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Skadden

Inside the Courts
An Update From Skadden Securities Litigators

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US Supreme Court

US Supreme Court Rules That Equitable Tolling Does Not Apply to Section 13 of the Securities Act

CalPERS v. Anz Sec. Inc., No. 16-373 (Sup. Ct. June 26, 2017)
Click here to view the opinion.

The U.S. Supreme Court resolved a circuit split by deciding that the three-year limit for filing lawsuits under Section 13 of the Securities Act is a statute of repose, not one of limitations, and thus is not subject to equitable tolling. In doing so, the Court barred a Section 11 claim that was filed more than three years after the debt offering at issue. The Court held that the equitable tolling doctrine described in *American Pipe & Construction Co. v. Utah*, 414 U.S. 538 (1974), did not apply to the "unconditional" language and purpose of Section 13's three-year statute of repose. In the case, one plaintiff alleged that an investment bank made certain misrepresentations and omissions in connection with a debt offering. More than three years after the debt offering was made, a different plaintiff filed a separate complaint asserting substantially the same allegations against the investment bank. After the earlier action had settled, the plaintiff in the later-filed action opted out of the settlement in order to continue pursuing its claim separately.

The Court affirmed the Second Circuit's dismissal of that later-filed action as untimely, holding that the earlier-filed action concerning the same debt offering did not toll Section 13's three-year statute of repose. The Court considered the text, purpose, structure and history of the Securities Act and determined that it "reflects the legislative objective to give a defendant a complete defense to any suit after a certain period." The Court determined that the tolling decision in *American Pipe* — which involved a statute of limitations — derived from equity principles, not the judiciary's power to interpret and enforce statutory language, and thus was inapplicable in this case. The Court held that the timely filing of a class action complaint does not permit an individual class member to file suit after the statute of repose period has ended, as doing so would undermine the purpose of limiting a defendant's liability after a certain period. The Court also determined that the plaintiff's concerns about certain "inefficiencies" that might arise if the statute of repose could not be tolled were likely "overstated." There was no evidence of increased individual class member lawsuits in the Second Circuit, and even if there were, the process for an individual to be added to a putative class action suit was unlikely to be onerous.

Appraisal

Delaware Supreme Court Rejects Private Equity Carve-Out in Appraisal Proceedings; Remands for Further Consideration of Deal Price as Fair Value

DFC Global Corp. v. Muirfield Value Partners, L.P., No. 518, 2016 (Del. Aug. 1, 2017)
Click here to view the opinion.

The Delaware Supreme Court reversed the Court of Chancery's decision in the appraisal proceedings relating to the sale of DFC Global Corp. and remanded for further proceedings.

The Supreme Court declined to "establish, by judicial gloss, a presumption that in certain cases involving arm's-length mergers, the price of the transaction giving rise to appraisal rights is the best estimate of fair value." Instead, the court reiterated longstanding case law that the Court of Chancery in the first instance has the discretion to determine the fair value of the shares by taking into account all relevant factors.

However, the court refused to sustain the Court of Chancery's opinion, which gave one-third weight each to the deal price, a discounted cash flow analysis and a comparable companies analysis. The Supreme Court stated that, "[a]lthough there is no presumption in favor of the deal price, under the conditions found by the Court of Chancery, economic principles suggest that the best evidence of fair value was the deal price, as it resulted from an open process, informed by robust public information, and easy access to deeper, non-public information, in which many parties with an incentive to make a profit had a chance to bid." Among other reasons, the Court of Chancery did not give dispositive weight to the deal price because the prevailing buyer was a financial buyer focused on achieving certain internal rates of return. The Supreme Court stated, "[t]o be candid, we do not understand the logic of this finding," and observed that "the 'private equity carve out' that the Court of Chancery seemed to recognize, in which the deal price resulting in a transaction won by a private equity buyer is not a reliable indication of fair value, is not one grounded in economic literature or this record."

The Supreme Court concluded that "the Court of Chancery's decision to give one-third weight each to the deal price, the discounted cash flow valuation, and the comparable companies valuation was not explained. Given the Court of Chancery's findings about the robustness of the market check and the substantial public information available about the company, we cannot discern the basis for this allocation. On remand, if the Court of Chancery chooses to use a weighting of different valuation methodologies to reach its fair value determination, the court must explain its weighting in a manner supported by the record before it."

Fiduciary Duties – Mergers and Acquisitions

Court of Chancery Determines *MFW* Can Apply at Motion to Dismiss Stage Where Controlling Stockholder Is a Seller

In re Martha Stewart Living Omnimedia, Inc. Stockholder Litig., Consol. C.A. No. 11202-VCS (Del. Ch. Aug. 18, 2017)
Click here to view the opinion.

Vice Chancellor Joseph R. Slights III dismissed stockholder claims challenging the acquisition of Martha Stewart Living Omnimedia, Inc. (MSLO) by Sequential Brands Group, Inc. (Sequential), and determined that compliance with the procedural protections elaborated in *MFW* would result in application of the business judgment rule in third-party sales with a conflicted controller.

