

2017 Annual Securities Law Workshop

# SECURITIES LITIGATION UPDATE

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# Securities Class Actions Are Back

- In 2016, 300 securities class actions were filed in federal courts;
  - Big jump from 2015 (228 cases filed);
  - The last time there were more than 300 cases was in 2001;
- That is the highest number since the early 2000 dot.com suits;
- Most cases sought injunctive relief to enjoin mergers (88 of the cases) – “merger tax” cases;
- 262 securities class actions were either dismissed or settled in 2016;
- The average settlement amount grew 35%.

# Securities Class Actions Are Back

- 9th Circuit: 87 cases
- 2<sup>nd</sup> Circuit: 72 cases
- 3<sup>rd</sup> Circuit: 34 cases
- 28% of cases: Health Technology and Services
- 21% of case: Finance Sector
- Up trend continues in 2017: 246 cases in first 6 months of 2017

# Securities Class Actions Are Back

## Utah in 2017

- Lentsch v. Vista Outdoor (D. Utah filed January 25, 2017)  
(securities class action)
- Rumbaugh v. USANA (filed D. Utah Feb. 13, 2017)
- Berg v. Nutraceutical International Corporation (filed July 21, 2017  
D. Utah) (securities class action)

# Notable U.S. Supreme Court Cases

## California Public Employees' Retirement System v. ANZ Securities, Inc. (decided June 26, 2017)

- In a 5-4 decision, the U.S. Supreme Court held that an opt-out plaintiff who purchased Lehman Brothers Holdings Inc. securities in 2007 and 2008, but who did not sue under Section 11 until after opting out in February 2011 – more than 3 years after the securities offerings -- was time barred from suit;
- Section 13 of the Securities Act of 1933 provides two time limits for §11 suits:
  - An action “must be brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence. . . .” (statute of limitation)
  - “[i]n no event shall any such action be brought . . . more than three years after the securities was bona fide offered to the public. . . .” (statute of repose)

# Notable U.S. Supreme Court Cases

## California Public Employees' Retirement System v. ANZ Securities, Inc. (decided June 26, 2017)

- The Supreme Court held that there is no equitable tolling;
- A statute of repose cannot be extended based on equitable principles;
- The fact that there was a timely class action, and an opt out, does not permit equitable tolling;
- The dissent said that an opt out plaintiff should be protected by the original action.
- Take away: opt out at your SOL peril.

# Notable U.S. Supreme Court Cases

## Kokesh v. S.E.C. (decided June 5, 2017)

- In 2013, the U.S. Supreme Court held in *Gabelli v. SEC* that there was a 5-year statute of limitations for monetary penalties sought by the S.E.C.;
- The S.E.C. nevertheless took the position that there was no statute of limitations for disgorgement.
- The S.E.C. argued that the 5-year limitations period only applied to “civil fines, penalties or forfeitures” and disgorgement was not one of these items.
- The 10th Circuit agreed.
- The U.S. Supreme Court reversed and held that disgorgement is a penalty.
- Disgorgement actions are now subject to the 5-year statute of limitations.

# Notable U.S. Supreme Court Cases

## Leidos v. Indiana Public Retirement System (cert. granted March 27, 2017)

- U.S. Supreme Court granted cert. to resolve a circuit split on the issue of whether Item 303 of SEC Regulation S-K creates a duty to disclose that is actionable under Section 10(b) and Rule 10b-5.
- Item 303 of Regulation S-K sets forth the disclosure requirements for the MD&A section of public company Form 10-Qs.
- Item 303 states that a public company must:
  - “[d]escribe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations.”

# Notable U.S. Supreme Court Cases

Leidos v. Indiana Public Retirement System (cert granted March 27, 2017)

- The 2nd Circuit held that a failure to make the required Item 303 disclosure is an actionable omission under Section 10(b), provided it is material. Stratton v. City of Cleveland;
- The 9th Circuit disagreed, and held that 303 does not create a duty to disclose for purposes of Section 10(b) and Rule 10b-5. NVIDIA Corp. Sec. Litigation.
- The Court will hear the case in the term beginning October 2017 to resolve the split in the circuits.

# Notable U.S. Supreme Court Cases

Cyan, Inc. v. Beaver County Employees Retirement Fund (cert. granted June 27, 2017)

- The Supreme Court granted cert. to decide whether or not state courts retain concurrent jurisdiction for lawsuits under the 1933 Act, or whether as a result of the Securities Litigation Uniform Standards Act of 1998, state courts lack subject-matter jurisdiction over 1933 Act suits.
- California has a body of case law that holds that 1933 Act cases filed in state court under concurrent jurisdiction are not removable from state court to federal court.

