" that was the defendant's burden. Thus, plaintiffs "were not required to plead that Burns and Richter acted without it." As an added bonus for plaintiffs, that particular holding settled an issue of first impression in the Sixth Circuit.

Appellate Department partner **Joseph Daley**, who briefed and argued both of the Sixth Circuit *Dana Corporation* appeals, credited litigation partners **Darren J. Robbins**, **Michael J. Dowd** and **Debra Wyman** with putting together a strong complaint. "The necessary facts were always there," Daley noted. "It was gratifying that the three-judge panel took a fresh look at those facts and considered them collectively, as opposed to individually – just as the Supreme Court mandates."

Frank v. Dana Corp., No. 09-4233, 2011 U.S. App. LEXIS 10437 (May 25, 2011).

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Litigation Update

Motion to Dismiss
IGT: Gambled and Lost

On April 26, 2010, lead plaintiff **Iron Workers District Counsel of Western New York and Vicinity Pension Fund** and named plaintiff **International Brotherhood of Electrical Workers Local 697 Pension Fund** filed a Consolidated Complaint for Violations of the Federal Securities Laws against International Game Technology ("IGT") and two of IGT's senior officers.

IGT is the world's largest gaming company that specializes in the design, manufacture, and marketing of electronic gaming equipment and network systems, as well as licensing and services. Incorporated in Nevada, IGT's common stock is publicly traded on the New York Stock Exchange ("NYSE") under the symbol "IGT."

Plaintiffs' complaint alleges that during the November 1, 2007 through October 30, 2008 class period, defendants assured shareholders that IGT was impervious to economic downturns, uniquely positioned for continued growth, and that seasonality was responsible for any decrease in play levels. Plaintiffs also alleged that defendants made misrepresentations and omissions concerning the following topics: (1) game "play levels," *i.e.*, how much gamblers were gambling; (2) IGT's sales/revenue growth; (3) IGT's operating expenses; (4) IGT's server-based ("SB") technology; and (5) IGT's forecasts of quarterly earnings per share ("EPS") for the second and fourth fiscal quarters of 2008.

On March 15, 2011, the Honorable Edward C. Reed, Jr. of the United States District Court for the District of Nevada denied defendants' motion to dismiss plaintiffs' complaint. In evaluating plaintiffs' allegations concerning game play levels and defendants' false statements that IGT was uniquely positioned for continued growth and that seasonality was responsible for any decrease in play levels, Judge Reed pointed out that defendants made "numerous assurances" in this vein during the class period, and held that "[i]n light of these statements, we find that Plaintiffs have provided evidence of scienter" and that defendants' insistance that "any decline they were seeing is due to normal seasonality was not merely a matter of omission, but of misrepresentation and direct contradiction to any readily available information."

While the court found certain misstatements to be protected under the safe harbor provision of the Private Securities Litigation Reform Act of 1995, Judge Reed found that some of IGT's other claims were not. For example, the court found actionable as misstatements defendants' deficient announcements regarding agreements made with Harrah's and CityCenter, noting that in separate announcements regarding IGT's SB technology, defendants stated that IGT was "on target to begin commercializing this product in 2009" and that "pricing will remain a private conversation . . . [w]e feel fairly comfortable that the pricing is going to sort itself out . . . ." Judge Reed held that "[w]hile a generous view of Defendants' statements regarding SB technology and its expected profits might excuse Defendants' failure to disclose that the deals … were not made for profit, we find it equally compelling that Defendants may have intentionally misled the public and its investors when it failed to disclose that the agreements, when made, were not expected to generate any revenue for a number of years." Judge Reed concluded that "[v]iewed as a whole, we find that Plaintiffs have alleged inferences that Defendants intentionally misled investors to the investors' detriment at least as compelling as any plausible opposing inference."