Stockholders of MSLO brought claims against Martha Stewart, MSLO's former controlling stockholder, for breach of fiduciary duty and against Sequential for aiding and abetting that breach in connection with the MSLO board's approval of the merger. To determine the standard of review, the court first analyzed whether Stewart engaged in a conflicted transaction. Although Stewart was only on the sell side of the transaction and received the same per-share merger consideration as other stockholders, the plaintiffs alleged that Sequential lowered its offer after agreeing to "side deals" with Stewart. However, the court concluded that the plaintiffs had failed to plead facts supporting a reasonable inference that side deals with Stewart were unfair or "diverted" merger consideration that would otherwise have been paid to the minority stockholders. The court said "[i]t was entirely proper for [buyer] to pay, and for Stewart to accept, extra consideration (just as MSLO had paid before the Merger) to secure the immeasurable value of" Stewart's commitment of "time, energy and talent to keep the brand alive and thriving." Because the plaintiffs failed to allege facts that supported an inference "that the side payment represented an *improper* diversion" of consideration, the business judgment standard applied.

Nevertheless, the court also analyzed whether the approval by an independent, disinterested and properly empowered special committee and a nonwaivable, fully informed and uncoerced vote of a majority of the minority stockholders provided an independent basis to invoke the business judgment rule. Determining that the "need to incentivize fiduciaries to act in the best interests of minority stockholders ... is equally important in one-sided and two-sided conflicted controller transactions," the court held that "strict compliance with the transactional road map" in *MFW* "is required for the controlling stockholder to earn pleadings-stage business judgment deference when it is well-pled that the controller, as seller, engaged in a conflicted transaction ..." The court then considered when in the negotiation process the *MFW* protections would need to be agreed upon and determined that to obtain business judgment rule protection at the pleading stage, the dual protections must be in place before the controlling stockholder begins to negotiate with an acquirer for additional consideration. Finding that the plaintiffs failed to adequately plead that (1) the special committee lacked independence and was ineffective and (2) the majority of the minority vote condition was ineffective, business judgment review was appropriate. The court granted the motions to dismiss for all claims.

Court of Chancery Dismisses Fiduciary Challenge to Merger, Finding No Bad Faith

In re MeadWestvaco Stockholders Litig., Consol. C.A. No. 10617-CB (Del. Ch. Aug. 17, 2017)
Click here to view the opinion.

Chancellor Andre G. Bouchard, applying the business judgment rule, dismissed a stockholder complaint challenging a stock-for-stock merger.

In light of an 8 Del. C. § 102(b)(7) provision in the company's charter exculpating the directors for money damages, the Court of Chancery noted that the stock-for-stock merger without the presence of any controllers presumptively subjected the board's decision to the business judgment rule, absent a reasonable inference that either a majority of the board was not both disinterested and independent, or the board did not act in good faith. Because there were no allegations challenging the disinterestedness or independence of any of the directors, the plaintiffs were required to allege the board failed to act in good faith. The court reiterated that "'[i]n the transactional context, an extreme set of facts is required to sustain a disloyalty claim premised on the notion that disinterested directors were intentionally disregarding their duties,' and even one 'plausible and legitimate explanation for the board's decision' would negate a reasonable inference that the decision was 'so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith.'" The court further stated that "[a]s long as a board attempts to meet its duties, no matter how incompetently, the directors did not consciously disregard their obligations."

The Court of Chancery also noted that the Delaware Supreme Court has "equated showing that the substance of a board's decision is an act of bad faith to meeting the onerous burden of proving a waste claim." While the plaintiffs challenged the approximately 9 percent premium of the deal, the court stated that "[e]ven if it were true that the premium was low, 'there is no rule that a low premium represents a bad deal, much less bad faith.'"

The court held that the allegations of the complaint did not support a reasonable inference that the board's approval of the merger was an act of bad faith, noting, among other things, that the directors "asked a series of probing questions ... hardly evidence of an intentional disregard of one's duties"; the board utilized three financial advisors that all opined that the merger was fair; and the board agreed to the merger only after rejecting the buyer's proposal for an "at market" transaction. The court further rejected the plaintiffs' contention that the board entered into the merger in response to the potential threat of a proxy contest by one of the company's largest stockholders.

Because the allegations did not state a claim for bad faith, the court declined to address whether the board's decision alternatively would be cleansed by *Corwin*.

Insider Trading Claims

Second Circuit Affirms Dismissal of Insider Trading Claims Against Investment Entities Controlled by Billionaire Investment Magnate

Olagues v. Icahn, Nos. 16-1255-cv, 16-1259-cv, 16-1261-cv (2d Cir. Aug. 3, 2017)
Click here to view the opinion.

