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NINTH CIRCUIT STRICTLY ENFORCES HEIGHTENED PLEADING REQUIREMENT FOR PRIVATE SECURITIES LITIGATION CASES

In 1995, Congress passed the Private Securities Litigation Reform Act ("PSLRA"). The purpose of the Act was to eliminate abusive securities litigation and to put an end to the practice of pleading fraud by hindsight. In order to achieve this goal, the PSLRA significantly altered the pleading requirements in private securities fraud litigation by heightening the pleading requirements for falsity and scienter.

In order to meet the new scienter pleading requirement, a plaintiff must plead, in great detail, facts that constitute strong circumstantial evidence of deliberately reckless or conscious misconduct. As several recent decisions by the Ninth Circuit Court of Appeals demonstrate, the failure to sufficiently plead such facts will result in the dismissal of plaintiff's complaint.

For example, in DSAM Global Value Fund v. Altris Software, Inc., 288 F.3d 385 (9th Cir. April 19, 2002) the Ninth Circuit recently upheld the dismissal of plaintiff's claim against the accounting firm of Price Waterhouse. Plaintiff alleged that Price Waterhouse's egregious failure to adhere to Generally Accepted Accounting Principles ("GAAP") constituted a violation of the PSLRA. Although the court recognized that the complaint set forth a compelling case of gross negligence, the court held that it did not give rise to a strong inference that Price Waterhouse acted with the intent to defraud, that it engaged in conscious misconduct, or that it acted with deliberate recklessness. As such, the court upheld the dismissal of plaintiff's complaint.



Recent Cases

PLAINTIFF DID NOT SUFFER DAMAGES AS A RESULT OF \$15 PER SHARE GAIN

In re Broderbund/Learning Co. Securities Lit.
2002 U.S. App.LEXIS 12825 (9th Cir. June 28, 2002)

Plaintiff was a shareholder in Broderbund Software, Inc., which was acquired by The Learning Channel ("TLC"). Before the two companies' merger, TLC had merged with another company and filed a registration statement that required subsequent changes. The changes had no effect on the market price of TLC stock. Plaintiff received \$17.6875 per share of TLC stock as a result of the merger.

Shortly thereafter, TLC was acquired by Mattel, Inc. As part of this acquisition, Plaintiff received \$33.45 per share, a premium of more \$15 per share. Over the following months, Plaintiff's Mattel stock declined to \$14 per share. Plaintiff filed suit claiming that he suffered injury as a result of the faulty statements contained in TLC's registration statement. The Ninth Circuit disagreed. Specifically, the Ninth Circuit noted that Plaintiff did not suffer any loss as a result of the TLC/Broderbund merger and that, in fact, he had received a substantial gain. Accordingly, the court upheld the dismissal of his claim.

STATE COURTS RETAIN JURISDICTION TO DETERMINE CLASS ACTION CERTIFICATION DESPITE EXPRESS AGREEMENT BETWEEN THE PARTIES TO ARBITRATE

Sanders v. Kinko's, Inc.
2002 Cal. App. LEXIS 4356 (June 28, 2002)

Plaintiff filed a class action on behalf of all current and former store management employees of Kinko's. The basis of the complaint was that although plaintiffs spent much of their time performing non-exempt tasks, defendant had improperly classified them as exempt management employees thereby denying plaintiffs their right to overtime compensation. The employment contracts at issue contained an mandatory arbitration provision

requiring the parties to arbitrate any dispute under the Federal Arbitration Act.

Defendants argued that the mandatory arbitration provision precluded a state court from determining class certification issues before compelling the parties to arbitration. The court disagreed. The court held that the state courts, absent an express agreement between the parties not to proceed to arbitration on a classwide basis, have the inherent authority to resolve class action issues before compelling the parties to arbitration. The court's rationale was that deciding the class certification issues would enhance the benefits of arbitration by eliminating the need to decide the same issue in numerous individual cases.