# Notable U.S. Supreme Court Cases

## Cyan, Inc. v. Beaver County Employees Retirement Fund (cert. granted June 27, 2017)

- In this case, shortly after an IPO, a class action was filed in state court in California. The defendants filed a motion for judgment on the pleadings, arguing that the state court lacked subject matter jurisdiction under SLUSA. The trial court denied the motion. The California Court of appeals denied the writ of mandate.
- The California Supreme Court also denied a petition for review.
- The question pending before the U.S. Supreme Court is whether “state courts lack subject matter jurisdiction over covered class actions that allege only 1933 Act claims.”

# Notable U.S. Supreme Court Cases

## Salman v. United States (decided December 6, 2016)

- The U.S. Supreme Court unanimously affirmed the 9th Circuit's holding that a tipper's gratuitous "gift" of inside information to a trading relative or friend did, in fact, provide a "personal benefit" to the tipper, such that the tipper could be considered to have breached his fiduciary duty and the tippee could be liable for trading on the non-public information.
- The case resolved the split between the 9th circuit and the 2nd Circuit, which held in United States v. Newman that a gift could only support an insider trading conviction if the tipper received something of pecuniary or similar value in exchange for the gift.

# Notable Case Impacting SEC ALJs

- The District of Columbia Circuit Court of Appeals' earlier decision in Lucia v. SEC that the SEC ALJs are employees who are not subject to the Appointments Clause of the U.S. Constitution remains the law in the D.C. Circuit after a ten-judge *en banc* panel of the Court deadlocked on the issue, resulting in a one-page per curiam order issued on June 26, 2017, denying Lucia's petition for review. No appointments violation in D.C. Circuit.
  - The SEC's Office of Administrative Law Judges appoints ALJs.
  - They are not appointed by the President.
  - There is now a circuit split.
- The 10<sup>th</sup> Circuit Court of Appeals found ALJs to be appointed in violation of the Constitution's Appointments Clause, requiring appointment by the President. Bandimere v. SEC (10<sup>th</sup> Cir. Dec. 27, 2016, reh'g denied, 855 F.3d 1128 (May 3, 2017)).

# Notable Case Impacting SEC ALJs

- The SEC issued a stay of all cases in the 10th Circuit as a result of Bandimere.
- The 2nd, 8th, 9th and 11th Circuits all have similar cases pending.
- The 8th Circuit's case – Bennett v. SEC -- was argued and submitted on June 7, 2017.
- No petition for certiorari has been filed in Lucia or Bandimere, but petitions are expected.
- A ruling by the US Supreme Court that SEC ALJs have been unconstitutionally appointed potentially might call into question all prior SEC ALJ adjudications.

# Notable Cases in State Court in Utah

## Rawcliffe v. USANA Health Sciences, Inc. (filed June 2014)

- Derivative case filed in Third Judicial District Court;
- Dismissed by Keith Kelly;
- On appeal to the Utah Supreme Court;
- Oral argument was on May 10, 2017;
- The case challenges an award of stock-settled stock appreciation rights (“SSARs”) that were “spring-loaded, i.e., granted just prior to the release of material information expected to drive the market price of the Company’s stock higher, thereby artificially increasing the value of the SSARs by establishing an artificially low exercise price.”

# Notable Cases in State Court in Utah

## Rawcliffe v. USANA Health Sciences, Inc. (filed June 2014)

- Alleges that the Compensation Committee “granted the spring-loaded SSARs . . . when they knew that USANA was about to announce impressive financial results . . . .”
- Judge Kelly dismissed the Complaint for failure to state a claim.”
- Plaintiffs allege breach of fiduciary duty.
- There are no Utah cases.
- There is some limited Delaware case law.

# Notable Cases in State Court in Utah

## Gordon v. InContact (filed June 2016)

- Filed in Third Judicial District Court;
- Challenged proposed merger of inContact with Nice-Systems, Ltd. through Victory Merger Sub Inc.;
- Alleged state law claims of an alleged breach of the duty of loyalty and duty of care;
- Alleged self-dealing in terms of compensation packages;

# Notable Cases in State Court in Utah

## Gordon v. InContact (filed June 2016)

- Alleged an inadequate price;
- Prayed for injunctive relief;
- Case was recently settled for expanded shareholder disclosures;
- Attorneys' fees were permitted by the Court.
- Some might call it a “merger tax” case.

# Notable Cases in State Court in Utah

## Jack Phillips v. Department of Commerce, Division of Securities (Utah Court of Appeals, May 18, 2017)

- Held that there was not a 5-year statute of limitations for administrative disciplinary proceedings filed by the Division of Securities;
- Moot: Legislature passed a Statute of Limitations last session;
- Held: that the Commission has the power to enforce a fine free from the limitations that would apply in district court, i.e., \$10,000 per violation;
- The Court also provided guidance to what fines the Commission can award and remanded for clarification of fines.

