

## Supreme Court to Clarify “Storm Warnings” of Securities Fraud

BY BEN SEESSEL

Courts generally apply a two-step analysis in determining when the statute of limitations begins to run on a federal securities fraud claim: (1) were there “storm warnings” sufficient to put a plaintiff on inquiry notice of possible wrongdoing; and (2) if so, did the plaintiff exercise reasonable diligence in attempting to discover information necessary to state a claim. The Third and Ninth Circuits, however, have recently held that before a plaintiff is placed on inquiry notice, there must be “storm warnings” that defendant acted with scienter. No other circuit court of appeal has similarly held.



*Unexpected reference to PSLRA a head-scratcher*

The Supreme Court has granted certiorari in *In re Merck & Co. Securities, Derivative & ERISA Litigation*, in which the Third Circuit held that “to trigger ‘storm warnings of culpable activity,’ in the context of a claim alleging falsely-held opinions or beliefs, investors must have sufficient information to suspect that the defendants engaged in culpable activity, i.e., that they did not hold those opinions or beliefs in earnest.” In a later case, the Third Circuit clarified that “Merck found that inquiry notice, in securities fraud suits, requires storm warnings indicating that defendants acted with scienter.” The Ninth Circuit has held similarly in a recent case. Ironically, the Third and Ninth Circuit’s decisions rely on the heightened pleading standards of the Private Securities Litigation Reform Act (PSLRA), which require that a plaintiff in a securities fraud case “state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.” This is an unexpected reference to the PSLRA, given that it was enacted with the general intent of reducing the number of securities fraud cases.



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### Possible Change to Section 530 Independent Contractor Safe Harbor in the Wind

BY JANEL FRANK

In H.R. 3408, introduced by Representative Jim McDermott (D-WA), is intended to limit the ability of taxpayers to utilize the independent contractor safe harbor provided by section 530 of the Revenue Act of 1978 (a non-Code provision). Currently, the section 530 safe harbor protects taxpayers who treat workers as independent contractors when the taxpayers historically and consistently treated its workers as independent contractors and had a reasonable basis for doing so. To establish a reasonable basis for independent contractor treatment, taxpayers can rely on court decisions and published rulings involving similarly-situated taxpayers, or technical advice and letter rulings directly involving the taxpayers. Taxpayers can also rely on the results from concluded audits and long-standing industry practices.

H.R. 3408 would significantly curtail the sources that could be relied upon to establish a reasonable basis for treating workers as independent contractors. Under H.R. 3408, safe harbor protection would only be available to taxpayers who treat workers as independent contractors on the basis of either a written determination from the IRS or a concluded audit. In addition, H.R. 3408 would terminate a taxpayer’s ability to continue to rely on the written determination or concluded audit if facts and circumstances change, or if the Secretary subsequently issues contrary guidance. H.R. 3408 places the burden on the taxpayer to prove entitlement to the safe harbor by a preponderance of the evidence. Although not clear, it appears that the preponderance standard would only apply when a taxpayer is at risk of losing its entitlement to the safe harbor. For example, a taxpayer may need to prove by a preponderance of the evidence that its facts and circumstances have not changed since the initial determination of independent contractor status. If enacted, H.R. 3408 is expected to be a “small” revenue raiser.