BULLETIN

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A Quarterly Newsletter for Institutional Investors by Schiffrin & Barroway, LLP

S&B ACHIEVES VICTORY UNDER OFTEN OVER-LOOKED SECURITIES ACT

By: Andrew L. Zivitz, Esquire

In today's era of corporate fraud, with the likes of Enron and WorldCom dominating the public stage, investors need to be reminded that the Federal Securities Laws hold corporate wrongdoers responsible for negligent, as well as fraudulent, conduct. For example, the Securities Act of 1933 (the "Securities Act") strictly prohibits companies from offering securities to the public pursuant to a materially false or misleading registration statement or prospectus. Notably, fraudulent conduct is not an element of a claim brought under the Securities Act. The reason: companies have a strict obligation to ensure the accuracy of their offering documents before taking millions of dollars from unsuspecting investors. The benefit: it is a less onerous burden to prove a negligence claim under the Securities Act than a fraud claim under the Securities Exchange Act of 1934.

On July 21, 2005, S&B obtained a significant victory under the Securities Act against the officers, directors, underwriters, and controlling shareholder of DDi Corporation as the court sustained plaintiff's complaint. The facts are as follows: On February 14, 2001, DDi, certain of its officers and a controlling shareholder, captured $132 million from investors in a secondary securities offering. Just over 2 years later, in August 2003, DDi filed for bankruptcy. With the help of S&B, plaintiffs discovered that at the time of the February 2001 offering, DDi was already suffering from a material decline in business and the loss of its principal customers. The offering documents did not mention this information. Accordingly, on February 22, 2005, S&B filed a complaint under the Securities Act on behalf of a proposed investor class. In response, defendants filed a motion to dismiss the complaint arguing, in part, that plaintiffs were obligated, but failed, to allege that: (1) the offering

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SCHIFFRIN & BARROWAY – THE FRENCH CONNECTION

By: Roy Jones

Regular readers are already aware of the commitment that Schiffrin & Barroway has to helping international investors better understand how U.S. shareholder litigation works in practice. Only by being knowledgeable and informed of their rights and responsibilities, are international investors able to fully participate in appropriate cases, whether as lead or co-lead plaintiff in a class action, as a plaintiff in a direct action, or as a passive class member. Much of our job here is educational: to objectively and patiently explain the facts, where a lack of awareness, inexperience, or in the worst cases, deliberate misinformation, has clouded the debate. We take the same approach in helping these international investors, governments and other activists, in order to make them aware of the advantages and disadvantages of U.S. class actions in general, especially institutions in which they are seeking to introduce class litigation to their own legal systems.

In order to spread the word, Schiffrin & Barroway recently traveled to Paris, France on June 28, 2005, to co-host with the highly influential French Corporate Governance Association (l'AFAGE), a dinner debate which focused on class actions in the U.S. and France. Founding partner, Richard Schiffrin, Director of Institutional Relations, Darren Check and Roy Jones of Schiffrin & Barroway, joined Jean-Aymon Massie (l'AFAGE President), Colette Neuville (the "dean" of French investor rights) and several other key investors, representatives of business and employee shareholder associations, and journalists — all luminaries of the Parisian corporate governance world — in the debate.

The discussion first distinguished U.S. shareholder litigation from class actions litigation. Confusion between the two types of litigations has led some of the French participants to underestimate the size of institutional investor recoveries from shareholder litigation. After explaining the likely reasons behind the current trend of larger investor losses, the Schiffrin & Barroway team highlighted how the involvement of institutional investors as lead plaintiffs was driving higher recoveries, and causing errant corporate executives to contribute from their own pockets. The U.S. system of contingency based fees surprised many in the audience, as lawyers are only paid if they obtain a recovery and in the event of a loss, absent unusual circumstances, each side typically bears its own expenses. By contrast, the French system operates under "English Law," where the loser typically pays the costs of litigation. Surprise was also expressed at the effective and lasting corporate governance reforms that were being achieved through shareholder litigation.

Our experience in Paris reconfirmed our commitment to working with overseas institutions. On the one hand, there are those committed to constructively engaging in U.S. securities class actions, while on the other hand, some are simply seeking to learn from our experience as they chart their own course. Whatever the needs, we will continue to bring our experience to bear and help the education process through conferences and seminars, or in small group meetings with investors, trustees or labor unions. To date, that has taken Schiffrin & Barroway across Europe, and also into Canada and Australia, with more countries on the horizon.

COURT UPHOLDS 10B-5 CLAIMS AGAINST PARMALAT'S AUDITORS AND BANKERS

By: Eric Lechtzin, Esquire

Since the Supreme Court's 1994 decision in *Central Bank v. First Interstate Bank of Denver, N.A.*,[1] which eliminated the implied right of action for aiding and abetting violations of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5, and the passage of the Private Securities Litigation Reform Act of 1995 ("PSLRA"), it has become increasingly difficult for plaintiffs in securities fraud cases to bring state claims against corporate advisors, such as auditors and investment banks. As Judge Lewis A. Kaplan found in two separate opinions in the *Parmalat* class action,[2] however, the massive fraud perpetrated by Parmalat Finanziaria, S.p.A. and Parmalat S.p.A. and its affiliates (collectively "Parmalat" or "the Company"), presents a compelling case for holding auditors and investment banks accountable for directly participating in their client's fraudulent schemes. As a result, Judge Kaplan has allowed claims against many of Parmalat's advisors to go forward.

BACKGROUND

Often called "Europe's Enron,"[3] Parmalat's fraud resulted in the understatement of the Company's debt by approximately $10 billion and the overstatement of its assets by $16.4 billion. Parmalat's scheme has its origins in the early 1990s, when the Italian dairy conglomerate took on huge debts to finance its aggressive growth strategy. Its expansion into South America turned out to be ill-fated, and Parmalat began to lose hundreds of millions of dollars from its operations there. To conceal these losses, service its massive debt, and hide the personal diversion of funds by CEO Calisto Tanzi, the Company required constant infusions of cash. To this end, insiders at Parmalat and Grant Thornton S.p.A. ("GT-Italy") were alleged to have concocted a Ponzi scheme involving numerous transactions and offshore entities that created the appearance of financial health. For example, Parmalat used a fictitious sale of 300,000 tons of powdered milk to Cuba for $620 million, and then obtained loans on the basis of this phony sale that, in turn, were used to service debt and obtain more loans.