The Second Circuit affirmed the dismissal of claims brought by an investor in three companies alleging that Carl Icahn and certain investment entities he controls violated Section 16(b) of the Securities Exchange Act and Rule 16b-6(d) promulgated thereunder by obtaining "short-swing" profits from the sale of certain unexercised put options pertaining to shares of those three companies. Specifically, the plaintiff alleged that the defendants sold put options to third parties for cash premiums and purchased call options for the same amount of securities from the same third parties. Under the structure of the defendants' options contracts, when the defendants exercised a call option, a corresponding put option would automatically be canceled unexercised.

Although the defendants had disgorged all the premiums obtained by selling the unexercised put options ($0.01/share), the plaintiff alleged that the defendants were required to additionally disgorge the "value" of the alleged discounts that the defendants received on the purchases of related call options. That is, the plaintiff alleged that the defendants "received additional undeclared consideration for writing the put options in the form of discounts on the premiums they paid to buy the corresponding call options." To support that allegation, the plaintiff compared the premiums associated with the defendants' option contracts with the premiums associated with open-market option contracts and argued that the defendant "charged too little for the put options and did not pay enough for the call options." The plaintiff further argued that the discounts "received on the call option premiums were consideration for writing the put options."

The Second Circuit disagreed, finding that "the open-market option contracts are not meaningfully comparable to the option contracts bought and sold by the Icahn Entities." The court noted that unlike the open-market contracts, which were all "American style" option contracts exercisable at any time through the expiration date and were "not combined with any corresponding options that ensured an exchange of shares by the expiration date," the defendants' option contracts were paired. The defendants purchased "American style" option contracts and sold "European style" option contracts that were exercisable only on the expiration date. This structure "b[ound] the parties to an exchange of shares at a fixed price on or before the expiration date" and thus were not subject to Rule 16(b). The court noted that Rule 16(b) was concerned with stopping corporate insiders from receiving a premium for an option based on inside information that the option would not be exercised within six months. The court found that that was not the case here because, under the structure of the contracts, "the underlying shares did in fact change hands." The court held that the "complaint does not state a claim for relief because it relies exclusively on comparisons to options traded on the open market that have no meaningful similarities to the options at issue here."

Investment Company Act

Eighth Circuit Affirms Summary Judgment for Investment Adviser Defendant in Funds-of-Funds Excessive Fees Case

Am. Chems. & Equip. Inc. 401(k) Ret. Plan v. Principal Mgmt. Corp., Nos. 16-1576, 16-1580, 16-1712 (8th Cir. July 24, 2017)
Click here to view the opinion.

The Eighth Circuit affirmed summary judgment in favor of the defendant, an investment adviser, facing breach of fiduciary duty claims under Section 36(b) of the Investment Company Act (ICA). The plaintiff, a retirement plan, alleged that the investment adviser breached its fiduciary duty under the ICA by charging excessive fees related to the plan's investment in "funds of funds" mutual funds. Rather than basing its claim on the fees the relevant mutual funds paid directly to the adviser, the plaintiff alleged excessiveness of the fees paid to the defendant by the funds in which the plaintiff's mutual funds invest. The district court granted summary judgment in favor of the adviser.

The Eighth Circuit affirmed the grant of summary judgment, adopting the district court's reasoning that the plaintiff lacked standing to bring a Section 36(b) fiduciary duty claim on the basis of fees paid by funds in which it did not directly invest. The court noted that the plaintiff falls within the "zone of ... interest[]" created by Section 36(b), citing the Supreme Court's recent standing decision in *Lexmark Int'l Inc. v. Static Control Components, Inc.*, 134 S. Ct. 1377 (2014). However, the court determined that satisfying the *Lexmark* zone-of-interest standard is not sufficient, focusing instead on the text of Section 36(b). Because the statute creates a cause of action only for fees paid by the entity in which the security holders have an interest, the court explained, the plaintiff could not bring an action involving fees paid by the underlying funds in which the plaintiff did not directly invest. The court rejected the plaintiff's argument that it did pay those fees because the payment of the fees by the underlying funds reduced the net asset value of those underlying funds, subsequently reducing the value of the plaintiff's shareholdings in the mutual funds. The court explained that the mere reduction of an asset's value does not mean that the reduction was paid by the asset's investors. The ICA only permits excessive fee claims based on fees directly paid by a fund in which a party invests.

Materiality

Eighth Circuit Affirms Dismissal of Putative Securities Fraud Class Action Alleging Misstatements in Promotional Materials

In re Stratasys Ltd. S'holder Sec. Litig., No. 16-3264
(8th Cir. July 25, 2017)
Click here to view the opinion.

The Eighth Circuit affirmed the dismissal of claims brought under Section 10(b) of the Securities Exchange Act against a corporation that manufactures 3-D printers as well as certain directors and officers. After acquiring another manufacturer, the defendant corporation stated that its new printers were "unmatched" in reliability, quality, connectivity and speed. Buyers experienced problems with the printers and returned them, and the corporation's stock price fell. The plaintiff shareholders claimed that the defendants' statements about the quality of the printers were misleading and that the defendants knew the printers had quality issues while making those statements. The district court dismissed the claims.

