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Cover: "Walking Thunderstorm"
Photograph by Larry Gustafson, Dallas, Texas

Dear Section Members:

I am delighted to be the new Chair of the Section. As one of my first official acts, it is my privilege to introduce the latest edition of the *Journal*. I would also be remiss if I failed to mention the tremendous effort Mike Ferrill puts into the editing and publication of the *Journal*. Mike, on behalf of the Section, thanks for all you do on our behalf.

I also want to extend the thanks of the Section to William Frank Carroll, last year's Section Chair. Frank performed the role of Chair most admirably. I can only aspire to serve in this position as well as Frank.

The Section held its annual meeting at the State Bar's conference this summer in Austin. The Section was pleased to award the Distinguished Counselor Award to Allene Evans. Allene is a former Chair of the Section, former Chief of the Antitrust Section in the Texas Attorney General's Office, and currently serving in the Office of General Counsel for the University of Texas System. Allene was an outstanding selection for this award.

The Section also sponsored a lively CLE panel discussion titled "Federal and State Antitrust Review of Mergers – Strategies and Practical Guidance for the Challenge to American Airlines/U.S. Airways." Many thanks to panelists Joe Alioto of the Alioto Law Firm, Renata Hesse of the DOJ Antitrust Division, Bruce McDonald of Jones Day and Bruce Wark of American Airlines for their enlightening and entertaining presentation.

During the business meeting, I was elected Chair, Bill Whitehill of Gardere Wynne was named Chair-Elect, and Rick Milvenan of McGinnis Lochridge was selected as Secretary-Treasurer. We also elected a slate of council members for terms expiring in 2017. For a complete list of our council and for other important Section information, I invite you to visit the Section's website, http://texbuslit.org.

As a Council, we are constantly looking for ways to improve our service to our members. To do that effectively, we need your suggestions for ways the Section could assist your practice. Please send your comments to me or any other Council member.

Now, back to the *Journal*. There are two articles in this *Journal*: "Securities Developments" by Gerry Pecht and Peter Stokes and "RICO Developments" by Heather Lohman and Alston Walker. The cover photo is by Larry Gustafson. Many thanks to all four authors and to Larry for the cover art. I hope you enjoy the *Journal*. If you are interested in submitting an article, please contact Mike Ferrill (amferrill@coxsmith.com).

I look forward to an exciting year for the Section and I await your thoughts and suggestions.

Regards,

Thomas R. Jackson
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This issue of the Journal features the annual survey articles on Fifth Circuit securities development by Gerry Pecht and Peter Stokes, and RICO developments by Heather Lohman and Alston Walker.

As always, we solicit written contributions to the Journal. We currently have commitments for annual survey articles on antitrust, securities, RICO, business torts, arbitration, class actions D&O and expert witness developments. If you have an idea for a survey article in another area of business litigation, or an article focusing on a particular aspect of or development in the law (even if it falls within one of the broad survey categories), contact me at 112 E. Pecan, Suite 1800, San Antonio, Texas 78205 (210) 554-5282; (210) 226-8395 (fax), amferrill@coxsmith.com.

A. Michael Ferrill
Editor

Fifth Circuit Securities Update

By Gerard G. Pecht and Peter A. Stokes[1]

Since the end of the last survey period, the Supreme Court issued a significant decision preserving the fraud-on-the-market presumption in securities class actions but allowing defendants an opportunity to defeat class certification by demonstrating that the alleged misrepresentations did not affect the stock price. The Supreme Court also issued a significant opinion eliminating the "presumption of prudence" in actions against ERISA fiduciaries, which affected two pending matters in the Fifth Circuit. The Fifth Circuit also addressed numerous other important securities-related issues, including issues relating to: (i) the protections for putative whistleblowers under the Dodd-Frank Act and the Sarbanes-Oxley Act; (ii) the pleading requirements for scienter and loss causation under the Private Securities Litigation Reform Act ("PSLRA"); (iii) proxy access litigation; (iv) criminal prosecutions and SEC enforcement actions; (v) continued fallout from the collapse of Stanford Financial; (vi) tolling of the statute of repose for securities actions under the *American Pipe* doctrine; and (vii) whether loss causation must be proven in a Louisiana statutory claim involving the sale of auction rate securities.

I. The *Halliburton* Decision

In a closely-watched decision arising out of a long-running Northern District of Texas securities class action, the United States Supreme Court declined Halliburton Company's invitation to jettison the "fraud-on-the-market" presumption, which is the glue that allows Rule 10b-5 fraud cases to be certified as class actions. *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398, 2014 WL 2807181 (2014). The Supreme Court did, however, provide defendants a potential pretrial off-ramp by allowing them to introduce evidence at the class certification stage that the alleged misrepresentation did not actually affect the stock price ("price impact").[2] By demonstrating a lack of price impact, a defendant could rebut the fraud-on-the-market presumption and defeat class certification, thus avoiding a classwide trial on the merits.

To invoke the fraud-on-the-market presumption, a plaintiff must show that: (1) the alleged misrepresentations were publicly known; (2) they were material; (3) the stock traded in an efficient market; and (4) the plaintiff traded the stock between when the misrepresentations were made and when the truth was revealed.[3] The fraud-on-the-market presumption allows securities fraud plaintiffs to establish reliance on a classwide basis by presuming that the price of stock traded in an efficient market incorporates all material information, including any material misrepresentations. *Id.* at *1, 4 (citing *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988)). This presumption is based on the theory that efficient markets incorporate all publicly available information, including alleged misrepresentations, about the company into the share price. Accordingly, when investors buy or sell shares at market price, they do so in presumptive reliance on the alleged misrepresentations.

Some economists have criticized the fraud-on-the-market presumption, arguing that it overstates market efficiency, ignores differences in how quickly public information is incorporated into the stock price, and erroneously presumes that investors rely on the integrity of stock prices when in fact many investors buy and sell because they believe the stock price does ***not*** accurately reflect all material information – *i.e.*, that the company is undervalued or overvalued.[4] Commentators have also criticized the proliferation of meritless class action "strike suits" by plaintiffs who use the threat of class certification to magnify their settlement leverage on unmeritorious claims.[5] If the presumption had been invalidated, securities fraud plaintiffs would likely have had to establish individual reliance by each class member, which would have made class certification virtually impossible.