By late 2003, the scheme became unsustainable, and Parmalat had a liquidity crisis. Its collapse was rapid. In early December, Parmalat was unable to pay certain maturing bonds. By December 11th, its stock had lost half its value and Italian regulators sus-

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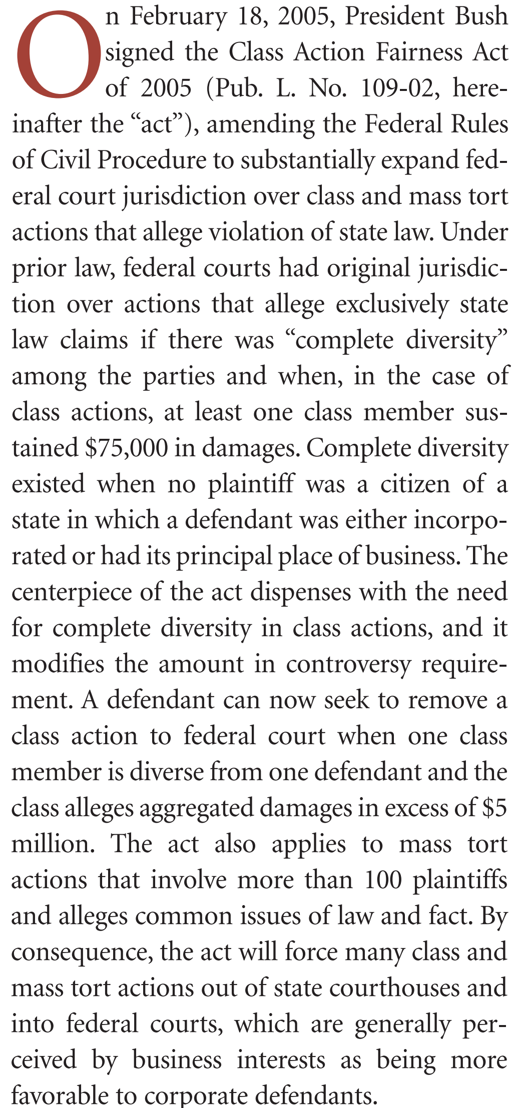
LITIGATION BULLETIN: CLASS ACTION FAIRNESS ACT OF 2005

By: John A. Kehoe, Esquire



On February 18, 2005, President Bush signed the Class Action Fairness Act of 2005 (Pub. L. No. 109-02, hereinafter the "act"), amending the Federal Rules of Civil Procedure to substantially expand federal court jurisdiction over class and mass tort actions that allege violation of state law. Under prior law, federal courts had original jurisdiction over actions that allege exclusively state law claims if there was "complete diversity" among the parties and when, in the case of class actions, at least one class member sustained $75,000 in damages. Complete diversity existed when no plaintiff was a citizen of a state in which a defendant was either incorporated or had its principal place of business. The centerpiece of the act dispenses with the need for complete diversity in class actions, and it modifies the amount in controversy requirement. A defendant can now seek to remove a class action to federal court when one class member is diverse from one defendant and the class alleges aggregated damages in excess of $5 million. The act also applies to mass tort actions that involve more than 100 plaintiffs and alleges common issues of law and fact. By consequence, the act will force many class and mass tort actions out of state courthouses and into federal courts, which are generally perceived by business interests as being more favorable to corporate defendants.

There is widespread disagreement over the need for such legislation and whether it improperly, and perhaps unconstitutionally, erodes the right of state courts to adjudicate state law claims. However, supporters and opponents of the legislation agree on at least one point: the act favors corporate defendants, which perhaps explains why the U.S. Chamber of Commerce spent more than $53 million in 2004 alone on efforts to lobby for the legislation. According to critics of the legislation, the bias in favor of corporate defendants occurs on several fronts. First, federal courts are reluctant to certify a class that includes citizens from multiple states when there are conflicting state laws that control the underlying claims at issue. Second, federal court judges have been more inclined than state court judges to grant a defendant's request to throw out suits or parts of a civil case before trial in a ruling known as summary judgment. Third, the federal jury system favors defendants because juror verdicts must be unanimous, whereas in at least 28 states a jury (in a civil action) can rule in a plaintiff's favor with a less than unanimous verdict, commonly referred to as the "three-fourths" or "five-sixths" rule.

In addition, federal civil dockets are backlogged from an unprecedented number of judicial vacancies and the federalization of criminal drug laws that take priority over civil disputes. For these reasons, the Federal Judicial Conference and Chief Justice Rehnquist opposed the legislation, citing the extraordinary burden it will place on the federal court system. Former Assistant Attorney General Eleanor D. Acheson of the U.S. Department of Justice warned that "federalizing of class actions [will] overburden the federal judiciary with class actions dealing solely with issues of state law." Burdening the federal courts with the class actions that were historically reserved for state courts will only further delay adjudication of complex class actions, an outcome that favors defendants.

Many political organizations, consumer groups, and trade unions, including the AARP, AFL-CIO, Consumer Federation of America, Consumers Union, Leadership Conference on Civil Rights, NAACP, Public Citizen, The National Conference of State Legislatures and the UAW, among others, voiced strong opposition to the legislation. They argued that the act is skewed in favor of corporate defendants at the expense of consumers and workers. Furthermore, Attorneys General from California, Illinois, Iowa, Kentucky, Maine, Maryland, Massachusetts, Minnesota, New York, New Mexico, Oklahoma, Oregon, Vermont, and West Virginia wrote to Senate leaders and expressed their collective view that the legislation "unduly limits the right of indi-