The Eighth Circuit affirmed the district court's dismissal, holding that the defendants' statements regarding the products' quality were not material because they were puffery — statements so vague that no reasonable investor would rely upon them. The court stated that optimistic statements like those made by the defendants are not actionable under Section 10(b) if they cannot be supported by objective data, and that the defendants' statements regarding unmatched reliability, quality and connectivity could not be verified with objective data. The court noted that the defendants' statement regarding unmatched speed could potentially be actionable because that statement could be tested with objective data. However, the court determined that the plaintiffs here did not allege specific facts with respect to speed, and therefore the claims were properly dismissed. The court also rejected the plaintiffs' argument that the context of these product claims — a highly anticipated product launch following the acquisition of a specific manufacturer — made the claims material, distinguishing the out-of-circuit authority cited by the plaintiffs.

Second Circuit Rejects 'Extreme Departure' Materiality Test

Stadnick v. Vivint Solar, Inc., No. 16-65-cv
(2d Cir. June 21, 2017)
Click here to view the opinion.

The Second Circuit affirmed the dismissal of claims under Section 11 of the Securities Act that a company made material misrepresentations in connection with its initial public offering (IPO) regarding certain financial results disclosed in the quarter following the IPO. The plaintiffs alleged that the company failed to disclose the anticipated financial results and adequately warn investors about certain risks associated with the company's business.

The Second Circuit affirmed dismissal because the quarterly financial results were not material, but it applied different reasoning than the district court. Judge Katherine B. Forrest of the district court had applied the "extreme departure" test articulated in *Shaw v. Digital Equipment Corp.*, 82 F.3d 1194 (1st Cir. 1996). Under that test, information is deemed material if it represents an "extreme departure" from the information or performance previously disclosed. Judge Forrest determined that the quarterly performance disclosed following the company's IPO did not represent an "extreme departure" from previously disclosed results. The Second Circuit rejected that approach because it left "too many open questions, such as: the degree of change necessary for an 'extreme departure'; which metrics courts should look to in assessing whether such a departure has occurred; and the precise role of the familiar 'objectively reasonable investor' in assessing whether a departure is extreme." Also, the Second Circuit explained that the "extreme departure" test can sometimes be "analytically counterproductive."

Instead, the Second Circuit held that the test articulated by the Supreme Court in *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976), and applied in *DeMaria v. Andersen*, 318 F.3d 170 (2d Cir. 2003), should apply. *DeMaria* holds that the test for materiality is whether "a reasonable investor would view the omission [the information at issue] as 'significantly alter[ing] the "total mix" of information made available."' In this case, the Second Circuit held that the third-quarter financial results were not material because of the company's previous financial and business disclosures, including with respect to the "peculiarities of its business model," its accounting, its past performance and the risks associated within one of the markets in which the company operates. Therefore, the Second Circuit held that the subsequent financial results would not have substantially altered the total mix of information available to investors at the time of the IPO.

PSLRA

Pleading Standards

Ninth Circuit Extends Supreme Court's *Omnicare* Standard to Claims Brought Under Section 10(b)

City of Dearborn Heights Act 345 Police & Fire Ret. Sys. v. Align Tech. Inc., No 14-16814 (9th Cir. May 5, 2017)
Click here to view the opinion.

The Ninth Circuit affirmed the dismissal of a putative securities fraud class action brought under Sections 10(b) and 20(a) of the Securities Exchange Act and Securities and Exchange Commission (SEC) Rule 10b-5, holding that the pleading standards announced in *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*, 135 S. Ct. 1318 (2015), apply to claims brought under the Securities Exchange Act, and that the allegations here failed to satisfy those standards.

The plaintiff alleged that the defendants made false and misleading statements in press releases and public filings regarding the company's goodwill valuation of a subsidiary it acquired in 2011. In 2012, defendants announced that the company was conducting interim goodwill impairment tests. The announcement led to a drop in the company's stock price.

In affirming dismissal of the claims, the Ninth Circuit first held that goodwill valuations are statements of opinion because they are inherently subjective and depend on management's opinion of fair value. Next, the panel held that the three standards for pleading falsity of opinions statements articulated in *Omnicare*, a case that involved Section 11 claims under the Securities Act, apply equally to Section 10(b) and Rule 10b-5 claims. Under *Omnicare*, a plaintiff can plead falsity under three theories: (1) a material misrepresentation theory, whereby the plaintiff must allege both that "'the speaker did not hold the belief she professed' and that the belief is objectively untrue"; (2) the theory that a statement of fact contained within an opinion statement is materially misleading, whereby "the plaintiff must allege that 'the supporting fact [the speaker] supplied [is] untrue'"; and (3) a theory of omission, where the plaintiff must allege "facts going to the basis for the issuer's opinion ... whose omission makes the opinion statement at issue misleading to a reasonable person reading the statement fairly and in context." The panel held that to the extent the Ninth Circuit's prior standard permitted plaintiffs to plead falsity by alleging that "there is no reasonable basis for the belief" under a material misrepresentation theory of liability, the prior standard was "clearly irreconcilable" with *Omnicare* and was therefore overruled.