Said plaintiffs' attorney **Brian O. O'Mara** of Robbins Geller Rudman & Dowd LLP, "The court's opinion sustaining plaintiffs' complaint moves the class of injured IGT investors one step closer to obtaining vindication for defendants' misconduct."

International Brotherhood of Electrical Workers Local 697 Pension Fund v. International Game Technology, No. 3:09-cv-00419-ECR-RAM, Order (D. Nev. Mar. 15, 2011).

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Motion to Dismiss
Sanofi's Killer Obesity Drug?

On March 30, 2011, Judge George B. Daniels of the United States District Court for the Southern District of New York denied defendants' motion to dismiss as to defendants sanofi-aventis ("Sanofi") and two of its officers, Executive Vice President of Pharmaceutical Operations, Hanspeter Spek, and Senior Executive Vice President of Scientific and Medical Affairs, Gerard Le Fur. The amended complaint was filed by lead plaintiffs **The City of Edinburgh Council on Behalf of the Lothian Pension Fund** and **New England Carpenters Guaranteed Annuity Fund**.

Sanofi was the third largest pharmaceutical company in the world, concentrating on both the development and marketing of pharmaceuticals for therapeutic areas such as cardiovascular and metabolic disorders and oncology. While incorporated in France in 1994, where its common stock trades on Euronext, its American Depository Shares have traded on the New York Stock Exchange. Plaintiffs' complaint concerns the alleged misleading statements and material omissions concerning Sanofi's April 2005 New Drug Application ("NDA") for a drug known as rimonabant to be used to combat obesity and its use and marketing in the United States. Already marketed as "Acomplia" in Europe, Sanofi intended to release the drug under the trade name "Zimulti" in the U.S. In its use as an anti-obesity drug, rimonabant operates on brain receptors, affecting the hunger signals and reducing cravings. Sanofi had invested millions of dollars and several years conducting trials to assure regulators of the drug's safety and efficacy. Analysts had estimated annual sales in the billions of dollars should FDA approval be assured.

Everything started to go wrong when the FDA asked Sanofi for more details on suicidal thoughts and actions, or "suicidality," in the rimonabant clinical trials. Sanofi provided records of additional cases of suicidality in test subjects that had not initially been reported in the NDA. On February 17, 2006, the FDA requested that Sanofi reassess the trials' database in light of the suicidality data. A formal, independent assessment on suicidality and rimonabant was conducted by Dr. Kelly Posner at Columbia University. That assessment showed what plaintiffs alleged was a definite and statistically significant link. The results of the assessment were submitted to the FDA by Sanofi in October 2006. In June 2007, after reviewing the assessment, the FDA's Advisory Committee unanimously recommended that the NDA be denied due to the suicidality findings. Sanofi then withdrew its application. Sanofi also announced over a year later that it would stop marketing rimonabant in Europe.

Citing the recent unanimous Supreme Court decision in *Matrixx Initiatives, Inc v. Siracusano*, 131 S. Ct. 1309 (2011), Judge Daniels wrote that defendants could not contend they had no duty to disclose the suicidality information and that "Sanofi had an unwaivable duty to be both accurate and complete when it spoke to investors." One omission the judge found to be actionable was from a presentation to analysts and investors on February 24, 2006. Defendant Le Fur said that "in the approvable letter, no additional trial in obesity has been requested by the agency." In his analysis of defendants' statements during the class period, Judge Daniels also pointed to a statement made on October 31, 2006, when an analyst asked, "'Was additional data submitted?' … Sanofi, through Defendant Spek, responded, … 'as the [FDA's] approvable letter did not ask

for new additional clinical trials, consequently it is easier for me to say that we have not submitted new data in this respect.'" In his analysis, Judge Daniels ruled this to be an actionable statement because the defendant could have either declined to answer or to have answered "yes" to the question of additional data submissions. But the answer given "could have led a reasonable investor to believe that [S]anofi had not submitted new data on some issue that concerned the FDA." Judge Daniels also wrote that plaintiffs adequately pleaded scienter as "[t]he factual allegations … are sufficient to raise a strong inference that [S]anofi's alleged omission constituted recklessness."