A. Background on prior district court and Fifth Circuit decisions

Filed in the Northern District of Texas more than a decade ago, the *Halliburton* complaint alleged that the company misrepresented material facts to investors during 1999-2001 by understating its projected liability for asbestos claims, overstating its revenues by failing to write down doubtful receivables, and exaggerating the cost savings from its merger with Dresser Industries. In 2010, the Fifth Circuit affirmed the denial of class certification, holding that the plaintiff failed to prove loss causation – *i.e.*, that the stock price fell in response to a corrective disclosure about the alleged misstatements – and thus could not establish the fraud-on-the-market presumption. *See Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, 597 F.3d 330, 344 (5th Cir. 2010). In 2011, however, the Supreme Court reversed the Fifth Circuit's decision and held that Rule 10b-5 plaintiffs were not required to prove loss causation as a condition for certifying a class. *See Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179, 2184 (2011).

Following remand, the Northern District of Texas granted class certification and refused to allow Halliburton to present evidence showing lack of price impact, concluding that this was simply loss causation by a different name. *Halliburton*, 2014 WL 2807181, at *5. The Fifth Circuit affirmed. *Erica P. John Fund, Inc. v. Halliburton Co.*, 718 F.3d 423 (5th Cir. 2013). While the Fifth Circuit agreed that price impact could be contested at trial, the court concluded it would be improper to litigate the issue at the class certification stage because it did not bear on predominance, as the absence of price impact would defeat the claims of all class members.[6] The Supreme Court granted *certiorari* both to determine whether price impact could be litigated at the class certification stage as well as to determine whether *Basic* itself should be overruled or modified.

B. The Supreme Court's decision

In a six-justice majority opinion authored by Chief Justice John Roberts, the Supreme Court charted a middle course. It declined to overrule *Basic*, holding that the decision was settled law and that Halliburton failed to demonstrate the "special justification" required before "overturning a long-settled precedent." *Halliburton*, 2014 WL 2807171, at *6. The majority noted that *Basic* rested on the "fairly modest premise that 'market professionals generally consider most publicly announced material statements about companies thereby affecting stock market prices,'" and that "[e]ven the foremost critics of the efficient-capital-markets hypothesis acknowledge that public information generally affects stock prices." *Id.* at *9 (quoting *Basic*, 485 U.S. at 247 n.24). While a value investor may believe that the stock price understates the company's current value, the majority concluded that a value investor still places ***some*** reliance on the stock price's integrity, which allows the investor to determine how undervalued the stock currently is.

The opinion also rejected Halliburton's argument that the *Basic* decision impermissibly broadened what should have been a "narrow" implied right of action under Rule 10b-5 and is contrary to the Supreme Court's recent class certification decisions in *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541 (2011), and *Comcast Corp. v. Behrend*, 133 S. Ct. 1426 (2013). While the court noted Halliburton's concerns regarding the proliferation of securities class action, it concluded that such concerns are more appropriately addressed to Congress. *Halliburton*, 2014 WL 2807171, at *12-13.

The Supreme Court next rejected Halliburton's argument that plaintiffs should bear the burden of proving price impact directly at the class certification stage.[7] The court noted that *Basic* actually incorporates two presumptions: (i) a presumption that the misrepresentation affected the stock price if the misrepresentation was public and material and the market was efficient; and (ii) a presumption that a plaintiff who purchased at the market price during the class period relied on the defendant's misrepresentation.[8] In the majority's view, requiring direct proof of price impact would jettison the first *Basic* presumption, which the court was unwilling to do for the same reasons it declined to overrule *Basic* as a whole.[9]

The majority agreed, however, that defendants should be "allowed to defeat the [fraud-on-the-market] presumption at the class certification stage through evidence that the misrepresentation did not in fact affect the stock price."[10] *Basic* itself held that "[a]ny showing that severs the link between the alleged misrepresentation and . . . the price received (or paid) by the plaintiff . . . will be sufficient to rebut the presumption of reliance" because "the basis for finding that the fraud had been transmitted through market price would be gone." *Basic*, 485 U.S. at 248. The majority did not elaborate on the type or quantity of evidence that would be required for a defendant to rebut the presumption, leaving those issues for the district and circuit courts to refine over the coming years.

The Supreme Court also distinguished its holding in *Amgen* last year that the materiality of an alleged misrepresentation could not be litigated at the class certification stage even though materiality, like price impact, is also a requirement for establishing the *Basic* presumption. *Amgen, Inc. v. Connecticut Retirement Plans and Trust Funds*, 133 S. Ct. 1184 (2013). The majority distinguished materiality from price impact on the grounds that the class certification inquiry already requires evidence of market efficiency and publicity, which the court characterized as "indirect evidence" of price impact.[11] The court reasoned that it saw "no reason to artificially limit the inquiry at the certification stage to indirect evidence of price impact."[12] Defendants thus "may seek to defeat the *Basic* presumption at [the certification] stage through direct as well as indirect price impact evidence."[13]

In a concurring opinion joined by three of the six majority justices, Justice Ruth Bader Ginsburg emphasized "that it is incumbent upon the defendant to show the absence of price impact."[14] In the concurring justices' view, "[t]he Court's judgment, therefore, should impose no heavy toll on securities-fraud plaintiffs with tenable claims."[15]

In a second concurrence joined by Justice Antonin Scalia and Justice Samuel Alito, Justice Clarence Thomas argued that *Basic* should be overruled.[16] Justice Thomas asserted that *Basic* rested on "flawed intuitions about investor behavior" and conflicted with *Comcast* and *Dukes*, which require plaintiffs to "affirmatively demonstrate" compliance with the Rule 23 requirements.[17] In his view, the Supreme Court should require actual reliance, "not the fictional 'fraud-on-the-market' version."[18]

While the *Halliburton* decision did not deliver the fatal blow to securities class action litigation that many defendants wanted to see, it does provide defendants an opportunity to derail securities cases at the class certification stage when there is evidence that the alleged misrepresentation did not affect the stock price. As the parties in *Halliburton* continue to litigate this issue on remand, the Fifth Circuit will likely be asked to clarify the level of proof defendants must offer to succeed in rebutting the fraud-on-the-market presumption.

