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Investors' Fraud Suit Against ArthroCare Trimmed

By **Abigail Rubenstein**

Law360, New York (July 22, 2010) -- A federal judge has pared down a consolidated securities class action against medical device maker ArthroCare Corp. stemming from a 2009 financial restatement in which the company made numerous admissions of wrongdoing.

In response to motions to dismiss filed by the defendants, Judge Sam Sparks of the U.S. District Court for the Western District of Texas narrowed the timeframe for claims against the company and its former top executives and tossed claims against two lower-level officers and the company's outside auditor.

The plaintiffs brought claims on behalf of all persons or entities who purchased common stock in ArthroCare between May 10, 2005, and Feb. 18, 2009, against the company as well as former executives Michael Baker, Michael Gluck, John Raffle and David Applegate, as well as ArthroCare's auditor PricewaterhouseCoopers.

The suit alleges that ArthroCare and the individual defendants made numerous public statements during the class period — including statements to investors during earnings conference calls, in press releases, and in filings with the U.S. Securities and Exchange Commission — that were materially false and misleading and that failed to disclose a number of fraudulent activities within the company including selling a spinal surgery device to doctors through a scheme that involved patient referrals by personal injury lawyers.

On Feb. 18, 2009, the company restated its earnings from 2004 through the first quarter of 2008 and admitted to the sales scheme and a lack of internal controls. According to court papers, on the the day the restatement was released, ArthroCare's stock price closed at \$4.50 per share, down from a high during the class period of \$65.70.

Judge Sparks ruled that the plaintiffs had sufficiently alleged the falsity of the statements made by the company, ex-CEO Baker and former Chief Financial Officer Gluck, but that scienter as to the two executives, and thereby for the company, could only be established after December 2007 when media reports of the fraudulent sales practices began to proliferate.

As such, the court dismissed claims related to statements from before December 2007 but left the case

against ArthroCare, Baker and Gluck intact as to statements made after that time.

Judge Sparks also dismissed all claims against lower-level executives John Raffle and David Applegate, finding that they were not liable as control persons.

The court further held that PricewaterhouseCoopers did not intend to mislead investors and was itself misled by ArthroCare's executives about the company's questionable accounting practices. Judge Sparks therefore dismissed all claims against the auditor.

"Judge Sparks has sustained the securities fraud allegations against ArthroCare and its two key executives. We will now proceed into document and deposition discovery in preparation for trial," said Meryl W. Roper of Chitwood Harley Harnes LLP, who represents the plaintiffs.

An attorney for the company was not immediately available for comment Thursday.

The plaintiffs are represented by Chitwood Harley Harnes LLP and others.

ArthroCare is represented by DLA Piper. PricewaterhouseCoopers is represented by WilmerHale. Baker is represented by Fenwick & West LLP. Gluck is represented by Locke Lord Bissell & Liddell LLP. Raffle is represented by Andrews Kurth LLP. Applegate is represented by Vinson & Elkins LLP.

The case is In Re: ArthroCare Corp. Securities Litigation, case number 1:08-cv-00574, in the U.S. District Court for the Western District of Texas.

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