Under the proper *Omnicare* standard, the Ninth Circuit held, the complaint contained no allegations of subjective falsity and the plaintiff did not allege the actual assumptions that defendants relied upon in conducting their goodwill analysis. Absent such allegations, the court could not conclude that the defendants intentionally ignored the subsidiary's artificially inflated revenue when conducting the goodwill analysis, such that the goodwill valuations was knowingly false or misleading when made.

Safe Harbor Provision

Ninth Circuit Holds Nonforward-Looking Statements Included in Mixed Statements Are Not Protected by Safe Harbor Provision

In re Quality Sys., Inc. Sec. Litig., No. 15-55173 (9th Cir. July 28, 2017)
Click here to view the opinion.

The Ninth Circuit reversed the dismissal of a putative securities fraud class action. In doing so, it joined five other circuits in holding that a defendant may not transform nonforward-looking statements into forward-looking statements that are protected by the safe harbor provision of the Private Securities Litigation Reform Act (PSLRA) by combining nonforward-looking statements about past or current facts with forward-looking statements about projected revenues and earnings.

The defendant is a developer of software systems for health care providers. The plaintiffs alleged that during the class period, the market for health care software systems became increasingly saturated, and sales opportunities for the defendants' systems decreased. The plaintiffs alleged that the defendants had information showing a sales decline but made public statements denying such a decline and released growth projections that failed to acknowledge this market reality.

The district court dismissed the plaintiffs' claims, finding some of the alleged misrepresentations were nonactionable puffery while others were forward-looking statements accompanied by proper cautionary language.

The Ninth Circuit reversed. After noting that the Ninth Circuit had yet to address whether the PSLRA's safe harbor provision covers the nonforward-looking portions of forward-looking statements, the panel joined the unanimous view of the sister circuits that have addressed this issue in holding that the PSLRA's safe harbor provision does not insulate nonforward-looking statements merely because they are contained within otherwise forward-looking statements. Applying that standard, the court determined that the defendants had made several nonforward-looking statements about the state of the company's current sales pipeline, and those statements were, therefore, not protected. Next, the court concluded that the defendants' nonforward-looking statements were materially false or misleading. The court disagreed with the district court's finding that the defendants' statements were mere puffery because the statements provided descriptions of the past and present state of the sales pipeline. Additionally, the defendants' nonforward-looking statements were inconsistent with real-time financial information. Finally, the court held that some of the forward-looking statements within nonforward-looking statements were not accompanied by the requisite cautionary language.

District Court Holds That Statements Regarding Revenue Projections Not Covered by Safe Harbor Provision

Bielousov v. GoPro, Inc., No. 16-cv-06654-CW
(N.D. Cal. July 26, 2017)
Click here to view the opinion.

The Northern District of California denied the defendants' motion to dismiss a putative securities class action brought under Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5.

The defendant company makes and sells mountable and wearable cameras. On a September 2016 call, the company unveiled two new cameras and a drone, telling investors that the drone "would take [the company] to 'new heights'" and that the company "believe[d] [it was] still on track" to meet its revenue guidance of over $1 billion in revenue for 2016. The defendants also made statements that the drone could capture "amazingly smooth" footage.

The plaintiffs alleged that these statements were false and misleading because the company had a shortage of drones, and the new cameras and drones had a design defect (which eventually caused them to be recalled). The plaintiffs further alleged that the defendants knew of the shortage because they had a system that gave them real-time access to supply chain information.

In moving to dismiss the claims, the defendants argued that their statements fell within the PSLRA's safe harbor provision for forward-looking statements. The court disagreed, finding that the statement that the company believed it was on track to meet its revenue guidance was a statement of present opinion, not a forward-looking statement. With regard to the defendants' statements that the drone could capture "amazingly smooth" footage, the court found that such statements were objectively verifiable promises, not mere puffery or corporate optimism.

The court also found that the plaintiffs adequately pleaded scienter because the defendants had a system that could look up supply chain information, and they were inclined to use that system due to prior issues with inventory.

Scienter

First Circuit Holds That Pharmaceutical Company's 'Positive Spin' on FDA Comments Do Not Support Inference of Scienter

Corban v. Sarepta Therapeutics, Inc., Nos. 15-2135, 16-1658
(1st Cir. Aug. 22, 2017)
Click here to view the opinion.