II. The Presumption of Prudence and the Definition of ERISA "Fiduciaries"

In *Whitley v. BP, P.L.C.*, _ Fed. Appx. _, 2014 WL 3412205 (5th Cir. 2014), the Fifth Circuit revived (temporarily, at least) a putative class action filed on behalf of participants in four employee investments and savings plans sponsored by BP North America, Inc. The plaintiffs alleged that the plans' fiduciaries made imprudent investments in BP securities, which declined in value after the Deepwater Horizon incident.[19] The United States District Court for the Southern District of Texas dismissed the suit on the pleadings, holding that the allegations failed to overcome a "presumption of prudence" that other courts had applied to ERISA fiduciaries who invest funds from an "eligible individual account plan" ("EIAP") in the company's own stock.[20] On June 24, 2014, however, the United States Supreme Court unanimously held in *Fifth Third Bancorp v. Dudenhoeffer*, 134 S. Ct. 2459, 2463 (2014), that there is no special "presumption of prudence" for EIAP fiduciaries and that a fiduciary's decision to invest EIAP funds in a company's own stock is governed by the same duties and standards of prudence as any other ERISA fiduciary, "except that they need not diversify the fund's assets." *Id.*

The Fifth Circuit thus vacated the district court's dismissal and remanded for reconsideration in light of *Dudenhoeffer*.[21] While the Supreme Court eliminated the "presumption of prudence," it also made clear that plaintiffs in ERISA class actions must normally allege more than a simple failure to "outsmart" the stock market to state a plausible "duty of prudence" claim.[22] Accordingly, the elimination of the "presumption of produce" does not guarantee safe passage for ERISA plaintiffs at the motion to dismiss stage. In addition, the Supreme Court vacated another Fifth Circuit ERISA "presumption of prudence" decision, *Kopp v. Klein*, 722 F.3d 327 (5th Cir. 2013), *vacated and remanded*, _ S. Ct. _, 2014 WL 2931835 (July 1, 2014), (which had affirmed a dismissal based on the presumption) and similarly remanded it to the Fifth Circuit for reconsideration in light of *Dudenhoeffer*.

The Fifth Circuit also addressed ERISA fiduciary liability issues in *Tiblier v. Dlabal*, 743 F.3d 1004 (5th Cir. 2014), holding that an investment adviser who recommended a failed $100,000 oil company bond investment for a cardiology practice's retirement fund was not a "fiduciary" for ERISA purposes. In affirming the district court's summary judgment in favor of the adviser, the Fifth Circuit emphasized that an ERISA fiduciary must "exercise discretionary authority or control" over the investment at issue.[23] Because the adviser merely recommended the investment, and because the cardiology office made the decision to purchase the bonds (and also received advice from a *second* adviser in making the purchase), the Fifth Circuit held that the adviser did not "exercise discretionary authority or control" over the bond purchase and was therefore not an ERISA fiduciary with respect to the investment.[24]

III. Whistleblower Claims

The Fifth Circuit also decided two cases involving the protections for whistleblowers available under the Dodd-Frank Act and the Sarbanes-Oxley Act. In *Asadi v. G.E. Energy (USA), L.L.C.*, 720 F.3d 620 (5th Cir. 2013), the Fifth Circuit affirmed the dismissal of a purported whistleblower retaliation claim against GE Energy under 15 U.S.C. § 78u-6. The plaintiff, Khaled Asadi, asserted that GE improperly terminated him after he internally reported an alleged FCPA violation involving an Iraqi government official.[25] Asadi, however, did not report the alleged violation to the SEC.[26] In affirming the district court's dismissal of the complaint, the Fifth Circuit held that "[u]nder Dodd-Frank's plain language and structure, there is only one category of whistleblowers: individuals who provide information relating to a securities law violation ***to the SEC***."[27] Because Asadi did not report his alleged finding to the SEC, the Fifth Circuit held that he was not eligible to bring a Dodd-Frank whistleblower-protection claim.

The Fifth Circuit also rejected Asadi's argument that the anti-retaliation language in the third subcategory of 15 U.S.C. § 78u-6(h)(1)(A), broadened the Dodd-Frank Act's anti-retaliation protection beyond "whistleblowers" who report misconduct to the SEC. The relevant provision reads as follows:

> No employer may discharge, demote, suspend, threaten, harass, directly or indirectly or in any other manner discriminate against, a whistleblower in the terms and conditions of employment because of any lawful act done by the whistleblower
>
> (1) in providing information to the Commission in accordance with this section;
>
> (2) in initiating, testifying in, or assisting in any investigation or judicial or administrative action of the Commission based upon or related to such information; or
>
> (3) in making disclosures that are required or protected under the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7201 et seq.), this chapter, including Section 78j-1(m) of this title, Section 1513(e) of Title 18, and any other law, rule or regulation subject to the jurisdiction of the Commission.

By their plain terms, the first two subcategories apply only to information provided "to the Commission" itself. While the third subcategory does not contain the same "to the Commission" qualifier, the subcategory is still qualified by the phrase "any lawful act done by the whistleblower." The third subcategory thus applies only to "whistleblowers" as defined in 15 U.S.C. § 78u-6(a), which limits the class of protected "whistleblowers" to persons who report securities violations "to the Commission."[28] Accordingly, the Fifth Circuit affirmed the district court's dismissal of Asadi's complaint.