Robbins Geller Rudman & Dowd LLP is lead counsel for plaintiffs. Said plaintiffs' attorney **Tor Gronborg**, "We concur with Judge Daniels' ruling and look forward to agressively prosecuting this case on behalf of the class."

In re Sanofi-Aventis Securities Litigation, No. 1:07-cv-10279-GBD, Memorandum Decision and Order (S.D.N.Y. Mar. 30, 2011).

Motion to Dismiss
Bear Stearns: Misconduct, Anyone?

On January 19, 2011, Judge Robert W. Sweet of the United States District Court for the Southern District of New York denied defendants' motion to dismiss in a securities class action suit filed on behalf of investors following Bear Stearns' March 2008 collapse and sale to JP Morgan. Lead plaintiff **State of Michigan Retirement Systems**, on behalf of the class, alleged that Bear Stearns and its former directors and officers engaged in a scheme to conceal the company's risky subprime mortgage portfolio and overstate its financial condition while assuring investors the company had sound risk management. As a result of defendants' false statements and use of inappropriate models to value the company's mortgage-related assets, Bear Stearns' stock traded at artificially inflated prices during the class period. The complaint also names the company's outside auditor, Deloitte & Touche, as a defendant for knowingly and recklessly offering materially misleading opinions about the company's financial statements and ignoring red flags about the company's mortgage valuation models.

Judge Sweet held that plaintiffs' allegations of materially misleading statements were sufficient, stating that where the complaint alleged that defendants' misstatements inflated asset values, understated risk and losses, and denied a liquidity crisis to investors, "[s]uch quantitatively and, particularly, qualitatively significant information goes to the heart of Bear Stearns' corporate value and financial stability, and it is far from being 'obviously unimportant to a reasonable investor.'"

The district court also held that plaintiffs' allegations "create a strong inference of scienter," where the complaint alleged that the defendants "willfully or recklessly disregarded warnings from the SEC regarding Bear Stearns' risk and valuation models, which allegedly were designed to give falsely optimistic accounts of the company's risk and finances during the Class Period" and that the defendants "improperly delayed taking the hedge fund collateral, thus intentionally or recklessly avoiding the revelation of losses and the consequent negative effect."

Judge Sweet rejected defendants' cries of "fraud by hindsight," and more specifically their contention that, along with virtually every other major financial institution and government regulation, they were unable to predict the unexpected market implosion that led to the company's collapse. The court held that "the incantation of fraud-by-hindsight will not defeat an allegation of misrepresentations and omissions that were misleading and false at the time they were made." With regard to a competing inference of unpredictable market-wide collapse advanced by defendants, the court cited with approval *In re Ambac*, 693 F. Supp. 2d 241 (S.D.N.Y. 2010), which held that the conduct that plaintiffs alleged, if true, "would make [defendants] an active participant in the collapse of their own business, and of the financial markets in general, rather than merely a passive victim." Judge Sweet added that the "same logic applies here, where Defendants' alleged misconduct was integral to the decline of Bear Stearns, and the financial markets with it."

Judge Sweet further held that plaintiffs had adequately alleged loss causation and rejected defendants' assertion that the drop was merely part of a market-wide downturn. The company's "failure to maintain effective internal controls, its substantially lax risk management standards, and its failure to report its 2006-2007 financial statements in accordance with GAAP," Judge Sweet noted, "conveyed the impression that the Company was more profitable, better capitalized, and would have better access to liquidity than was actually the case," and also artificially inflated the price of Bear Stearns' securities during the class period. Therefore, "the precipitous declines in value of the securities purchased by the Class were a direct, foreseeable, and proximate result of the corrective disclosures of the truth with respect to Defendants' allegedly false and misleading statements."