# Notable Cases in Federal Court in Utah

## SEC v. Traffic Monsoon, LLC (filed March 29, 2017 in D. Utah)

- Judge Parrish held that the S.E.C. can bring an enforcement action based on allegedly foreign securities transactions involving non-U.S. residents when sufficient conduct occurred in the United States;
- This decision gained national notoriety;
- It is the first decision to squarely resolve whether the Dodd-Frank Act succeeded in allowing the Government to pursue extra-territorial claims.
- The Utah court recognized that the Acts' grant of jurisdiction was in response to Morrison v. National Australia Bank (2010), where the U.S. Supreme Court limited jurisdiction to U.S. Based transactions.

# Notable Cases in Federal Court in Utah

## SEC v. Traffic Monsoon, LLC (filed March 29, 2017 in D. Utah)

- The Utah Court held that the S.E.C. can file suit based on “conduct” or “effects” in the U.S., regardless of where the actual securities transactions took place.
- Section 929P(b) of Dodd Frank provides that federal district courts “shall have jurisdiction of any action or proceeding brought or instituted by the [SEC] or the United States” alleging a securities violation involving:
  - “conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors;” or
  - “conduct occurring outside the United States that has a foreseeable substantial effect within the United States.”

# Notable Cases in Federal Court in Utah

## SEC v. Traffic Monsoon, LLC (filed March 29, 2017 in D. Utah)

- This does not apply to private securities litigation – just SEC/DOJ;
- Traffic Monsoon is a Utah-based company that sells packages to “members;”
- 90%+ of those members reside outside of the U.S.;
- The SEC accused the company of being an illegal Ponzi scheme;
- The defendants argued that for the non-U.S. transactions, the court could not enjoin the activity because the non-U.S. customers purchased the packages on the internet outside the U.S.;
- The court held that because the defendant operated in the U.S., the “conduct” test of the statute was satisfied and issued injunction.

# Notable Cases in Federal Court in Utah

## SEC v. Traffic Monsoon, LLC (filed March 29, 2017 in D. Utah)

- The court also held that because defendants delivered products from the U.S., the transaction test also was satisfied.
- Accordingly, the Court granted a preliminary injunction.
- The court immediately certified its decision for interlocutory appeal to the 10<sup>th</sup> Circuit.
- It will be interesting to see what the 10<sup>th</sup> Circuit does.

# Notable Cases in Federal Court in Utah

## Rumbaugh v. USANA (D. Utah filed February 13, 2017)

- On February 7, 2017, USANA disclosed that “[t]he Company is voluntarily conducting an internal investigation of its China operations, BabyCare Ltd. . . . focus[ing] on the compliance with the Foreign Corrupt Practices Act. . . .;”
- The Complaint alleges that “USANA’s share price fell \$7.25, or 11.57%, to close at \$55.40 on February 8, 2017;”
- Complaint purports to allege violations of Section 10(b) of the Exchange Act and Rule 10b-5, as well as Section 20(a) of the Exchange Act.
- Early stage in the litigation.

# Notable Cases in Federal Court in Utah

## Lentsch v. Vista Outdoor (D. Utah filed January 25, 2017)

- Plaintiffs allege that Vista was experiencing a softening of the retail market and an acceleration of its promotional activity, and failed to begin the impairment assessment for financial reporting purposes;
- Plaintiffs allege that Vista should have alleged an impairment charge in the range of \$400 million to \$450 million, but failed to do so.
- Early stage in the litigation.

# Notable Cases in Federal Court in Utah

## S.E.C. v. Michael D. Shumway (D. Utah filed April 5, 2017)

- Filed a case against the former corporate secretary and treasurer of two Utah water companies for allegedly misappropriating and fraudulently selling corporate shares.
- The S.E.C. alleges that Shumway misappropriated unauthorized shares of stock in American Fork Irrigation Company and Lehi Irrigation Company and sold them for \$435,000;
- Shumway also allegedly took \$633,396 from the companies;

# Notable Cases in Federal Court in Utah

## CFTC v. Tallinex (D. Utah filed May 30, 2017)

- Alleges failure to register with CFTC as required by Dodd-Frank with respect to offer and sale of off-exchange foreign currency (“forex”) transactions;
- Tallinex is an Estonian company;
- Alleges Tallinex solicited or accepted orders in the U.S. without being registered.
- So far, Tallinex is ignoring the lawsuit.

# Notable Cases in Federal Court in Utah

## Althaus v. Broderick (opinion dated July 22, 2016)(Judge Parrish)

- Violations occurring more than 5-years prior to filing are barred by the statute of repose;
- Judge Parish rejects the continuing fraud exception as inconsistent with the 5-year statute of repose;
- Similar to California Public Employees' Retirement System v. ANZ Securities, Inc. (decided by U.S. Supreme Court on June 26, 2017).
- A statute of repose is a bar – no equitable way around the 5 years.