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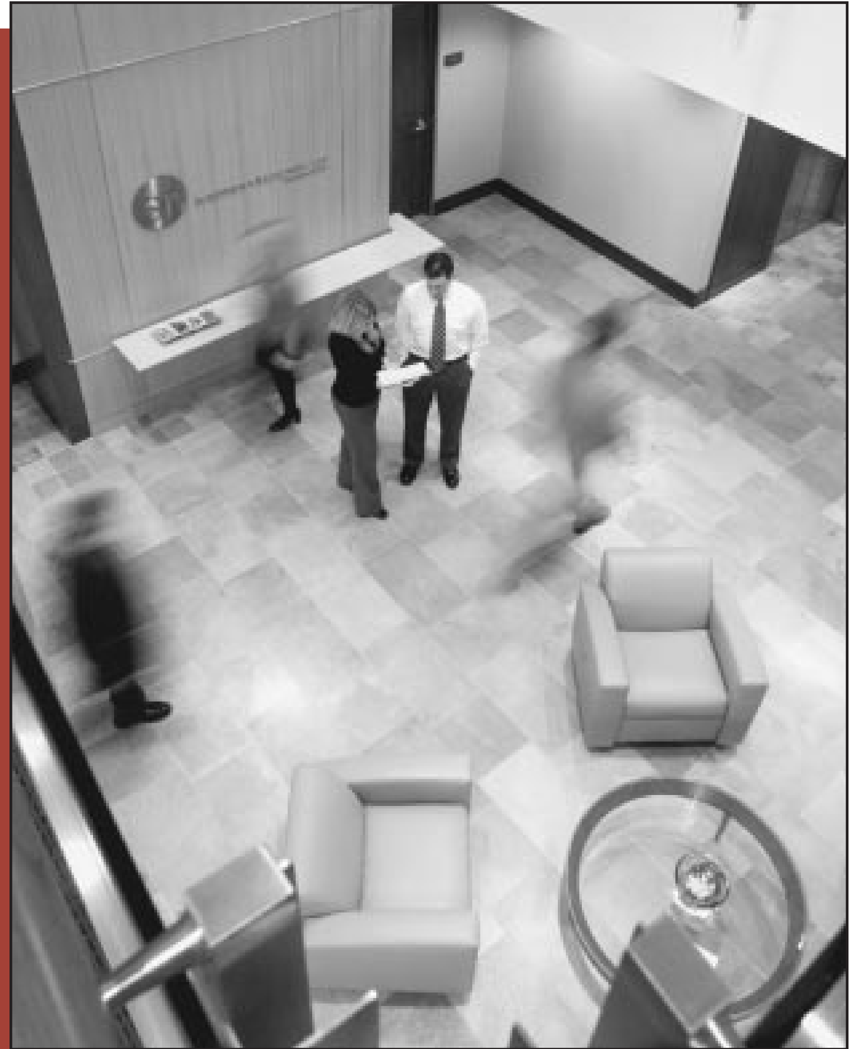
SCHIFFRIN & BARROWAY'S ERISA LITIGATION DEPARTMENT EARNS LANDMARK THIRD CIRCUIT DECISION

By: Katherine B. Bornstein, Esquire
Edward W. Ciolko, Esquire

In a landmark decision in the field of ERISA class action litigation, the United States Court of Appeals for the Third Circuit held that a subset of 401(k)-plan participants may seek relief on behalf of that plan under ERISA (Employee Retirement Income Security Act of 1974). *See In re: Schering-Plough Corporation ERISA Litigation,* No. 04-3073, — F.3d —, 2005 WL 1993990 (3d Cir. Aug. 19, 2005). This decision represents a major victory for all pension plan participants in the United States who contribute to their retirement savings accounts through 401(k) plans sponsored by their employers, and lends guidance to district courts across the country. The outcome is especially timely, given the increasing utilization of 401(k)-like defined contribution plans by employers as a primary retirement savings vehicle offered to their employees, in lieu of the traditional defined (guaranteed) benefit plans offered in the past.

The decision granted the appeal of Plaintiffs, whose claims for breach of fiduciary duty by fiduciary-defendants Schering-Plough Corporation ("Schering-Plough" or the "Company") and others, were dismissed by the United States District Court for the District of New Jersey.

Plaintiffs, former employees of Schering-Plough and participants in Schering-Plough's 401(k) plan, filed a complaint in the United States District Court for the District of New Jersey seeking relief for the plan under sections 409 and 502 of ERISA based on Defendants' mismanagement of the plan's assets. Specifically, the complaint alleged, *inter alia*, that Defendants' decision to make and maintain plan investments in Schering-Plough stock was imprudent, based on their actual or constructive knowledge of negative non-public information regarding the Company's manufacturing practices and drug product pipeline that artificially inflated the intrinsic value of Company stock, and hence



the suitability of the Schering-Plough stock fund as an investment option for the plan. Indeed, during the Class Period (as alleged by Plaintiffs), the price of Schering-Plough stock plummeted from over $60 to below $20, causing the plan to suffer over $138,000,000 in losses due to its heavy investment in Company stock.

The lower court dismissed Plaintiffs' claims based on Defendants' arguments that Plaintiffs were actually seeking "individualized damages," which is prohibited under ERISA §§ 409 and 502. These sections of ERISA provide remedies only from breaches

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THE DURA PHARMACEUTICALS OPINION: THE U.S. SUPREME COURT CONFIRMS EXISTING LAW ON PLEADING REQUIREMENTS AND LOSS CAUSATION

By: Katharine M. Ryan, Esquire

On April 19, 2005, the U.S. Supreme Court issued an opinion in *Dura Pharmaceuticals v. Broudo 161 L.Ed. 2d577, 25 S.Ct. 1627 (2005) ("Dura")*, a case regarding the pleading standards for loss causation in federal securities class actions. Some have argued this case has changed the law and made it much harder for plaintiffs to plead loss causation. However, most federal courts in the few months since *Dura* have held that, rather than change the law, *Dura* merely confirmed existing law on pleading requirements and thus settled once and for all what is required for plaintiffs to plead loss causation in order to withstand a motion to dismiss.

COMPLAINT AND MOTION TO DISMISS:

In order to prevail as a plaintiff in a securities class action lawsuit, the first hurdle after filing suit is to survive defendants' inevitable motion to dismiss. It is therefore crucial to draft a complaint alleging facts that show entitlement to relief, in such a manner that the court will allow the case to proceed. That's why *Dura* is of importance, for it rejected one particular approach to pleading and therefore brought more certainty to the pleading requirements plaintiffs have to meet in drafting a complaint.