With respect to claims against the company's accountant, Deloitte & Touche, Judge Sweet held that the securities complaint set forth specific GAAP and GAAS violations in addition to red flags Deloitte should have noticed, and thus adequately alleged the firm's recklessness, "if not actual knowledge, based on its awareness of red flags and its duty to investigate." Judge Sweet thus held that plaintiffs had adequately alleged scienter as to Deloitte, noting that "[t]he facts underlying the alleged accounting violations with respect to the valuation models and fair value measurements, the hedge funds and the inference from the events of the collapse establish the failure to consider the red flags and constitute an adequate allegation of reckless disregard sufficient to establish scienter."

In re Bear Stearns Companies, Inc. Securities, Derivative, and ERISA Litigation, No. 08 MDL 1963, 2011 U.S. Dist. LEXIS 6026 (S.D.N.Y. Jan. 19, 2011).

Motion to Dismiss
Coventry's Unhealthy Decline

On March 30, 2011, Judge Alexander Williams, Jr. of the United States District Court for the District of Maryland ruled on defendants' motion to dismiss plaintiffs' consolidated amended complaint, denying the motion as to two separate allegations that Coventry Health Care, Inc. ("Coventry") and four of its officers had deceived investors.

Coventry provides a range of medical-related products and services, including group and individual health insurance, Medicare and Medicaid programs, and coverage for specialty services such as workers' compensation and behavioral health care. Coventry's Private Fee-For-Service ("PFFS") product, a type of Medicare plan, allowed members to receive medical care from any providers eligible to treat Medicare beneficiaries. Plaintiffs alleged that Coventry rapidly gained market share in the PFFS business but that it overwhelmed their capacity to process claims, resulting in a host of errors and delays. Plaintiffs contended that Coventry concealed these problems and portrayed its loss ratios (as a percentage of premiums collected) as lower

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GovernanceMetrics International's
2011 Public Funds Forum

GovernanceMetrics International Presents: The Future of Corporate Reform 2011 Public Funds Forum

September 6-8, 2011 • Ritz-Carlton • Half Moon Bay, California

This September, representatives from public funds across the country will meet in beautiful Northern California to share new tools critical to help create a future which includes robust oversight and accountability in corporate practice and financial markets. The three days of informative panel sessions will permit attendees to hear analyses from corporate governance thought-leaders, share their experiences, and enjoy informal networking opportunities at events centered around the natural beauty of the California coast.

The current financial crisis has brought numerous changes. One of these developments is the emergence of new and stronger investor advocates. The merger of **The Corporate Library** with **GovernanceMetrics International** has created the world's leading independent firm dedicated to monitoring corporate risk ratings and providing suites of tools to active institutional investors. Public funds are partnering with investor advocates to reclaim their power to help repair and strengthen the investment climate. Although the losses suffered in the worst crisis since the Great Depression are still fresh, institutional investors are taking increasingly active roles in monitoring corporate malfeasance, reforming dysfunctional corporate boards, and safeguarding investor assets for the benefit of plan participants.

Governor Arnold Schwarzenegger
California's 38th Governor, Cultural Icon

Arianna Huffington
Author, Syndicated Columnist, Co-Founder, The Huffington Post

In furtherance of their mission, GovernanceMetrics International will host the third annual **Future of Corporate Reform Public Funds Forum** from September 6-8 at the Ritz-Carlton in Half Moon Bay, close to San Francisco and technology-rich Silicon Valley. Sponsors of the conference include **Robbins Geller Rudman & Dowd LLP**, the premier plaintiffs' securities litigation firm, and class-action administration experts **Gilardi & Co**. The exclusive conference sessions are designed to give representatives of public pension systems the knowledge and tools to help repair the markets, reshape corporate reform and create and protect long-term value.