In *Villanueva v. United States Department of Labor*, 743 F.3d 103 (5th Cir. 2014), the Fifth Circuit affirmed the dismissal of a purported whistleblower retaliation claim under section 806 of the Sarbanes-Oxley Act on the ground that the alleged misconduct reported by the whistleblower involved purported violations of Colombian tax law rather than U.S. mail, wire, bank, or securities fraud statutes, rules, or regulations.[29] The petitioner, William Villanueva, filed a complaint with the Occupational Safety and Health Administrative ("OSHA") alleging that he was terminated for reporting an alleged scheme to violate Colombian tax laws.[30] OSHA, an administrative law judge, and the administrative review board all rejected Villanueva's complaint.[31] The Fifth Circuit affirmed, holding that Villanueva failed to demonstrate that the alleged violations pertained to U.S. law rather than Colombian law and thus failed to established that he engaged in protected conduct under section 806.[32]

IV. PSLRA Pleading Standards

In *Spitzberg v. Houston American Energy Corp.*, _ F.3d _, 2014 WL 3442515 (5th Cir. 2014),[33] the Fifth Circuit reversed a Rule 12(b)(6) dismissal in a Rule 10b-5 securities class action against Houston American Energy Corporation and its officers and directors. Houston American is an exploration and production company that was developing an oil and gas concession in Colombia.[34] The suit alleged that that the defendants violated Rule 10b-5 by stating in November 2009 that the hydrocarbon blocks in the Colombian concession had "estimated recoverable reserves of 1 to 4 billion barrels." The complaint also alleged that Houston American made additional material misstatements in July 2011 regarding the progress of a test well (known as "Tamandua #1"). According to the plaintiffs, the company falsely stated that the test well produced "strong inflow[s]" and "significant shows" of both "gas and oil."[35] The complaint included allegations by "confidential witnesses" claiming that the test well produced no "inflows" or "shows" of oil or "flowable hydrocarbons."[36]

The United States District Court for the Southern District of Texas dismissed the case for failing to allege particularized facts supporting a strong inference of scienter as required by the PSLRA.[37] The district court noted that the complaint contained no allegations regarding the defendants' financial motive to make misstatements and reasoned that the company's decision to continue investing in the test well undercut any inference that the company believed there was no recoverable oil and gas.[38] The district court also granted dismissal based on the absence of loss causation.[39]

The Fifth Circuit reversed the district court's dismissal. In the appellate court's view, the allegations regarding the "1 to 4 billion barrels" estimate and the test well's performance were sufficient to support a "strong inference" of severe recklessness as required by the PSLRA.[40] On the reserves issue, the Fifth Circuit "assume[d] for the sake of argument that the industry-specific term, 'reserves,' would indeed communicate to investors that certain production or geological testing had already been conducted, as Plaintiffs-Appellants allege."[41] The court concluded that this statement presented "an 'obvious' danger of 'misleading buyers or sellers'" of Houston American's securities as to the value of the company's assets given that no testing had been done."[42] The court also recited a comment from an online web posting criticizing the "one to four billion barrels" estimate as "'one of the most audacious claims by any of the energy companies operating in that country.'"[43] With respect to the test well, the appeals court held that the contradiction between Houston American's public statements regarding the "strong inflow[s] of hydrocarbons" and the confidential witness's assertion that "neither oil nor flowable hydrocarbons were found" likewise supported a strong inference of severe recklessness at the pleading stage, although the court noted that additional evidence obtained later in the case could "undermine this factual proposition."[44] The appellate panel also took issue with the district court's emphasis on the absence of a financial motive for the alleged misstatements, holding that the absence of motive allegations is not dispositive in a recklessness analysis.[45]

The Fifth Circuit also reversed the district court's determination that the complaint failed to allege loss causation.[46] The opinion emphasized that "courts are 'not authorized or required to determine whether the plaintiffs['] plausible inference of loss causation is equally or more plausible than other competing inferences, as we must in assessing allegations of scienter under the PSLRA.'"[47] The court noted that the stock fell by 35.5% when Houston American announced that it was abandoning the Tamandua well.[48] While the appellate panel recognized that it was possible Houston American could have decided to abandon the well even if the earlier representations about hydrocarbon "inflow[s]" were true, a plaintiff need not affirmatively dispel other potential causes if it is at least plausible that the stock decline was connected to the earlier representation and if the announcement of the well's abandonment made it "more probable" that the earlier representations were inaccurate.[49]

The Fifth Circuit also rejected several alternate grounds for affirmance advanced by Houston American. The court rejected Houston American's arguments that the complaint did not adequately allege a false statement for essentially the same reasons as it rejected the district court's conclusion on scienter, holding that the use of the term "reserves" and the confidential witness's alleged contradictory statement about flowable hydrocarbons were sufficient to allege a false statement.[50] The court also held that the reserves estimate was not entitled to the safeharbor protection for forward-looking statements because the representation was arguably at least partially backward looking in implying that geological testing had already been done.[51] Lastly, the court declined to hold at the pleading stage that the two-year statute of limitations had run on the reserves estimate, holding that it was not conclusively apparent from Houston American's March 2010 Form 10-K (which only listed proved reserves and did not list probable or possible reserves) or the 2010 internet articles that a reasonable investor would have discovered the alleged falsity of the reserves representation at that time.[52] The court thus reversed the dismissal and remanded for further proceedings.[53]

In *Bailey v. Buck*, 543 Fed. Appx. 440 (5th Cir. 2013), the Fifth Circuit affirmed a bench trial verdict for the plaintiff in a federal Rule 10b-5 action. On appeal, the defendants argued that the district court lacked subject matter jurisdiction because, in the defendants' view, the complaint should have been dismissed for failure to satisfy the PSLRA's particularity requirements.[54] The Fifth Circuit affirmed the district court's decision, holding that the complaint contained specific allegations that the defendants "failed to reveal that they previously had entered into an agreement that effectively prohibited defendants from selling" the natural gas interests at issue.[55]