In particular, the Supreme Court ruled on the standard for pleading loss causation. In federal securities laws there are two types of causation, namely transaction causation and loss causation, that need be alleged simultaneously. Transaction causation is when the plaintiff alleges that he would not have entered into the transaction but for the fraudulent statement or omission. Loss causation is whether the subject of the fraudulent statement or omission was the cause of the actual loss suffered. In other words, loss causation "is the causal link between the alleged misconduct and the economic harm ultimately suffered by the plaintiff."

PRE-DURA:

Before *Dura*, several circuit courts had different views about loss causation and how it should be pleaded, which is the very reason the Supreme Court decided to take the *Dura* case. In the Ninth Circuit, to plead causation a plaintiff claiming securities fraud, in violation of section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, merely had to allege that the price of a security on the date of purchase was artificially inflated because of a misrepresentation or omission.

This "inflated purchase price" approach, which did not require a causal link between the alleged fraud and loss, was not followed by any other circuit courts. For example, the Second Circuit had established the standard where a plaintiff was required to explicitly allege a disclosure or some other corrective event as the cause of his loss, i.e. that the misstatement or omission concealed something from the market that, when disclosed, negatively affected the value of the security. The Third, Seventh and Eleventh Circuits also followed this same standard.

THE DURA DECISION:

In *Dura*, the Supreme Court rejected the Ninth Circuit's approach of a "permissive pleading standard for loss causation," holding that, "as a matter of pure logic," when buying a share at a certain price, one cannot suffer a loss at that time, because the purchase price is offset by ownership of a "share that at that instant possesses equivalent value." (Original emphasis.)

The Supreme Court reversed the Ninth Circuit and affirmed the district court's dismissal of the relevant claims in the complaint, because plaintiffs did not allege a causal connection between the loss and the relevant misrepresentation.

POST-DURA:

The Supreme Court provided further clarity by referring to Rule 8(a)(2) of the Federal Rules of Procedure, which only requires "a short and plain statement of the claim showing that the pleader is entitled to relief," in stating how loss cautions need to be alleged. The Court further noted that "it should not prove burdensome for a plaintiff who has suffered an economic loss to provide a defendant with some indication of the loss and the causal connection that the plaintiff has in mind."

Thus, a complaint alleging merely an inflated price will no longer suffice. It has to allege that the subject of the fraudulent misconduct was the cause of the loss suffered, because, as the Supreme Court stated, "allowing a plaintiff to forgo giving any indication of the economic loss and proximate cause that the plaintiff has in mind would bring about harm of the very sort the statutes seek to avoid . . . [It would amount to] a partial downside insurance policy."

CONCLUSION:

Dura did not change the law or create a heightened pleading standard, but merely clarified and explicitly confirmed the correctness of the decisions by the 2nd, 3rd, 7th and 11th Circuits, leveling the standard overall. It did not establish what would be a sufficient loss causation pleading standard or define a pleading standard for loss causation; it simply rejected the Ninth Circuit's standard as overly permissive and established what was not sufficient. Due to *Dura*, the standards are now the same regardless of the circuit.

Special thanks to Werner Kranenburg for his assistance in researching and writing this article. Werner is a law student at London Metropolitan University in the United Kingdom and spent the summer as an intern at Schiffrin & Barroway.

S&B LAWYERS TAKE PART IN PENSION FUND CONFERENCES

New England Public Employee Retirement Systems Forum — Newport, Rhode Island

By: Darren J. Check, Esquire

Over a three-day period running from July 20, 2005 through July 22, 2005 in Newport, Rhode Island, the first annual "NEPERS" Forum brought together representatives of public pension funds from across New England as well as investment professionals, attorneys, and elected officials, to learn more about the issues facing retirement systems and to exchange ideas on how to tackle these issues. One of the highlights of the conference was a panel, moderated by S&B founding partner Richard Schiffrin, which discussed corporate governance shareholder rights, and recouping damages as a result of corporate fraud and what these topics mean to a public retirement system. Participating in the panel with Mr. Schiffrin were **Hon. Jeb Spaulding, Treasurer of the State of Vermont, Hon. Timothy P. Cahill, Treasurer of the Commonwealth of Massachusetts, Hon. Paul J. Tavares, Treasurer of the State of**

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viduals to seek redress for corporate wrongdoing in their State courts." The American Federation of State, County and Municipal Employees cautioned that the act will "make it far more difficult and often impossible for workers to challenge illegal and harmful conduct by employers no matter how egregious the employer's behavior." Indeed, according to the Association of Trial Lawyers of America, "every American's legal rights are diminished by this anti-consumer legislation which establishes greater procedural hurdles for consumers, workers, homeowners and shareholders."

Despite this widespread and vocal opposition, President Bush and proponents of the act contend that the legislation is necessary to control trial lawyers and to curb perceived abusive and frivolous lawsuits filed against big business. However, this concern may be illusory because, according to a recent report by the consumer advocacy group Public Citizen, "American businesses file four times as many lawsuits as individuals represented by trial lawyers, and they are penalized by judges more often for pursuing frivolous litigation." The report also noted that in Mississippi, a state that the U.S. Chamber of Commerce has called a "judicial hell hole" for corporations, "businesses were 5.8 times more likely [in 2001] to file suit than were individuals." Further, in a recent survey of 278 federal court judges, only three percent responded that they felt frivolous litigation was a "large" or "very large problem."

The act is not retroactive, and thus it will take time to determine whether and how federal courts exercise the jurisdiction granted to them under the act. What is certain, however, is that the substantive and procedural provisions of the act significantly alter the landscape of class action litigation that involves state law claims. As courts begin to issue decisions that interpret the act, we will be better able to assess and report on the implication of the legislation.

The act is very complex, and the following summary is intended to provide a general overview of some of the more pertinent provisions.

Expansion of Federal Jurisdiction Over Class Actions

Whether the Federal courts have discretionary or mandatory authority to decline or exercise jurisdiction is generally determined by the percentage of class action plaintiffs who are residents of the state where the action is filed. According to the act, federal courts shall have original jurisdiction if the aggregated class-wide damages exceed $5 million, exclusive of interest and costs, and if any member of the plaintiff class is a citizen of a State different from any defendant. The court, however, may decline jurisdiction "in the interest of justice and looking at the totality of the circumstances" if greater than one-third but less than two-thirds of the class members and the primary defendants are citizens of the State in which the action was originally filed.