Opening remarks will be given by **Robert A.G. Monks**, referred to by *The Economist* and *Fortune* magazines as the leading shareholder activist and governance advocate in the world. A keynote address from former California Governor **Arnold Schwarzenegger** will follow. Panel leaders, including **Anne Sheehan**, the CalSTRS Director of Corporate Governance, corporate governance experts **Nell Minow** and GMI Executive Chairman **Richard A. Bennett**, and shareholder litigation expert **Darren J. Robbins**, will explore a variety of issues of keen interest to public fund representatives, ranging from the new rules on director nominations and "say on pay" to winning governance reforms through securities litigation. Other speakers include **Michael Power**, Director of Canada's OMERS Administration Corporation; **Bill Lockyer**, the State Treasurer of California; **Byron S. Georgiou**, a member of the Financial Crisis Inquiry Commission; **Professor Jesse M. Fried** of Harvard Law School; media mogul **Arianna Huffington**; and economist/humorist **Ben Stein**.

The long-term success of investment strategies that emphasize a focus on corporate governance has been borne out by the recent crisis. A new investment climate calls for new tools to shape policy and protect assets. For representatives of public funds and corporate governance leaders, the third annual Future of Corporate Reform is shaping up to be this year's must-attend conference. Participants and speakers alike will develop new contacts and exchange views while taking advantage of networking activities including a beachside "Taste of the Mediterranean" dinner, horseback riding on the beach, golf at Half Moon Bay and a Santa Cruz wine tasting tour.

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

Litigation Update continued from page 5

than they actually were. When bad news started to filter out, Coventry's stock declined by more than 20%. Finally, when Coventry disclosed that it was reducing its earnings guidance due to bad loss ratios (resulting from the PFFS business), its stock dropped another 51%.

New England Teamsters & Trucking Industry Pension Fund, United Food and Commercial Workers Union Local 880 – Retail Food Employees Joint Pension Fund and **Southern California IBEW-NECA Pension Plan** were designated lead plaintiffs for a proposed class of purchasers of Coventry stock between February 9, 2007 and October 22, 2008. Plaintiffs filed their consolidated amended complaint in May 2010, against Coventry and four of Coventry's officers alleging three counts of violations of the federal securities laws: I. Rule 10b-5; II. Rule 10b-5(a) and (c) (the first two counts being violations of Section 10(b) of the Securities Exchange Act of 1934 ("1934 Act")); and III. Section 20(a) of the 1934 Act. In Judge Williams' order on defendants' motion to dismiss, he ruled that some of plaintiffs' allegations were not actionable. However, he also denied defendants' motion as to all three counts of the complaint.

For Count I, Judge Williams held that plaintiffs adequately alleged that positive statements made by Coventry on April 25, 2008 and May 21, 2008 were materially misleading, and that defendants "knew or should have known about the claims processing issues and how this would affect [unreported reserve] levels" and that defendants' positive statements were made while they "allegedly had knowledge of the problems processing PFFS claim[s]," which, if true, "would render the statement materially misleading." For Count II, the judge wrote that one individual defendant's sales of Coventry stock after the statements adequately alleged in Count I meant he would deny defendants' motion to dismiss the count against Coventry and that individual defendant. Finally, Judge Williams upheld Count III, for violations of Section 20(a) against the individual defendants, finding that plaintiffs had shown that the individual defendants were controlling persons who used their power to cause the company to engage in wrongful conduct.

In re Coventry Healthcare, Inc. Securities Litigation, No. 8:09-cv-02337-AW, Memorandum Opinion (D. Md. Mar. 30, 2011). ■

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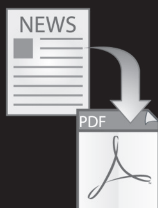
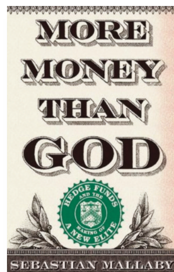