V. Proxy Access Litigation

In *Waste Connections, Inc. v. Chevedden*, 554 Fed. Appx. 334 (5th Cir. 2014), the Fifth Circuit reaffirmed its holding from a prior litigation matter involving shareholder activist John Chevedden. In the earlier case, *KBR v. Chevedden*, 478 Fed. Appx. 213 (5th Cir. 2012), the Fifth Circuit affirmed a Southern District of Texas order granting declaratory relief that Chevedden was ineligible to have his proposal included in KBR's proxy materials. KBR had requested that Chevedden voluntarily withdraw his proposal after Chevedden failed to document his stock ownership or otherwise demonstrate his eligibility under SEC Rule 14a-8.[56] The *KBR* opinion rejected Chevedden's argument that there was no private right of action under section 14 of the Securities Exchange Act, noting that the Supreme Court specifically recognized a private right of action under section 14(a) to enforce proxy regulations.[57] The Fifth Circuit also held that the proposal dispute was an "actual controversy" that impacted KBR's duties to other shareholders and therefore was a proper subject of declaratory relief.[58]

As in the *KBR* litigation, Waste Connections sought a declaratory judgment that it could lawfully exclude a proxy proposal from Chevedden and several other purported shareholders based on their failure to provide sufficient confirmation of share ownership as required by Rule 14a-8.[59] In affirming the district court's summary judgment in favor of Waste Connections, the Fifth Circuit noted that Chevedden and the other shareholders offered "no meritorious arguments for distinguishing KBR."[60] The Fifth Circuit further held that the possibility of an SEC enforcement action or shareholder lawsuit from refusing to include the proposal was sufficiently concrete to give Waste Connections standing to pursue its declaratory judgment action.[61]

VI. Criminal Prosecutions and SEC Enforcement Actions

The Fifth Circuit also addressed several matters involving criminal securities fraud prosecutions and SEC enforcement actions. In *United States v Bowden*, 542 Fed. Appx. 299 (5th Cir. 2013), the Fifth Circuit affirmed a securities fraud and mail fraud conviction arising from the sale of fraudulent short-term secured debt obligations ("SDOs") to retirees. The defendant, Dennis Bowden, allegedly misrepresented that each SDO was guaranteed by a commercial bank, secured by certain collateral, and insured against loss.[62] In fact, only $18 million of the $58 million raised through the CDOs at issue were secured by collateral.[63] The jury convicted Bowden of four counts of securities fraud and five counts of mail fraud.[64]

The Fifth Circuit rejected all of Bowden's challenges to the district court's judgment. It first rejected Bowden's argument that the jury should have received an advice-of-counsel instruction based on Bowden's assertion that his securities counsel approved of his business expenditures.[65] In the Fifth Circuit's view, the alleged advice regarding Bowden's business expenditures was irrelevant because the fraud convictions were based solely on Bowden's false representations and not on his business expenditures, and any reliance on counsel would be adequately covered in any event by the more general "good faith" instruction that the jury did receive.[66] The Fifth Circuit also rejected Bowden's argument that a government agent inappropriately confronted a witness outside of court after she testified inconsistently with what she had previously told the government, holding that the district court appropriately handled the incident by allowing Bowden's counsel to speak privately with the witness (who in any event did not provide crucial testimony during the case).[67] The Fifth Circuit lastly rejected Bowden's argument that the district court incorrectly calculated the investors' loss and that he should not have received a sentence enhancement for being a "leader" of a criminal enterprise, holding that the evidence sufficiently supported both determinations.[68]

In *SEC v. Halek*, 537 Fed. Appx. 576 (5th Cir. 2013), the Fifth Circuit affirmed a disgorgement and civil penalty judgment against an individual accused of making false statements to investors. After the SEC brought a civil enforcement action against Jason Halek and his two companies (CBO Energy and Halek Energy, LLC), the defendants consented to an interlocutory judgment enjoining them from future securities violations, but left open the amount of penalties and disgorgement that could be awarded.[69] The defendants later reached a mediated settlement with the SEC that was expressly "subject to approval by the SEC Commissioners."[70] The district court administratively closed the case when the mediated resolution summary was signed, but reopened the case as to Halek after the Commission staff found the defendants' sworn financial submissions insufficiently reliable to recommend approval of the settlement by the Commissioners.[71] After the parties made another unsuccessful attempt to settle the claims against Halek, the district court entered findings of fact that Halek and the other defendants reaped $21,452,137 in ill-gotten profits, commingled the funds, and spent the funds as a single economic unit.[72] The court found the defendants jointly and severally liable for disgorgement of the full ill-gotten gain plus prejudgment interest of $5,048,920.17.[73] The court also ordered Halek to pay a $50,000 civil penalty.[74]

The Fifth Circuit affirmed the district court's judgment. Noting that the mediated settlement resolution and administrative closure order specifically provided that Commission approval was required and that the case could be reopened, the appeals court held that the district court did not err in reopening the case to consider the SEC's motion.[75] The Fifth Circuit also held that the declaration from the SEC's forensic accountant sufficiently supported the trial court's determination that Halek jointly participated with the two companies in reaping the ill-gotten gains and jointly spent the funds as a single economic unit, thus exposing Halek to joint and several liability.[76] The Fifth Circuit also observed that Halek stipulated in the earlier consent judgment that the district court may accept the SEC's allegations regarding Halek's commingling of the companies' funds as true in determining disgorgement and penalties.[77] The appellate court also rejected Halek's argument that he should only be liable for the $473,502.52 that he claimed to have received from the alleged scheme (rather than the full amount received by the companies), noting that Halek did not dispute the accuracy of the $21,452,137 overall profit determined by the district court.[78] Finally, the Fifth Circuit rejected Halek's argument that the disgorgement should be reduced by the payments allegedly made to Halek Energy's shareholders in connection with the company's bankruptcy settlement, as Halek failed to show what payments were actually made in the bankruptcy settlement.[79] Halek was thus found jointly and severally liable with the two companies for the entire ill-gotten gain.