# Notable Cases in Federal Court in Utah

## S.E.C. v. Alpine Securities (S.D.N.Y. June 5, 2017)

- The S.E.C. charged Alpine Securities with securities law violations related to its process for clearing transactions;
- The Complaint alleges that Alpine Securities failed to file Suspicious Activity Reports (“SARs”) for stock transactions that were “suspicious”;
- The SEC’s Complaint charges Alpine with violations of Section 17(a) of the Securities Exchange Act of 1934 and Rule 17a-8.

# Notable Cases in Federal Court in Utah

## FINRA Department of Enforcement v. Scottsdale Capital Advisors (FINRA March 31, 2017)

- FINRA held that Scottsdale Capital Advisors Corporation violated Rule 2010 by selling securities without registration and without an exemption, in contravention of Section 5 of the Securities Act of 1933.
- FINRA fined SCA \$1.5 million.

# Notable 10th Circuit Cases

## The Pioneer Centres Holding Company ESOP v. Alerus Financial, N.A. (10th Cir. June 5, 2017)

- Granted summary judgment because the evidence of causation did not rise above speculation;
- ON appeal, the plaintiff argued that the burden of proving causation should be on the defendant to disprove causation, once the plaintiff made a prima facie case;
- The Tenth Circuit affirmed. It noted that the plaintiff did not establish a prima facie case of loss in the first instance.

# Notable 10th Circuit Cases

## BOSC v. Board of County Commissioners (10<sup>th</sup> Cir. April 11, 2017)

- A New Mexico Board sued its securities broker and registered agent in state court.
- The Board did not serve the complaint.
- It waited to figure out if it needed to arbitrate or not.
- In the interim, the securities broker and agent removed the case to federal court and moved to dismiss.
- The Board voluntarily dismissed and filed an arbitration.

# Notable 10th Circuit Cases

## BOSC v. Board of County Commissioners (10<sup>th</sup> Cir. April 11, 2017)

- The broker and agent then filed an action to enjoin the arbitration, arguing that the Board waived arbitration by first filing the state court action.
- The 10th Circuit affirmed the district court in dismissing the case. There was no waiver because the Board stopped short of choosing litigation over arbitration by refraining from service of process until it figured out what direction to go.
- Attorneys fees were denied the broker and agent because they voluntarily decided to show up in court and litigate.

# Notable 10th Circuit Cases

## SEC v. American Pension Services (10th Cir. March 9, 2017)

- A receiver settled with First Utah Bank with respect to funds misappropriated by a fund custodian.
- The settlement included a bar order, which barred all other claims against First Utah.
- 3 of the 5500 APS clients intervened and contended that the court could not bar them from filing their own claims against First Utah.
- The district court disagreed and approved the settlement with a bar order.
- The 10<sup>th</sup> Circuit affirmed. A key fact was that without the bar order, the viability of First Utah bank was potentially in jeopardy, so the 10<sup>th</sup> Circuit affirmed the equitable power of the district court to enter the bar order.

# Notable 10th Circuit Cases

## Avenue Capital Management v. Schaden (10<sup>th</sup> Cir. December 13, 2016)

- Quiznos was in financial trouble;
- Multiple investment funds came into restructure the debt and purchased controlling equity in Quiznos;
- After Quiznos finances further plummeted, the funds sued former Quiznos managers and officers for securities fraud;
- The district court dismissed the complaint because the funds could not prove that there were any investment contracts involved;
- The 10th Circuit affirmed. The transaction did not involve investment contracts because of plaintiffs' control.

# Notable 10th Circuit Cases

## Avenue Capital Management v. Schaden (10<sup>th</sup> Cir. December 13, 2016)

- The funds controlled Quiznos, and thus controlled the profitability of their own investments in Quiznos;
- Accordingly, because there was no dependency on the managerial skills of others, there was no investment contract. The funds owned 80% of the LLC.
- As for the alternative test of whether the investment involved “securities” and “stocks,” these alternative arguments were never made in the district court, so they were not preserved.

# Developing Case?

Newspapers have reported that the SEC is investigating The Falls Event Center. See, e.g., Oregon Business News, July 23, 2017 “Landlord of Oregon’s Evergreen Aviation & Space Museum subject of SEC inquiry”

So far, no legal action by S.E.C. or other regulators.

Something to watch?

## Other Notable Cases filed in Utah

- CFTC v. Parker (D. Utah September 21, 2016)
- S.E.C. v. Blackbird Capital Partners (D. Utah November 28, 2016)
- Baker v. Jensen (filed February 27, 2017)
- Lewis v. Lipocine Inc. (filed March 14, 2017)
- TDC Lending v. Private Capital Group (filed March 15, 2017)
- S.E.C. v. Thomas Andrews, Scott Walter Christensen (filed April 5, 2017)
- Garb Oil & Power v. Titan International Securities (filed July 12, 2017 D. Utah)