Recommended Reading



More Money Than God: Hedge Funds and the Making of a New Elite

Sebastian Mallaby

Penguin Press, 2010

Author Sebastian Mallaby lays out his central thesis in the first few pages of his book: "the future of finance lies in the history of hedge funds." It's not a bad thesis, and one that Mallaby takes nearly 500 pages to lay out in this thorough and readable book. The first hedge fund was a "hedged" fund, begun by Alfred Winslow Jones, a 1950s *bon vivant* who developed the strategy of reducing investment risk by going "long" on some stocks he thought would rise and "shorting" others he figured would fall, in other words, hedging the risk. This basic long-short strategy, taken to interesting extremes over the last decade, underlies a number of modern hedge funds who have made such impressive returns that they have accumulated more capital than John Pierpont Morgan himself ever did. Morgan, the legendary late 19th century banking tycoon, was sometimes called "Jupiter" (referring to the chief god of the Roman pantheon) for his sizeable fortune, over $1.4 billion in today's dollars. Today's modern hedge fund managers outpace even Morgan, hence the book's title. Mallaby's study of the rise of these latter-day financial Jupiters is timely.

Hedge funds have made a name for themselves of late – what with the outsized returns that many have earned for their partners, as well as their unfortunate role in collapsing certain sectors of the global economy. The fee structure of most hedge funds is fairly open, which contrasts with the secretive nature of their trading operations. The typical hedge fund, as Mallaby explains, has a "2/20" structure, meaning the fund collects 2% of the assets invested off the top, and keeps 20% of any profits made. Many hedge fund managers keep their own earnings in the fund as well. The objective of the fund is to beat the returns available to the average investor through novel and often complex trading strategies, mixing up short and long positions, which are often held for very brief periods, even just a few minutes, as part of hyperactive trading schemes. Since their positions are kept fairly secret, the funds hold their cards close to the vest.

Many of the most profitable hedge funds are suburban, based in places like Mayfair, London and Stamford, Connecticut. Despite the office-park dullness of their physical headquarters, hedge fund managers earn skyscraper-sized amounts of money. Consider that in 2006, the pay packet and bonus of Lloyd Blankfein, CEO of Goldman Sachs, was an amazing $54 million. Yet Blankfein's staggering income would not have even placed him among the top 25 hedge fund managers that year – No. 25 on *Alpha's* 2006 list took home $240 million. A few hedge fund managers have become famous – George Soros, who founded Quantum, and John Paulson, whose fund made a killing shorting the mortgage securities bubble. Many of the rest are hardly known outside financial circles – that is, until the recent indictment and conviction of Galleon Capital's Raj Rajaratnam on an array of fraud and conspiracy counts stemming from insider trading.

The obsession to maximize returns and prove they are smarter than the other guys has led hedge fund managers to engage in trades that have resulted in currency devaluations and economic hardship. Soros famously shorted the British pound, bringing the Central Bank of England to its knees. Similar devaluations struck the Thai and Indonesian currencies during the "Asian contagion" of the late 1990s, as hedge funds placed massive bets against the Thai baht and Indonesian rupiah. More recently, hedge funds have done well betting against the U.S. housing market, and furiously trading commodities like wheat and oil. The "hedges" employed often allow the funds to earn as much if not more money in "down" markets than in up – a cause for resentment among many. Unlike corporations, hedge funds have no boards of directors, no shareholders, and no corporate governance. And, although no hedge fund received a penny of taxpayer bailout money, the Americans who daily buy groceries and gasoline inadvertently contribute billions toward the funds' bottom line.

Mallaby acknowledges the current hostility towards the hedge fund industry, not the least of which is because of the outsize pay, and his lucid writing style brings interest to the topic. Sadly, what is left somewhat unexamined is whether the world really needs giant hedge funds. The sole social utility of hedge funds is ostensibly to "even out" the cyclical nature of economic trends, and reward the proper allocation of capital. *More Money Than God* establishes that this is quite often not the case. ■

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Calendar of Upcoming Events

July 14, 2011

PIRC
The Corporate Governance and Responsible Investment Journalism Awards 2011

London, England

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

In recognition of the important contribution that journalists make in the areas of corporate governance and responsible investment, and to encourage quality journalism, PIRC and Robbins Geller Rudman & Dowd LLP are pleased to announce the Corporate Governance and Responsible Investment Journalism Awards. Now in their second year, these awards are intended to recognize those journalists who are helping record and clearly explain the issues emerging in these vitally important areas.