There are numerous factors the court should consider in exercising this discretion, including: (a) whether the claims involve matters of national interest; (b) whether the claims are governed by laws of the State in which the action was originally filed; (c) whether the action has been pleaded in a way that avoids federal jurisdiction; (d) the nexus between the State and the class members, the alleged harm, or the defendants; (e) whether the number of class members who are citizens of the State in which the action was filed is substantially larger than the number of class members who are citizens from any other State, and the other citizens are dispersed among a substantial number of States; and (f) whether, during the 3-year period preceding the action, one or more other class actions asserting similar claims have been filed on behalf of the same or other persons.

The court must decline to exercise jurisdiction over a class action in which: (1) greater than two-thirds of the proposed class are citizens of the State in which the action was filed and at least one defendant from whom "significant relief is sought" and whose alleged conduct forms a "significant basis" for the claims asserted is a citizen of the State in which the action was originally filed, and; (2) the principal injuries were incurred in the State in which

the action was originally filed. The court shall also decline jurisdiction when two-thirds or more of the proposed class members and the "primary defendants" are citizens of the State in which the action was brought.

Expansion of Federal Jurisdiction Over Mass Actions

The act also confers federal jurisdiction over mass actions. A mass action involves the consolidation of claims asserted by a large number of plaintiffs who share common questions of law and fact but who do not seek class treatment. For purposes of the act, with certain exceptions, mass actions that involve 100 or more plaintiffs shall be treated the same way as class actions for jurisdictional purposes. The exceptions include when the claims arise from an event in the State in which the action was filed, and that allegedly resulted in injury in that State or a contiguous State, or when the claims have been consolidated solely for pretrial purposes.

Removal Procedures

The act also changes rules governing the process of removing the case from state to federal court. Under prior law, all defendants had to consent to removal and the case could not be removed to federal court more than one year after commencement of the action. Under the new provision, any defendant may seek removal without the consent of any other defendant and the one-year limit has been eliminated. Similar to prior law, the notice of removal must still be filed within 30 days of the first pleading showing federal jurisdiction.

Settlement Notice Requirements

In the event of a proposed settlement, the act imposes a new requirement that the defendants serve a settlement notice upon the United States Attorney General and any "appropriate" state official who has regulatory or supervisory responsibility with respect to the defendant for each state in which a class member resides, or to the state attorneys general if there is no primary state regulator. The settlement notice must be served within 10 days of the proposed settlement and shall include a copy of the complaint, the proposed or final settlement agreement (including any side agreements), the proposed or final class notice, and any proposed or final orders or judgments. Failure to meet this notice requirement may allow class members to not be bound by the settlement. Furthermore, because the notice is served upon governmental officials, the notice may be subject to the Freedom of Information Act disclosure requirements.

Coupon Settlements

If a proposed settlement provides for a recovery of coupons to class members, any portion of attorney's fees awarded to class counsel that is attributable to the award of coupons shall be based on the value of the coupons that are redeemed. The court may, in its discretion upon the motion of a party, receive expert testimony on the actual value to the class members of the coupons that are redeemed. Moreover, the court may approve a settlement in which class members would receive coupons only after a hearing and after issuing written findings that the settlement is fair, reasonable, and adequate for class members. The court, in its discretion, may also require that a proposed settlement agreement provide for the distribution of unclaimed coupons to one or more charitable or governmental organizations, as agreed to by the parties.

Appellate Review

The act also provides a mechanism for appellate review of a district court's decision to grant or deny remand, and the review is discretionary. An application for leave to appeal a remand decision must be filed within seven days after the remand order is granted or denied. If leave to appeal is granted, the appellate court must provide a final decision within 60 days of the application.

S&B LAWYERS TAKE PART IN PENSION FUND CONFERENCES *(Continued from page 7)*

Rhode Island, Catherine E. LaMarr, Legal Counsel to State Treasurer of Connecticut, and Robert S. Leggett, Executive Director of New Hampshire Retirement System. This top-flight group of speakers drew upon their years of experience not only to provide the audience with a great deal of information, but also to provoke thought and debate among those in attendance.

Schiffrin & Barroway also had the privilege of making two additional presentations. The first, entitled, "Are You Missing Out On A Lost Opportunity: How Institutional Investors Are Leaving Billions On The Table Every Year" was jointly made by S&B partner Stuart Berman and the firm's Director of Institutional Relations, Darren Check. The presentation focused on the continuing problem of institutional investors, especially public pension funds, in filing proof of claim forms in settled class action cases. This is an issue that affects institutional investors of all sizes and is a problem that is just beginning to be addressed. This is certainly a topic that will continue to be discussed and debated in the future. The second presentation was made by Eric Zagar, one of the managers of S&B's Derivative Litigation department, who sat on a panel entitled "Public Plans As Responsible Investors." The topics of this presentation included steps a plan sponsor should take to establish a responsible investing program, corporate governance through shareholder litigation, and legal settlements beyond monetary awards. Mr. Zagar participated on the panel with Meredith Miller, Assistant Treasurer for Policy for the State of Connecticut and Michael Musuraca, Trustee for the New York City Employees Retirement System.

10th Annual Fire & Police Pension Funds Summit — Santa Ana Pueblo, New Mexico

Held from June 26, 2005 through June 29, 2005, the 10th Annual Fire & Police Pension Funds Summit is one of the premier national summits on pension fund management for public safety board members, administrators, investment officers, and their advisors and legal counsel. The conference covered a wide range of topics, from fiduciary responsibility and investment strategies to corporate governance and asset protection and recovery. S&B attorney John Kehoe was selected to make one of the conference's opening presentations with "Protecting Your Investment: The Role Of Institutional Investors Serving As Lead Plaintiffs In Securities Class Actions." Mr. Kehoe's presentation focused on the increasing number of institutional investors taking on the lead plaintiff role and the improved results they have been able to accomplish, not just in dollars, but also in valuable corporate governance reforms. The presentation not only explained many of the trends in class action litigation, but also went through a case study to demonstrate exactly the benefits that an institutional investor brings to the table as a lead plaintiff. Mr. Kehoe's presentation was extremely well received and many greatly appreciated his attention to detail, which more clearly brought to light the need for institutional involvement in class actions. Several attendees commented that, unlike many presentations from law firms, they did not feel like they were receiving a sales pitch.