In *SEC v. Farmer*, _ Fed. Appx. _, 2014 WL 1245310 (5th Cir. 2014), the Fifth Circuit vacated an order holding that a recipient of an SEC document subpoena waived his assertion of the Fifth Amendment "act of production " privilege by not asserting the objection until after the SEC filed an action to enforce the subpoena. The subpoena recipient, Andrew Farmer, did not serve objections in response to the subpoena.[80] After he failed to produce documents, the SEC filed an action in federal court to enforce the subpoena under 15 U.S.C. § 78u(c), which authorizes the SEC to seek a federal court order compelling compliance with an SEC subpoena.[81] Farmer then asserted for the first time that the requested document production violated his Fifth Amendment act-of-production privilege, which applies when the production of documents "implicitly communicates 'the papers existed, were in [the custodian's] possession, and were authentic.'"[82] The district court held that Farmer waived the privilege by not asserting it in his initial response to the subpoena.[83] On appeal, however, the SEC agreed with the appellate panel's suggestion during oral argument that the case should be remanded so that the district court could review the documents *in camera* and determine whether the privilege applied, thus mooting the waiver issue.[84] While the Fifth Circuit did not hold that a party who fails to object to an SEC subpoena waives the objection in a subsequent civil enforcement proceeding, SEC subpoena recipients should strongly consider immediately raising all appropriate objections in response to the subpoena to avoid the waiver argument initially advanced by the SEC and district court in this matter.

VII. Additional Fallout from Stanford Financial Collapse

As in previous years, the Fifth Circuit once again waded into the aftermath of Stanford Financial's collapse. In *Anderson v. United States of America*, _ Fed. Appx. _, 2014 WL 1409451 (5th Cir. 2014), the Fifth Circuit affirmed the dismissal of a Federal Tort Claims Act (FTCA) claim against the U.S. government based on the Securities and Exchange Commission's failure to take action against Stanford Financial after receiving previous reports of suspicious conduct. The suit alleged that the SEC's former regional enforcement director in Fort Worth received prior reports from SEC examiners in 1997 and 2002 that Stanford Financial was selling fraudulent securities and had decided to refer the matter to the National Association of Securities Dealers and Texas State Securities Board for further investigation, but failed to carry out the referral.[85] The plaintiffs asserted that the regional office's failure to carry out the referrals exceeded the SEC's discretionary authority and was therefore actionable under the FTCA.[86] The Fifth Circuit, however, agreed with the Middle District of Louisiana that the plaintiffs failed to identify "any mandatory obligations violated by SEC employees in the performance of their discretionary duties" and failed to "overcome the strong presumption that the SEC's decision not to pursue Stanford, however regrettable, was grounded in policy considerations."[87] The SEC's failure to take earlier action against Stanford Financial was therefore not actionable under the FTCA.[88]

In *Janvey v. Alguire*, 539 Fed. Appx. 478 (5th Cir. 2013), the Fifth Circuit rejected an attempt by the receiver for the Stanford entities to avoid an arbitration agreement in a fraudulent transfer suit against the entities' former employees (the "Employee Defendants"). In denying the Employee Defendants' motion to compel arbitration pursuant to their employment agreements, the district court held that the receiver was not bound by the arbitration agreements because he was asserting claims on behalf of creditors (who were not bound by the arbitration agreements) rather than on behalf of the Stanford entities themselves.[89] In 2013, however, the Fifth Circuit held that the receiver "'has standing to assert only the claims of the entities in receivership.'"[90] Accordingly, the receiver lacked standing to assert claims on behalf of the estate's creditors and thus could not avoid the arbitration agreements on this ground.[91] The Fifth Circuit remanded for the district court to determine whether the claims on behalf of the Stanford entities (as opposed to the creditors) were subject to the arbitration agreements.[92]

VIII. *American Pipe* Tolling

In *Hall v. Variable Annuity Life Ins. Co.*, 727 F.3d 372 (5th Cir. 2013), the Fifth Circuit affirmed the dismissal of a securities fraud action based on the Exchange Act's five-year statute of repose for Rule 10b-5 actions. In April 2001, a different set of plaintiffs filed a class action over the same issues in the District of Arizona.[93] The Arizona court certified a class in January

2004, but the certification order was vacated on August 17, 2004 after class counsel in that action failed to identify experts or produce an expert report.[94] On December 21, 2009, the plaintiffs in *Hall* filed their own class action in the Southern District of Texas based on the same underlying claims as in the Arizona case.[95] While the certification of the Arizona class tolled the statute of limitations under the so-called *American Pipe* doctrine, the tolling ceased upon the Arizona court's decision to vacate the class certification order.[96] The district court and Fifth Circuit further held that the Arizona's unsuccessful appeal of the certification order, which was not decided until 2007, did not extend the tolling period, as it was no longer reasonable for putative class members to assume that their interests would be vindicated by the putative class representatives.[97] Accordingly, the Fifth Circuit affirmed the district court's dismissal based on the five-year statute of repose.

IX. Auction Rate Securities Litigation

In *Fishman v. Morgan Keegan & Company, Inc.*, No. 11-31090, 2014 WL 2943201 (5th Cir. 2014), the Fifth Circuit affirmed an Eastern District of Louisiana judgment in favor of Morgan Keegan on a Louisiana Securities Law claim alleging that Morgan Keegan made misrepresentations in the sale of auction rate securities ("ARS"). The plaintiffs argued on appeal that the district court erred by forcing them to prove loss causation, which the plaintiffs maintained was not required under section 712 of the Louisiana Securities Law.[98] The Fifth Circuit held that the plaintiffs did not adequately assert their argument regarding loss causation in the district court.[99] The appellate court further held that the case did not present the sort of "extraordinary circumstances" that would allow reversal based on an argument not presented to the trial court, noting that the sole on-point Louisiana case cited by the parties held that proof of loss causation was required to assert a section 712 claim.[100]

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[2] *Id.* at *1.

[3] *Id.* at *13.

[4] *Id.* at *9-10.

[5] *Id.* at *12.

[6] *Id.* at 435.

[7] *Id.* at *14.

[8] *Id.*

[9] *Id.*

[10] *Id.*

[11] *Halliburton*, 2014 WL 2807181, at *16-17 ("*Basic* allows plaintiffs to establish price impact indirectly, by showing that a stock traded in an efficient market and that a defendant's misrepresentations were public and material").