IN A VOLUNTARY WINDING UP OF A CORPORATION THE COURT'S DETERMINATION OF FAIR VALUE SHOULD BE BASED ON AN OBJECTIVE ANALYSIS

Mart v. Severson
95 Cal. App. 4th 521 (Jan. 23, 2002)

Plaintiff and Defendant were each 50% shareholders of a corporation. Plaintiff sought to voluntarily wind down the corporation. In order to avoid dissolution of the corporation, Defendant exercised his right under Section 2000 of the California Corporations Code to purchase Plaintiff's shares of the corporation at their fair value. An outside appraiser determined that the fair market value of the corporation was \$5.6 million dollars. However, because the Plaintiff refused to sign the covenant, the court reduced the market value of the corporation to reflect its piecemeal liquidation value.



The appellate Court reversed the lower court's determination of fair value and reinstated the findings of the appraiser. The appellate court held that Section 2000 establishes an

objective process for valuing a corporation after dissolution proceedings have commenced. Therefore, the question for the appraisers is whether the entire corporation **could** have been sold as a going concern in liquidation on the valuation date. The appellate court found that the appraisers properly assumed that a hypothetical willing seller of the corporation would execute a covenant not to compete. The court further held that Section 2000 requires that the fair value determination reflect the corporation's value as a going concern if a sale of the corporation as a going concern in liquidation was possible.

FEDERAL STATUTE CRIMINALIZES FALSE STATEMENTS IN CONNECTION WITH ANY BANK APPLICATION OR COMMITMENT, NOT JUST THOSE RELATING TO LOANS

United States of America v. Allan Boren
278 F.3d 911 (9th Cir. Jan. 23, 2002)

Defendant investor was indicted by a grand jury for making false statements to a financial institution in violation of 18 U.S.C. § 1014. Defendant obtained an official bank check from Citibank for \$1 million dollars and used the money to gamble at a casino in Las Vegas. When Defendant lost the money, he requested that Citibank stop payment on the check and claimed that the check had been lost or stolen. The district court dismissed the counts for false statements because the indictments failed "to allege conduct by Defendant which amounts to inducing Citibank to grant him an advance, loan, or commitment."



The Ninth Circuit reversed the judgment of the District Court and found that 18 U.S.C. § 1014 is not limited to lending transactions. The Ninth Circuit specifically found that "the statute's reach is not limited to false statements made with regard to loans,

but extends to any application, commitment, or other specified transaction." The Ninth Circuit's interpretation is consistent with a majority of the other circuits.

WITHOUT EXPRESS CONSENT, BANKS MAY NOT USE A CUSTOMER'S SOCIAL SECURITY BENEFITS TO REPAY AN OVERDRAWN ACCOUNT

Lopez v. Washington Mutual Bank, Inc.
2002 U.S. App.LEXIS 4130 (9th Cir. Mar. 14, 2002)

When Plaintiffs opened checking accounts with Defendant, their account agreements included provisions regarding overdrafts. The agreements generally explained that if the account holder had insufficient funds to pay a check, the bank had the option of rejecting the check or creating an overdraft on the account. The agreement also specified that the account holder would immediately pay the deficient amount. The Plaintiffs received social security benefits, which they had deposited in their accounts. When each of the plaintiffs overdrew their accounts the bank used their deposited social security benefits to set off overdrafts and overdraft fees.

Plaintiffs' complaint alleged that Defendant's practice of using Social Security Benefits to set off overdraft fees violated 42 U.S.C. §§ 407(a). Under this provision, social security benefits are not assignable or transferable under any legal process including the operation of bankruptcy. The Ninth Circuit Court of Appeals found that Defendant's overdraft setoff constituted a seizure of the protected benefits and was the type of extrajudicial self-help remedy that was prohibited by the Social Security Act. Consequently, the use of Plaintiffs' social security benefits to pay the overdraft fees violated the Social Security Act.