S&B attorney Sean Handler was privileged to participate on a panel at the conference entitled "Understanding The Full Extent Of Your Fiduciary Responsibilities." Mr. Handler was joined by John Keane, Executive Director-Administrator of the Jacksonville Police and Fire Pension Fund and Lydia Lee, Principal, Trustee Law and Former General Counsel, Oklahoma Public Employees' Retirement System. The panel focused on the need for plan administrators to focus more on their responsibilities and the closer scrutiny they receive in this day and age.

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documents were false and misleading; and (2) defendants acted with fraudulent intent. Plaintiffs responded that they properly alleged that the offering documents were materially false and misleading, and, most importantly, that they had no obligation to allege that defendants engaged in fraud to support their Securities Act claims.

The July 21, 2005 Opinion and Order handed down by The Honorable Judge Nora Manella of the United States District Court for the Central District of California, held that the complaint filed by S&B stated a claim for liability under Section 11, 12(a)(2) and 15(a) of the Securities Act. Specifically, the Court held that the complaint properly pled that: (1) the February 14, 2001 registration statement and prospectus issued by DDi contained materially false and misleading statements and omissions; and (2) the defendants were obligated, but failed, to reasonably investigate the veracity of the offering documents. Most notably, the Court held that plaintiffs had no obligation to plead that defendants acted with fraudulent intent to assert a pure Securities Act claim.

In an environment where the heightened pleading burdens associated with securities fraud claims often make it difficult to successfully plead a claim, the DDi decision, handed down in what has long been considered the most challenging jurisdiction for plaintiffs' securities cases, makes it easier for investors to recover damages incurred in the securities offering context.

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pended trading. On December 19th, Parmalat announced that a Bank of America account allegedly held by Bonlat (an entity formed for the purpose of carrying out many of the Company's illicit transactions) that supposedly held $4.9 billion, did not exist. Parmalat filed for bankruptcy on December 24th, and was declared insolvent shortly thereafter.

PARMALAT'S AUDITORS

Throughout the class period (between January 5, 1999 and December 18, 2003), Parmalat's primary auditors were the Italian affiliates of two multinational accounting firms: Grant Thornton International ("GTI") and Deloitte Touche Tohmatsu ("DTT"). Based on conventional agency theory, Judge Kaplan held that plaintiffs stated 10b-5 claims against both GTI and DTT for the acts of their Italian affiliates. Importantly, the court held that agency need not be pled with particularity and that "[t]he agency allegations are governed by [the more lenient notice pleading standard of] Rule 8."[4] Applying New York agency law, the Court found that plaintiffs sufficiently alleged that Deloitte Italy audited Parmalat as the agent of DTT based on the following facts: (1) "the Deloitte organization has centralized leadership headed by a global chief executive officer and a global board of directors;" (2) Deloitte offices throughout the world audited Parmalat as agents of DTT and signed reports with the common "Deloitte" logo; and (3) DTT squelched and ultimately removed an auditor in Deloitte's Brazilian firm who raised concerns about the transfer of inter-company debt to Parmalat's Brazilian affiliate, and stated that he would be unable to issue a clean audit opinion.[5] Judge Kaplan concluded that plaintiffs alleged specific facts "from which it could be inferred that DTT was in ultimate control of the audit," and, thus, an agency relationship existed.[6] Although plaintiffs defeated DTT's motion to dismiss, they were unable to keep Deloitte USA and its CEO, James Copeland, in the case.[7] Judge Kaplan granted Deloitte USA's motion to dismiss because plaintiffs failed to allege "any facts that would tend to show that Deloitte USA used the close relationship to dominate DTT," nor could "an alter ego relationship . . . be inferred from the close relationship and overlap in executives [with DTT]."[8]

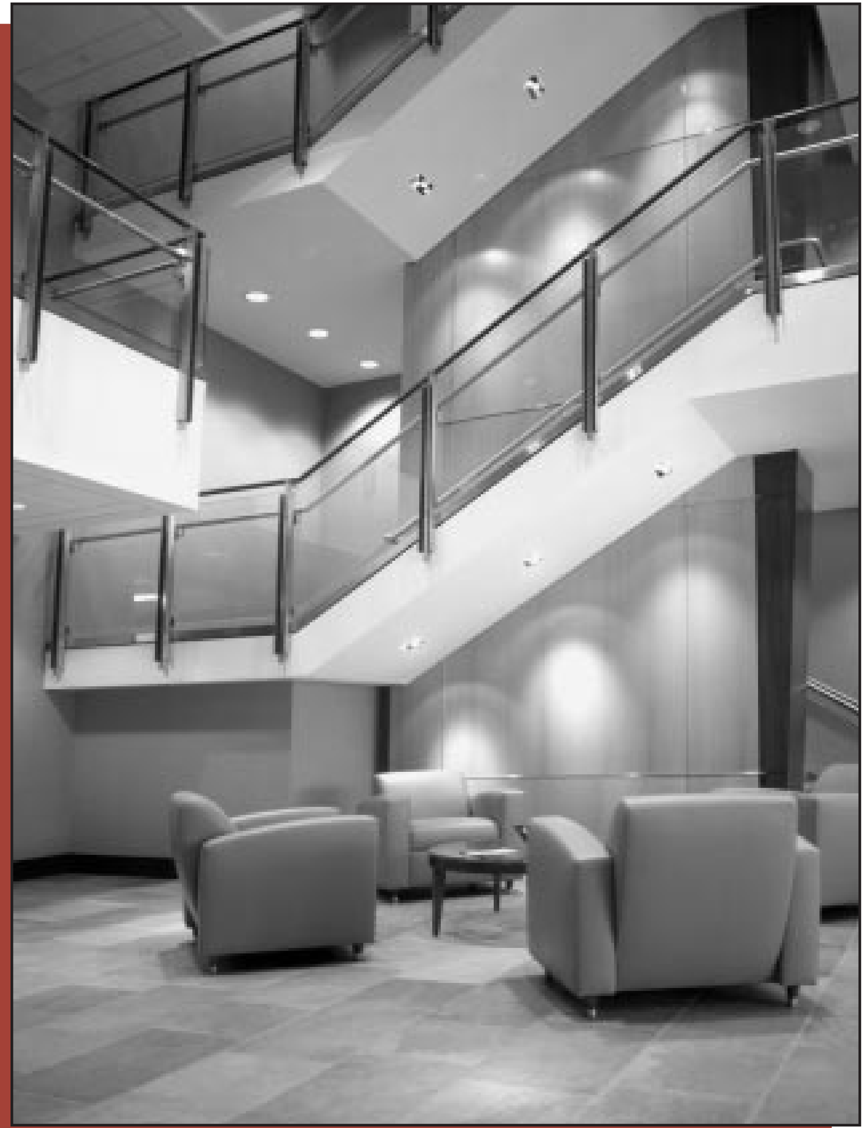
Additionally, the *Parmalat* court held that plaintiffs adequately alleged that GTI exercised control over Grant Thornton Italy in a manner typical of a principal-agent relationship based on the following facts: (1) Grant Thornton member firms cooperated in setting up Camfield Pte. Ltd. ("Camfield"), a Singapore-based holding company that was used in certain fictitious sales of powdered milk to Cuba. Camfield operated out of the offices of Grant Thornton's Singapore affiliate and an employee of this affiliate firm served as Camfield's corporate secretary; and (2) after Parmalat's fraud was revealed, "GTI investigated and disciplined the Italian member firm and ultimately expelled it from the group."[9] Although plaintiffs defeated GTI's motion to dismiss, the court granted Grant Thornton USA's motion to dismiss, finding that plaintiffs "failed to state a claim against GT-USA on the basis that GTI was its agent or alter ego."[10]