The First Circuit affirmed the dismissal of claims under Section 10 of the Securities Exchange Act that a company and its executives made material misrepresentations about the likelihood that the Food and Drug Administration (FDA) would accept its new drug application. The plaintiffs filed their lawsuit after the company's announcement that the FDA had deemed its application premature, alleging that company executives disclosed too little of FDA officials' reactions to interim trial results and were misleadingly optimistic about the drug's prospects for approval. The court dismissed the claims because the plaintiffs failed to plead sufficient facts to give rise to a strong inference of scienter. Although the plaintiffs alleged that the CEO's statement that he was "encouraged" by FDA feedback was misleading because it failed to disclose that FDA officials had voiced concerns concerning the type of data generated by clinical trials, the court found that the statement was inactionable opinion "replete with caveats."

At worst, the court held, the statement was a "positive spin," and not an actionable misstatement. The court emphasized that the company accurately reported that the FDA had declined to offer any assurances that the new drug application would be acceptable for filing, and that there is "no legal obligation to loop the public into each detail of every communication with the FDA." The facts did not support a finding of scienter where the company "faithfully represent[ed the FDA's] position" while "neglect[ing] to mention specific factors ... contributing to [that] position." The court further rejected the argument that the company's at-the-market offering several months before the stock drop, which raised $125 million in capital, provided a motive to lie: "'The usual concern by executives to improve financial results' does not support an inference of scienter."

SDNY Holds That Company Not Required to Disclose Contract Dispute With Largest Customer

In re Express Scripts Holding Co. Sec. Litig., No. 16 Civ. 3338 (ER) (S.D.N.Y. July 31, 2017)
Click here to view the opinion.

Judge Edgardo Ramos dismissed a putative securities fraud class action, holding that a company has no duty to disclose a contractual dispute with its largest customer unless one party purports to terminate the contract. The plaintiff alleged the company and certain of its officers violated Section 10(b) and Section 20(a) of the Securities Exchange Act because they did not disclose an ongoing contractual dispute and related negotiations with their largest customer. The plaintiff claimed the "truth was revealed" when, after more than a year of negotiations, the parties reached an impasse and the customer filed a lawsuit claiming the company had breached the parties' contract. The company subsequently adjusted its accounting for the 10-year contract assuming it was no longer likely to be renewed.

Judge Ramos rejected the plaintiff's theory that because the company made statements about its "great" relationship and "active" negotiations with the customer, it also was required to disclose the specific nature of the dispute and the strain in the parties' relationship. The company was not required to speculate that the negotiations would prove unsuccessful and the parties would ultimately be unable to resolve their dispute short of litigation. Critically, the court held the plaintiff failed to allege that the customer definitively told the company that it intended to terminate the business relationship, despite allegations that the customer had twice given the company notice of alleged breaches and threatened litigation, and the parties had exhausted their contractual dispute resolution process. The court further held that the plaintiff failed to sufficiently allege scienter with respect to any of the alleged misstatements or omissions, including the claim that the company had improperly accounted for the contract. The plaintiff failed to sufficiently allege that the defendants knew any facts that undermined the basis for the accounting at the time it was made — when negotiations with the customer were still ongoing.

SDNY Dismisses Claims Alleging That a Mining Company Misled Investors

In re Pretium Res. Inc. Sec. Litig., No. 13-CV-7552 (VSB) (S.D.N.Y. Jun. 13, 2017)
Click here to view the opinion.

Judge Vernon S. Broderick dismissed claims asserted by a putative class of investors in a mining company alleging that the company and certain of its officers violated Sections 10(b) and 20(a) of the Securities Exchange Act. The plaintiffs alleged that during the class period, the company issued press releases and made statements in SEC filings that misrepresented the prospects of recovering gold from a mining and exploration project in British Columbia. The plaintiffs alleged that notwithstanding the company's positive public statements, a consulting firm hired by the company to test the concentration of gold in the mine and the project's profitability resigned from the project, allegedly informing the company that there "are no valid gold mineral resources." The plaintiffs argued that the company's profitability forecasts pertaining to the mining site were misleading because they omitted information the consulting firm had provided to the company about its view of the mine's gold reserves. Regarding the mine's future profitability, the company argued that its forecasts were genuinely held statements of opinion that happened to differ from those of the consulting firm.

Citing the Supreme Court's decision in *Omnicare*, the district court agreed that the company's projections about the mine's "future productivity and profitability are statements of opinion since they do not express presently existing objective facts." The court found that the statements were not misleading because the company's "SEC filings advised investors" that the process of estimating mine reserves is a "subjective process that relies on the judgment of the persons preparing the estimates." Further, the court found that "Plaintiffs allege no facts suggesting that Defendants engaged in any deliberate illegal behavior." Although the plaintiffs argued that the defendants had the motive of proving that the mine was profitable, and that hitting certain market capitalization goals would lead to performance bonuses for certain defendants, the court found that the plaintiffs alleged, at most, negligence, which is insufficient to support a fraud claim.

Securities Exchange Act

DC Circuit Deems SEC's Approval of Self-Regulated Organization's Capital Plan 'Arbitrary and Capricious,' Requires SEC to Provide Closer Scrutiny

Susquehanna Int'l Grp., LLP v. SEC, No. 16-1061
(D.C. Cir. Aug. 8, 2017)
Click here to view the opinion.