[12] *Id.* at *17.

[13] *Id.*

[14] *Id.* at *18 (Ginsburg, J., concurring).

[15] *Id.*

[16] *Id.* at *18 (Thomas, J., concurring).

[17] *Id.* at *20-21.

[18] *Id.* at *26.

[19] *Id.* at *1.

[20] *Id.*

[21] _ Fed. Appx. _, 2014 WL 3412205, at *1.

[22] *Dudenhoeffer*, 134 S. Ct. at 2472.

[23] *Id.* at 1008.

[24] *Id.* at 1008-09.

[25] *Id.* at 621.

[26] *Id.* at 625.

[27] *Id.* (emphasis added).

[28] *Id.* at 626-27.

[29] *Id.* at 104.

[30] *Id.* at 105.

[31] *Id.*

[32] *Id.* at 109-110.

[33] The authors of this article are counsel for Houston American and the other defendants in this litigation.

[34] 2104 WL 3442515, at *2.

[35] *Id.* at *3.

[36] *Id.*

[37] *Id.* at *4.

[38] *Id.* at *6.

[39] *Id.* at *7.

[40] *Id.* at *5-6.

[41] *Id.* at *5.*

[42] *Id.*

[43] *Id.*

[44] *Id.* at *6.

[45] *Id.* at *6-7.

[46] *Id.* at *7.

[47] *Id.* at *8 (quoting *Lormand v. U.S. Unwired, Inc.*, 565 F.3d 228, 267 (5th Cir. 2009)).

[48] *Id.*

[49] *Id.* at *8-9.

[50] *Id.* at *11-12.

[51] *Id.* at *12.

[52] *Id.* at *13.

[53] *Id.* at *14.

[54] *Id.* at 441.

[55] *Id.*

[56] *Id.* at *1-2.

[57] *Id.*

[58] *Id.*

[59] *Waste Connections*, 554 Fed. Appx. at 334-35.

[60] *Id*. at 335.

[61] *Id.* at 335-36.

[62] *Id.* at 300.

[63] *Id.*

[64] *Id.*

[65] *Id.* at 301-02.

[66] *Id.*

[67] *Id.* at 302.

[68] *Id.* at 303-04.

[69] *Id.* at 578.

[70] *Id.*

[71] *Id.* at 578-59.

[72] *Id.* at 579.

[73] *Id.*

[74] *Id.*

[75] *Id.* at 579-80.

[76] *Id.* at 580-81.

[77] *Id.* at 581.

[78] *Id.*

[79] *Id.* at 582.

[80] *Id.* at *1.

[81] *Id.*

[82] *Id.* at *1-2 (quoting *United States v. Hubbell*, 530 U.S. 27, 36 (2000)).

[83] *Id.* at *1.

[84] *Id.* at *3.

[85] *Id.* at *1.

[86] *Id.*

[87] *Id.*

[88] *Id.*

[89] *Id.* at 479.

[90] *Id.* at 480 (quoting *Janvey v. Democratic Senatorial Campaign Committee, Inc.*, 712 F.3d 185, 190 (5th Cir. 2013)).

[91] *Id.*

[92] *Id.*

[93] *Id.* at 374.

[94] *Id.*

[95] *Id.*

[96] *Id.* at 376 (citing *American Pipe & Construction Co. v. Utah*, 414 U.S. 538, 550-52 (1974)).

[97] *Id.*

[98] *Id.* at *3.

[99] *Id.* at *3-4.

[100] *Id.* (citing *Williams v. Edward D. Jones & Co.*, 556 So. 2d 914, 916 (La. Ct. App. 1990)).

Civil RICO Update – July 2014

By Heather A. Lohman and Alston L. Walker

The Fifth Circuit issued only a few substantive civil RICO opinions in the last year, but they cover a broad spectrum of factual and legal issues. This article briefly summarizes those decisions, as well as some of the recent civil RICO opinions and orders from federal district courts in Texas. The summaries are organized by topic.

Enterprise or Association-in-Fact

St. Gregory Cathedral Sch. v. LG Elecs., Inc., No. 6:12-cv-739, 2014 WL 979196 (E.D. Tex. Mar. 5, 2014).

St. Gregory was a class action lawsuit in which the plaintiffs alleged that LG Electronics, Inc., a Korean manufacturer of heating, ventilation, and air conditioning (HVAC) units, and several of its wholly-owned American subsidiaries conspired to conceal defects in HVAC units bought by class members. The issue before the court was whether LG Electronics and its subsidiaries constituted an "enterprise" under 18 U.S.C. § 1961(4). Under RICO, a defendant's alleged racketeering activity must be connected to an "enterprise,"[1] which section 1961(4) defines as "any individual, partnership, corporation, association, or other legal entity, and any union or group of individuals associated in fact although not a legal entity."[2] Based on circuit court precedent, however, the court concluded that a subsidiary acting on behalf of a parent company does not create an enterprise "unless the use of subsidiaries or agents somehow allowed a corporation to carryout [sic] the predicate acts in a way it could not have if it were vertically integrated." The plaintiffs argued that the LG conglomerate fit within this exception because the LG holding company knew more about the defects than did any of the subsidiary defendants. The court disagreed. It ruled that the asymmetry of information between the defendants was insufficient to overcome other evidence establishing that the defendants acted as a vertically-integrated company. The court thus held that the LG defendants were not an "enterprise" under section 1961(4) and granted the motion to dismiss. The court declined to elaborate on the circumstances under which corporate entities could fairly constitute a RICO entity, stating instead that establishing a RICO enterprise from reputable corporations "requires more than what Plaintiffs have alleged."