PARMALAT'S BANKS

Plaintiffs also sued Parmalat's investment banks, including Citigroup, Bank of America ("BoA"), Banca Nazionale de Lavoro ("BNL"), and Credit Suisse First Boston ("CSFB") under Section 10(b) and Rule 10b-5. In their various motions to dismiss, the banks argued, among other things, that: (i) they did not make any actionable misstatements or omissions; (ii) their scienter, or culpable state of mind, was not alleged with sufficient particularity; and (iii) they were not primary violators of Rule 10b-5(a) and (c) because they did not orchestrate the alleged manipulative or deceptive scheme.

In his July 13th opinion, Judge Kaplan made important rulings concerning claims alleging the banks' participation in the fraudulent scheme, brought under Rule 10b-5(a) and (c); as distinguished from more conventional claims based upon false and misleading statements, brought under Rule 10b-5(b). First, the court stated that subsections (a) and (c) of Rule 10b-5 apply not only to technical forms of market manipulation, but also to other forms of deception.[11] Second, the court held that the PSLRA's pleading requirements regarding misleading statements and omissions do not apply to claims that allege no misstatement or omission, but instead are based on participation in a manipulative or deceptive scheme under Rule 10b-5(a) and (c). Because these claims sound in fraud, however, plaintiffs must still meet the specificity requirements of Rule 9(b).[12] Based on the foregoing, Judge Kaplan framed the issue of whether Parmalat's banks were liable for participating in a fraudulent scheme as follows: "The basic question here is not whether the banks' action made them aiders and abettors . . . but rather whether the banks are subject to private civil liability as primary violators of *Rule 10b-5.*"[13]

Plaintiffs allege that Citigroup entered into transactions with Parmalat in which Citigroup purportedly securitized Parmalat invoices for the purpose of disguising loans to Parmalat as equity investments. Plaintiffs contend that Citigroup had intimate knowledge of Parmalat's finances, including the fact that the securitized invoices were worthless, but nonetheless actively participated in Parmalat's fraudulent scheme. In support of these allegations, plaintiffs described three specific arrangements where Citigroup "designed the financing transactions to enable Parmalat to characterize and maintain the false appearance of a lower debt-to-equity ratio."[14] The court concluded that the Citigroup transactions were deceptive devices for purposes of Section 10(b) and denied Citigroup's motion to dismiss.[15] The court rejected Citigroup's contention that they were merely aiders and abettors



because, "the transactions in which they were engaged were by nature deceptive. They depended on a fiction, namely that the invoices had value."[16] Moreover, plaintiffs sufficiently alleged Citgroups scienter by establishing that it was intimately familiar with Parmalat's billing system and structured the invoice securitization program.[17]

Plaintiffs allege that BNL entered into fictitious "factoring" transactions (a transaction where one party purchases, at a discount, receivables from the party that issued them and then attempts to collect the face amount of the invoice) as a device that enabled Parmalat to record revenue and conceal what were, in fact, loans.[18] Plaintiffs allege that BNL was motivated to participate

(Continued on page 14)

COURT UPHOLDS 10B-5 CLAIMS AGAINST PARMALAT'S AUDITORS AND BANKERS *(Continued from page 13)*

in the fraud by profits from the factoring scheme and receiving fees for underwriting two Parmalat bond offerings.[19] The court concluded that these factoring arrangements were deceptive devices for purposes of Section 10(b) and denied BNL's motion to dismiss for the same reasons it rejected Citigroup's motion.

The core allegation against CSFB is that it designed and participated in a set of transactions in late 2001 and January 2002, in which CSFB executed a subscription agreement with Parmalat pursuant to which CSFB paid $500 million to a Brazilian subsidiary of Parmalat in exchange for an entire issue of bonds from the Parmalat subsidiary. At the same time, CSFB and Parmalat entered into an agreement whereby CSFB, in exchange for consideration of $250 million, relinquished conversion rights amounting to half the value of the bond issue. The complaint alleges that these transactions amounted to nothing more than $500 million in financing; however, CSFB knew that Parmalat made these transactions to conceal $248 million in debt on its financial statements. Plaintiffs allege that CSFB was motivated to commit fraud because it received millions of dollars in fees and commissions for designing and participating in these transactions, and lucrative underwriting roles in three Parmalat securities offerings.[20] The court denied CSFB's motion based on plaintiffs' allegations that CSFB grossly overstated the value of the conversion rights for the purpose of inflating Parmalat's assets and, therefore, CSFB engaged in a course of business that operated as a fraud or deceit.[21]

With respect to BoA, plaintiffs allege that BoA proposed and arranged loans to private investors disguised as an equity investment in a Brazilian Parmalat subsidiary, but in reality was a $300 million private debt offering. The court granted BoA's motion because there was no suggestion that these transactions were something other than what they appeared to be. At worst, the court found that BoA entered into transactions with the expectation that Parmalat would misrepresent the nature of the arrangements — in other words, aiding and abetting.[22]

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[1] 511 U.S. 164, 180 (1994) (holding that a plaintiff must show reliance on the defendant's misstatement or omission to recover under Rule 10b-5 and to allow a defendant to be held liable for aiding and abetting would undermine this reliance requirement).

