

Laddering Suits Allowed to Proceed

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The U.S. District Court for the Southern District of New York (Judge Scheindlin) has granted in part and denied in part a series of motions to dismiss filed in connection with the so-called "laddering" consolidated class action lawsuits. *In re Initial Pub. Offering Sec. Litig.*, No. 21 MC 92 (SAS), 2003 WL 358003 (S.D.N.Y. Feb. 19, 2003). Those lawsuits allege that numerous public offerings for high technology and Internet-related stock from 1998 to 2000 were manipulated by the underwriting investment banks through the use of "laddering" or "tie-in agreements," whereby the underwriters required customers wishing to receive stock in connection with the public offerings to agree to buy additional shares of the stock in the aftermarket and, in some cases, to agree to make the aftermarket purchases at predetermined escalating prices. In addition, the complaints allege that the underwriters required certain customers to pay them a portion of the profits made by selling the IPO shares (referred to by the court as "undisclosed compensation"). In response, the defendants argued that the complaints failed to meet the pleading requirements of the Private Securities Litigation Reform Act of 1995 (PSLRA) and Federal Rules of Civil Procedure and otherwise failed to state a claim upon which relief could be granted.

In a detailed opinion that focused at length on the parties' legal and factual arguments, the court determined that the majority of the plaintiffs' claims were sufficiently pled under the PSLRA and constituted cognizable claims. According to the court, the plaintiffs successfully alleged "one coherent scheme to defraud, the entire purpose of which was to artificially drive up the price of securities" and which "offend[ed] the very purpose of securities laws." In considering each of the claims for relief, the court found at least one group of plaintiffs could proceed with the lawsuit, as follows:

- **Section 11 Claims:** The court determined that the plaintiffs sufficiently pled, under Federal Rules of Civil Procedure 8, that all those defendants who signed the registration statements or prospectuses violated Section 11 because the documents failed to disclose the tie-in agreements and the undisclosed compensation to the underwriters. Moreover, the court determined that, with respect to certain secondary offerings, the complaints adequately pled that the registration reports were prepared by analysts who were "tainted by undisclosed conflicts of interest." The court also concluded, however, that certain plaintiffs who sold their shares above the offering prices had no damages as a matter of law and, accordingly, dismissed their claims.
- **Section 15 Claims:** The court held that these claims were likewise adequately pled with respect to the individual defendants who allegedly controlled the issuers subject to the surviving Section 11 claims.

- **Section 10(b) Claims (Material Misstatements and Omissions):** Under both the PSLRA and Federal Rules of Civil Procedure, the court concluded that the plaintiffs successfully pled that all underwriters made material misstatements and omissions in connection with the public offerings, and that those misstatements damaged the plaintiffs. In particular, the court focused on the fact that the various registration statements did not disclose the tie-in agreements or the undisclosed compensation, that they misstated the amount of compensation the underwriting syndicates were to receive, that the underwriters were sharing in profits of their customers and were charging excessive commissions, and that the registration statements were otherwise inaccurate. The court did, however, determine that these claims were not adequately pled as to the intent of every issuer and individual defendant. Specifically, the court permitted the claims to proceed against those issuers who allegedly exploited the excessive profits through a subsequent merger or to raise more money through further offerings and against those individual issuer defendants who allegedly sold large amounts of stock at a significant profit near the time of the IPO were adequately pled. The court indicated that, "in all other instances, the pleading of intent to defraud is inadequate and therefore the claims" against those issuers and individual issuer defendants were dismissed.
- **Section 10(b) Claims (Market Manipulation):** The court determined that the plaintiffs successfully pled market manipulation claims against allocating underwriters through allegations that those defendants acted with the requisite intent to defraud by requiring customers to engage in tie-in agreements and pay undisclosed compensation.
- **Section 20 Claims:** Determining that the plaintiffs adequately alleged control of the entities subject to the surviving 10(b) claims, the court allowed all Section 20 claims relating to such entities to proceed.

The court denied leave to replead the dismissed Section 11 and Section 15 claims, as well as certain Section 10(b) claims against issuers whose alleged motive was derived from events occurring far after the initial public offerings occurred or from relatively minor sales of stock (less than 10 percent of their total holdings), as it determined those claims failed as a matter of law. In addition, the court indicated that, with respect to other claims dismissed based on insufficient particularity, the plaintiffs had been aware of those deficiencies for over a year and had multiple opportunities to correct their pleadings to date. Accordingly, with respect to those claims, leave to replead was denied, with the limited exception of a number of complaints specifically identified by the court.

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