Standing

***Mid-Town Surgical Ctr., L.L.P. v. Humana Health Plan of Tex., Inc.*, No. H-13-2620, 2014 WL 1653085 (S.D. Tex. Apr. 23, 2014) (to be published in F. Supp. 2d).**

In *Mid-Town Surgical*, a same-day surgery center sued health insurance provider Humana for conspiring to overcharge Humana members whom the surgery center treated. Humana argued that the Mid-Town Surgical lacked standing to sue on behalf of Humana members and moved to dismiss for failure to state a claim. Although the Fifth Circuit has not squarely addressed the assignability of RICO claims, the court found that similar precedent in the Fifth Circuit[3] and elsewhere[4] justified its recognition of the assignment of RICO claims. The court, however, held that Mid-Town Surgical still lacked standing because the Humana beneficiaries failed to effectively assign their RICO claims. The Humana beneficiaries signed three agreements assigning rights to Mid-Town Surgical. The first agreement assigned Mid-Town Surgical the right to Humana's payments for medical services provided by Mid-Town Surgical. The second and third agreements, executed after the commencement of the lawsuit, expressly assigned RICO claims and ERISA claims. The court held that the first assignment did not assign the RICO claim because a party must expressly assign a RICO claim and the first assignment made no mention of RICO. The court ruled that the second and third assignments were irrelevant to establishing standing because a party must have standing at the time it files the complaint and the plaintiff did not become the assignee of the RICO claims until after the suit commenced.[5] Consequently, the court held that Mid-Town Surgical lacked standing to assert RICO claims against Humana and dismissed the claims without prejudice.

Injury

***Welborn v. Bank of N.Y. Mellon Corp.*, Nos. 13-30103, 13-50080, 2014 WL 843262 (5th Cir. Mar. 5, 2014) (per curiam) (to be published in F. App'x), *petition for cert. filed*, No. 13-1449 (June 2, 2014).**

Welborn presented the question of whether diminished fees at a government real estate recordation office constitutes injury to "business or property" under 18 U.S.C. § 1964(c). Local conveyance records offices in Louisiana and Texas sued member banks of the Mortgage Electronic Registration System, Inc. (MERS)—an entity allowing banks to reassign and convey mortgages without the need to rerecord the new transactions—for issuing fraudulent statements about the legal effects of MERS. Claiming that the fraudulent statements constituted federal mail and wire fraud and injured them by decreasing their fee revenues, the plaintiffs sought damages under RICO. The Fifth Circuit affirmed Rule 12(b)(6) dismissal on the ground that a government entity's loss of recording fees is not a cognizable injury under RICO. Under 18 U.S.C. § 1964(c), a viable civil RICO claim requires a plaintiff to show injury "in his business or property." Where a government entity brings civil RICO claims, it must show that its injury harmed its "capacity as a consumer of goods and services" rather than its "ability to carry out its functions."[6] With an eye toward statements by the supreme courts of Texas and Louisiana asserting that the purpose of local recordation offices was to protect the public's interest in stability of land titles, the court found that the plaintiffs' fee collection aided their governmental functions, not their capacity as consumers of goods and services. Consequently, the court held that a reduction in the plaintiffs' fees was not a cognizable injury under RICO.

Proximate Causation

***Jackson v. NAACP*, 546 F. App'x 438 (5th Cir. 2013) (per curiam).**

In *Jackson*, an attorney terminated by the NAACP's Houston office sued the national organization, the local branch, and the local branch's executive director for the executive director's alleged malfeasance in office. Grants from the Texas Access to Justice Foundation (TAJF) funded the attorney's employment with the NAACP. Jackson alleged that the Executive Director committed mail and wire fraud against TAJF and that the fraud in turn prompted TAJF to cut the funding responsible for her employment. Based on the predicate allegation of mail and wire fraud, she sought RICO damages against the NAACP defendants for her employment termination. On appeal, the Fifth Circuit affirmed the district court's Rule 12(b)(6) dismissal because Jackson failed to show proximate causation of her injuries. As a factual matter, the court determined that TAJF pulled the funding responsible for Jackson's employment for entirely different reasons than the alleged mail and wire fraud. The court held further that even if TAJF were to have terminated the grants because of the mail and wire fraud, Jackson still lacked causation because it would have been the discovery of the alleged RICO activity by TAJF—and not the RICO activity in itself—that would have proximately caused Jackson's termination.

Limitations

***Melcher v. Wiggins*, No. G-13-388, 2014 WL 2171212 (S.D. Tex. May 23, 2014).**

In this case, the plaintiff argued that his RICO claim had not expired under the four-year statute of limitations because he was not aware of the defendant's alleged RICO scheme until five months before he filed suit. The court found that *Rotella v. Wood*, 528 U.S. 549 (2000), foreclosed the plaintiff's theory. In *Rotella*, the Supreme Court held that the statute of limitations for civil RICO claims begins to run from the discovery of the plaintiff's injury rather than the discovery of the predicate RICO activity. The court thus held that the plaintiff's RICO claim had expired under the RICO statute of limitations and issued summary judgment for the defendant.

***Jaso v. Coca Cola Co.*, 537 F. App'x 557 (5th Cir. 2013) (per curiam).**

The Fifth Circuit affirmed summary judgment against plaintiff's RICO claims as time-barred. A person claiming civil RICO must file suit within four years after the plaintiff's injury accrues. Because the defendant's alleged racketeering activity occurred more than four years before the plaintiff filed suit, the Fifth Circuit held the statute of limitations barred its prosecution.

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[1] *St. Paul Mercury Ins. Co. v. Williamson*, 224 F.3d 425, 439 (5th Cir. 2000).

[2] 18 U.S.C. § 1961(4).

[3] *See Harris Methodist Fort Worth v. Sales Support Servs. Inc. Emp. Health Care Plan*, 426 F.3d 330, 334-35 (5th Cir. 2005) (recognizing the assignment of ERISA claims from the ERISA beneficiary to a healthcare provider).

[4] *See, e.g.*, *Lerman v. Joyce Int'l, Inc.*, 10 F.3d 106, 111-12 (3d Cir. 1993).

[5] *Pluet v. Frasier*, 355 F.3d 381, 385-86 (5th Cir. 2004).

[6] *Hawaii v. Standard Oil Co.*, 405 U.S. 251, 265 (1972).

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