[2] *See In re Parmalat Sec. Litig.,* Master Docket 04 MD 1653 (LAK), 2005 U.S. Dist. LEXIS 12553 (S.D.N.Y., June 28, 2005) (auditors opinion) and *In re Parmalat Sec. Litig.,* Master Docket 04 MD 1653 (LAK), 2005 U.S. Dist. LEXIS 12553 (S.D.N.Y., July 13, 2005) (investment banks opinion).

[3] *See, e.g.,* The Guardian (London) — Final Edition, December 24, 2003 ("As Parmalat becomes cast as Europe's Enron there will be calls for tighter regulation, better controls."); eFinancialNews.com, December 21, 2003, *Parmalat: Europe's Enron,* ("Italian financial police raided the offices of Grant Thornton . . . in what is becoming a criminal fraud investigation and has already been called Europe's Enron."); The International Herald Tribune, December 22, 2003, *Italy To Aid Parmalat; Berlusconi Vows To Avert Bankruptcy,* ("Italian newspapers quoted Economics Minister Giulio Tremonti as describing Parmalat as 'Europe's Enron,' referring to the collapse two years ago of the huge U.S. energy group.").

[4] Parmalat, 2005 U.S. Dist. LEXIS 12553, at *27.

[5] Id. at *32-33.

[6] Id. at *38.

[7] Id. at *50-52 (the court held that "plaintiffs have not alleged that Copeland was the mastermind or architect of any fraud, but only that he assisted by encouraging others not to disclose the alleged fraud . . . Plaintiffs' allegations therefore do not state a claim for primary liability under Section 10(b) against Copeland").

[8] Id. at *44.

[9] Id. at *55-58.

[10] Id. at *61.

[11] Parmalat, 2005 U.S. Dist. LEXIS 12553, at *44.

[12] Id.

[13] Id. at *48.

[14] Id. at *7-19.

[15] Id. at *81.

[16] Id. at *82.

[17] Id. at *86.

[18] Id. at *29.

[19] Id. at *32.

[20] Id. at *33-36.

[21] Id. at *84.

[22] Id. at *82-83.

SCHIFFRIN & BARROWAY'S ERISA LITIGATION DEPARTMENT EARNS LANDMARK THIRD CIRCUIT DECISION *(Continued from page 5)*

of fiduciary duty brought on behalf of a plan as a whole, not individual plan participants. Plaintiffs argued on appeal that the district court misconstrued the nature of their claims and erred in failing to distinguish between the nature of the losses caused by Defendants' fiduciary breaches — which affected the value of assets held in a unitary trust by and for the plan itself — and the fact that the losses caused by those breaches are merely *reflected* — in an accounting sense — in the plan's individual participant accounts, as they must be in any defined contribution/401(k)-type plan.

The Third Circuit agreed with Plaintiffs and reversed the District Court's decision, finding: "The Plan held Schering-Plough stock as an asset and that asset was greatly reduced in value allegedly because of breaches of fiduciary duty. This clearly was a 'loss' to the Plan within the meaning of [ERISA § 409]." *3.

In addition, the Third Circuit indirectly addressed holdings in a number of other analogous cases where courts in the past few years have employed varying contextual treatment of Third Circuit precedent in this novel and complex area of ERISA jurisprudence, muddying the precedential waters for ERISA litigants. For instance, the Court revisited its own seminal decision of *Moench v. Robertson*, 62 F.3d 553 (3d Cir. 1995). Specifically, the *Schering-Plough* Court noted that "[t]he principle announced in Moench has no application to the duty of a fiduciary of pension benefit plans to diversify investments 'so as to minimize the risk of large losses.'" *6. The Court concluded that the principle announced in Moench, that presumes prudence by fiduciaries who allow the holding of employer securities in an employee stock ownership plan ("ESOP"), has no bearing on determining the prudence of the same action in a "Individual Account Plan" of which 401(k) retirement savings plans are a common variety, such as the Schering plan, which does not mandate such plan investments. *4.

Further, the Schering decision sheds light on a Supreme Court decision that has been serially mischaracterized by the ERISA defense bar in attempts to dismiss analogous claims, *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134 (1985) ("*Russell*"). *3, n. 4. The *Schering* Court noted that the issue presented in the *Schering* case — whether participants of an ERISA defined contribution plan could sue on behalf of that plan for imprudent investment of plan assets — was not even addressed in *Russell* and, in any case, the holding in *Russell* did *not* prevent the relief sought in ERISA cases seeking redress from fiduciaries for breach of their duties to a plan, even if not all participants of a plan were equally affected by such breach. *Id.*

The *Schering* decision provides resolution, at least in the Third Circuit, of a rather controversial issue on the national ERISA litigation landscape. It will certainly be interesting to see how or if the Fifth Circuit rehearing of *Milofsky v. American Airlines, Inc.,* 404 F.3d 338 (5th Cir. 2005) reh'g en banc granted, No. 03-11087 (5th Cir. 2005) will be affected by this strongly-worded opinion (although it is worth noting that the *Schering* Court easily distinguished the facts of *Milofsky*, describing the plaintiffs in *Milofsky* as seeking damages for harm caused by the failure of the plan's fiduciaries to transfer assets as agreed, not to make the plan whole or restore to it assets lost). *7. The Sixth Circuit has also definitively held that a subset of plan participants has standing to bring claims for relief on behalf of a plan under ERISA. See Kuper v. Iovenko, 66 F.3d 1447 (6th Cir. 1995).

The United States Department of Labor also appeared on behalf of Plaintiffs at the oral argument before the Third Circuit in Philadelphia. In addition, the Department of Labor and the AARP filed amicus briefs on behalf of Plaintiffs.

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