For more information, visit: www.pirc.co.uk/awards

August 5-10, 2011

National Association of State Retirement Administrators (NASRA)
2011 Annual Conference

Grand Geneva Resort
Lake Geneva, Wisconsin

This annual conference offers approximately 20 hours of program to conference participants. Presentations are on a variety of subjects, including investment management, world events applicable to the pension industry, data processing, healthcare and significant happenings in each of the states and territories.

For more information, visit: www.nasra.org

August 28-31, 2011

National Association of State Treasurers (NAST)
2011 Annual Conference

Bismarck, North Dakota

The nation's state treasurers will gather at this conference to examine both the critical issues impacting the state treasuries and the innovative programs that benefit their citizens. The government and public finance leaders of the 21st century will debate the new dynamics that will bring about a "future of opportunity" in public finance.

For more information, visit: www.nast.org

September 6-8, 2011

GovernanceMetrics International
The Future of Corporate Reform 2011 Public Funds Forum

Ritz-Carlton
Half Moon Bay, California

This is an invitation-only educational conference designed to educate public fund representatives on practices to best fulfill fiduciary duties, protect portfolio assets and create long-term value. This three-day event is intended for executive directors, chief executives, administrators, general counsel, investment officers, finance officers, fund trustees, corporate governance officials and other representatives of public funds across the United States and Europe.

For more information, visit: GMIconferences.com

September 12-14, 2011

International Corporate Governance Network (ICGN)
2011 Annual Conference

Pullman Montparnasse
Paris, France

This conference will inform institutional investors, business leaders, policymakers and professional advisors on best practice guidance, leadership development and emerging issues in corporate governance.

For more information, visit: www.icgn.org

September 20, 2011

Practising Law Institute
Securities Litigation & Enforcement Institute 2011

PLI New York Center
New York, New York

Featured Speaker: **Samuel H. Rudman**,
Robbins Geller Rudman & Dowd LLP

This institute is designed for the securities practitioner, outside and in-house counsel, compliance officers, regulators, investment bankers and securities dealers. This event will focus on government enforcement initiatives and how to deal effectively with the government; criminal investigation and prosecution of securities violations; the latest on corporate governance litigation; and what the financial crisis means for securities litigation. There will also be a discussion on the view from in-house: advising the board and effectively handling such corporate issues as D&O liability and the effects of M&A transactions.

For more information, visit: www.pli.edu

September 25-27, 2011

Council of Institutional Investors (CII)
2011 Fall Meeting

The Westin Boston Waterfront
Boston, Massachusetts

The Council of Insitutional Investors is a nonprofit association of public, union and corporate pension funds. Member funds are long-term shareowners with a duty to protect the retirement assets of millions of American workers. The annual meeting will educate members, policymakers and the public about good corporate governance, shareowner rights and related investment issues.

For more information, visit: www.cii.org

September 26-28, 2011

National Coordinating Committee for Multiemployer Plans (NCCMP)
2011 Annual Conference

The Diplomat Hotel
West Hollywood, Florida

The NCCMP is dedicated exclusively to the advocacy and protection of multiemployer plans, their participants and their families. By communicating with government officials, members of Congress and staff about the unique characteristics of multiemployer plans, the NCCMP has saved multiemployer plans hundreds of millions of dollars in regulatory and administrative costs. These savings enable plans to remain financially secure and healthy, while providing enhanced benefits to plan participants.

For more information, visit: www.nccmp.org

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