**NINTH CIRCUIT EXTENDS THE
CONTEMPORANEOUS TRADING
REQUIREMENTS TO INSIDER TRADING
ACTIONS BROUGHT UNDER SECTION 14(E) OF
THE SECURITIES EXCHANGE ACT**

Crawford v. Transitional Hospitals Corp.
280 F.3d 997 (9th Cir. Feb. 7, 2002)

Plaintiffs were shareholders who alleged violations of Sections 10(b) & 14(e) of the Securities Exchange Act and Rules 10b-5 and 14e-3. The district court found that Plaintiffs did not have standing to sue under these securities laws because they failed to meet the contemporaneous trading requirements. Plaintiffs challenged the district court's decision on two grounds. First, that the contemporaneous standard for Rule 10b-5 should include trading within six months of insider trading. Second, that the contemporaneous requirement only applies to Rule 10b-5 and since Plaintiffs were also bringing the complaint under Rule 14e-3, they had standing.

The Ninth Circuit upheld the trial court's dismissal. The court rejected plaintiff's argument that contemporaneous should include up to six months. Although the court did not specify the amount of time that satisfy the contemporaneous requirement, the court held that two months was not contemporaneous. The court also held that because Rule 10b-5 and Rule 14e-3 contain similar insider trading prohibitions, the contemporaneous trading requirement also applies to Section 14(e) and Rule 14(e)(3).

**SECTION 1681S-2(B) OF FAIR CREDIT
REPORTING ACT CREATES CAUSE OF ACTION
FOR CONSUMER AGAINST FURNISHER OF
CREDIT INFORMATION**

Nelson v. Chase Manhattan Mortgage Corp.,
282 F.3d 1057 (9th Cir. Mar. 1, 2002)

Plaintiff brought a cause of action against Defendant under the Fair Credit Reporting Act, 15 U.S.C. § 1681 ("the FCRA"). The claim stated that Defendant furnished inaccurate information about the Plaintiffs credit even after they received notice of the inaccuracy. The District Court dismissed the

case holding the FCRA section 1681s-2(b) does not create a cause of action for a consumer against a furnisher of credit information.

However, the Ninth Circuit reversed the District Court's holding and found that consumers could bring a cause of action against furnishers of credit under the FCRA. The Court noted that the purpose of the FCRA was to protect consumers



against inaccurate and incomplete credit reporting. If consumers could not sue furnishers of credit under section 1681s-2(b) of the FCRA, then there would be no other way for the consumers to hold the furnishers accountable.

Legislative Changes

Recently, the California Legislature passed Assembly Bill 655 in an attempt to increase protections against identity theft. The Bill became effective on January 1, 2002 and makes amendments to the Investigative Consumer Reporting Agencies Act (California Civil Code Section 1786 et seq.). Prior to the amendments, employers could conduct their own background checks for purposes of promotion or reassignment without providing the employee notice of the background check. Employers were only required to provide notice to the employee if they obtained the report from an investigative consumer reporting agency. Now, if an employer seeks an investigative consumer report, other than suspicion of wrongdoing by the subject of the investigation, the employer is required to give notice the employee in writing within three days.

Advisory Opinions

INVESTOR'S ALERT

On February 14, 2002, the California Department of Corporations released an investor's alert concerning promissory notes issued by J.T. Wallenbrock Associates. In a lawsuit brought by the SEC, a federal district court froze Wallenbrock's assets. Wallenbrock had been seeking investors to transfer their notes to Village Capital Trust Limited, an unlicensed entity operating out of Belize. The California Department of Corporations is urging holders of Wallenbrock promissory notes take appropriate protective action

SERVICE STATIONS CANNOT PLACE A HOLD ON BANK ACCOUNTS OF CUSTOMERS WHO USE DEBIT CARDS

On January 24, 2002, the California Attorney General released an advisory opinion concerning service stations that place a hold on a customer's bank account when they use their debit card to purchase gasoline. The opinion states that when a hold on a customer's account exceeds the purchase price of the gasoline, the service station owner must inform the customer about the hold. However, if the amount of the hold does not exceed the price of the gasoline that is purchased, or if the hold is immediately reduced to the amount of the purchase upon completion of the fueling event, then the customer would have no need to know of the hold's existence.



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