On August 8, 2017, a three-judge panel of the D.C. Circuit held that the SEC approval of a self-regulated organization's capital plan was arbitrary and capricious, and it remanded the case to the SEC for further proceedings.

The Options Clearing Corporation (OCC), a clearing agency that facilitates trades in options and other financial instruments, is a "self-regulatory organization" under the Securities Exchange Act and is closely regulated by the SEC. Two nonshareholder exchanges, a clearing member and a market participant, sought judicial review of the SEC's early 2016 approval of OCC's proposed capital plan, which was developed to amass the capital reserves OCC determined it needed. Under the plan, OCC's five shareholder exchanges, including petitioners, would be required to make capital contributions and pledge to provide replenishment capital upon request. The plan would then compensate those contributions with dividends paid out from approximately half of OCC's unused fees, which had previously been refunded in their entirety to clearing members.

Petitioners argued that (1) the SEC was required to, but did not, actually find or determine that OCC's plan met the Securities Exchange Act requirements, and (2) the plan is inconsistent with various Securities Exchange Act requirements. The court addressed only the latter argument.

A central issue was whether the plan pays dividends to shareholder exchanges at a reasonable rate. The court concluded that the SEC's "unquestioning reliance on OCC's claim that the dividend rate is reasonable" was not a defense to the SEC's lack of reasoned analysis in its order approving the plan. The court stated that the Securities Exchange Act required the SEC to make findings and determinations about OCC's plan and that "the SEC effectively abdicated that responsibility."

The court was not swayed by the SEC's argument that it was reasonable to "trust the process" undertaken by OCC. First, the court noted that the negotiation process that culminated in a supermajority of OCC's board voting in favor of the capital plan was hardly the "arm's-length negotiation[]" that the SEC claimed it to be. Second, the court stated that the SEC could not rely on OCC's process divorced from any examination of the substance of the plan, especially where the OCC's process involved merely "the general elements of OCC's governance structure."

The court also determined the SEC's order lacked reasoned decision-making because the SEC (1) concluded that the capital target of the plan was reasonable simply because OCC represented that it was; (2) blindly accepted OCC's claims that the plan would not increase fees for customers; (3) rejected, without explanation, petitioners' objection that the plan was unfairly discriminatory by treating refunds to clearing members differently from dividends to shareholders; and (4) summarily rejected petitioners' objection that OCC violated its own bylaws in the development of the plan by simply accepting OCC's representation that it had taken all actions required under its bylaws.

Thus, the court held that the SEC's order approving the plan was arbitrary and capricious, unsupported by substantial evidence and otherwise not in accordance with law. The D.C. Circuit remanded the case to "give the SEC an opportunity to properly evaluate the Plan."

The D.C. Circuit's highly critical decision may prompt the SEC to step up its scrutiny of future rules changes by self-regulatory organizations, which could have profound implications for major stock exchanges like the New York Stock Exchange and the Nasdaq as well as quasi-regulators such as the Financial Industry Regulatory Authority. In *Susquehanna*, the court sent the clear message that the SEC must conduct its own reasoned analysis rather than defer to representations made by the organizations it oversees.

Standing

District Court Holds Indirect Purchasers Have Standing to Sue Under California Securities Laws

Colman v. Theranos, Inc., No. 16-cv-06822-NC
(N.D. Cal. Apr. 18, 2017)
Click here to view the opinion.

The Northern District of California held that indirect purchasers, *i.e.*, shareholders who purchased their shares from intermediaries rather than directly from the issuer, have standing to sue for violations of California Corporations Code Section 25400(d). That section makes it unlawful for a person selling securities to make false or misleading statements of material fact for the purpose of inducing the purchase or sale of that security.

Here, the plaintiffs were investors who had purchased the defendant's securities from third-party investment funds. The defendants moved to dismiss, arguing that the plaintiffs lacked standing as indirect purchasers. In rejecting the defendant's argument, the court noted that the purpose of Section 25400(d) is "to protect the market generally from a security seller's misrepresentations." Moreover, Section 25500, which is Section 25400(d)'s civil enforcement mechanism, extends protections to all persons affected by market manipulations without requiring reliance or privity. As such, plaintiffs need not have purchased their shares directly from defendant in order to trigger the statute's protections. However, the court found that the plaintiffs could not bring suit under Sections 25401 and 25501 because those sections are expressly limited to suits between a buyer and a seller.

Statute of Limitations

Ninth Circuit Expands *American Pipe* Tolling to Subsequent Securities Class Action by Unnamed Class Members

Resh v. China Agritech, Inc., No. 15-55432 (9th Cir. May 24, 2017)
Click here to view the opinion.

The Ninth Circuit reversed the dismissal of a putative securities class action, holding the claims were not time-barred based on *American Pipe* tolling.

In February 2011, the plaintiffs filed suit against the defendant corporation and certain of its officers and directors, alleging that the defendants misstated the company's net revenue and income. The complaint alleged violations of Section 10(b) and 20(a) of the Securities Exchange Act, SEC Rule 10b-5, and Sections 11 and 15 of the Securities Act. The district court denied the plaintiffs' motion for class certification, finding that they failed to satisfy the predominance requirement of Federal Rule of Civil Procedure 23(b)(3). The Ninth Circuit affirmed.

In October 2012, a substantially similar class action complaint was filed, though alleging only Securities Exchange Act violations. The district court, again, denied the motion for class certification, this time on typicality grounds, holding that the named plaintiffs' relationship with the named plaintiffs in the first action subjected them to a claim preclusion defense that was not available against unnamed class members.

In June 2014, a third class action was filed, this one also alleging only Securities Exchange Act violations. The defendants moved to dismiss the complaint, arguing that it was time-barred under the Securities Exchange Act's two-year statute of limitations. The district court granted the motion without leave to amend, concluding that while the statute of limitations was tolled for the individual claims of the named plaintiffs, the statute was not tolled for the class claims.

The Ninth Circuit reversed, stating that in *American Pipe*, the Supreme Court held that "unnamed members of an uncertified class could intervene as individual plaintiffs in the individual suit that remained even if the statutory limitations period had passed." In *Crown, Cork & Seal Co. v. Parker*, 462 U.S. 345 (1983), "the Supreme Court extended American Pipe to permit tolling not only for individual intervention in the named plaintiffs' original suit, but also for individual filing of entirely new suits." In light of this precedent and its progeny, the Ninth Circuit held that the class claims in the third complaint were not time-barred. If the plaintiffs were unnamed class members in the previously uncertified classes, then under *American Pipe* and *Crown* their class claims were tolled during the pendency of the first and second actions. The court cautioned, however, that the named plaintiffs must still satisfy the requirements of Rule 23 and persuade the district court that claim preclusion does not bar certification.

Inside the Courts
An Update From Skadden Securities Litigators

Contacts

New York
Four Times Square
New York, NY 10036
212.735.3000

John K. Carroll
212.735.2280
john.carroll@skadden.com

Jonathan Frank
212.735.3386
jonathan.frank@skadden.com

William P. Frank
212.735.2400
william.frank@skadden.com

Robert A. Fumerton
212.735.3902
robert.fumerton@skadden.com

Jay B. Kasner
212.735.2628
jay.kasner@skadden.com

Jonathan J. Lerner
212.735.2550
jonathan.lerner@skadden.com

Scott D. Musoff
212.735.7852
scott.musoff@skadden.com

Joseph N. Sacca
212.735.2358
joseph.sacca@skadden.com

Susan L. Saltzstein
212.735.4132
susan.saltzstein@skadden.com

Seth M. Schwartz
212.735.2710
seth.schwartz@skadden.com

Robert E. Zimet
212.735.2520
robert.zimet@skadden.com

George A. Zimmerman
212.735.2047
george.zimmerman@skadden.com

Boston
500 Boylston St.
Boston, MA 02116
617.573.4800

James R. Carroll
617.573.4801
james.carroll@skadden.com

Thomas J. Dougherty
617.573.4820
dougherty@skadden.com

Peter Simshauser*
617.573.4880
peter.simshauser@skadden.com

Chicago
155 N. Wacker Drive
Chicago, IL 60606
312.407.0700

Matthew R. Kipp
312.407.0728
matthew.kipp@skadden.com

Michael Y. Scudder
312.407.0877
michael.scudder@skadden.com

Charles F. Smith*
312.407.0516
charles.smith@skadden.com

Houston
1000 Louisiana St., Suite 6800
Houston, TX 77002
713.655.5100

Noelle M. Reed
713.655.5122
noelle.reed@skadden.com

Los Angeles
300 S. Grand Ave., Suite 3400
Los Angeles, CA 90071
213.687.5000

Peter B. Morrison*
213.687.5304
peter.morrison@skadden.com

Palo Alto
525 University Ave.
Palo Alto, CA 94301
650.470.4500

Jack P. DiCanio
650.470.4660
jack.dicanio@skadden.com

Amy S. Park*
650.470.4511
amy.park@skadden.com

Washington, D.C.
1440 New York Ave., N.W.
Washington, D.C. 20005
202.371.7000

Charles F. Walker
202.371.7862
charles.walker@skadden.com

Jennifer L. Spaziano
202.371.7872
jen.spaziano@skadden.com

Wilmington
One Rodney Square
920 N. King St.
Wilmington, DE 19801
302.651.3000

Paul J. Lockwood
302.651.3210
paul.lockwood@skadden.com

Edward B. Micheletti*
302.651.3220
edward.micheletti@skadden.com

Robert S. Saunders
302.651.3170
rob.saunders@skadden.com

Jennifer C. Voss
302.651.3230
jennifer.voss@skadden.com

Edward P. Welch
302.651.3060
edward.welch@skadden.com

*Editors