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Skadden

Inside the Courts
An Update From Skadden Securities Litigators

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Appraisal

Court of Chancery Relies on Deal Price as Best Indicator of Appraisal Value

In re Appraisal of Stillwater Mining Co., Consol. C.A. No. 2017-0385-JTL (Del. Ch. Aug. 21, 2019)
Click here to view the opinion.

In a 139-page post-trial opinion, Vice Chancellor J. Travis Laster awarded petitioners seeking appraisal of shares of Stillwater Mining Company the merger price of $18 per share, plus interest. The appraisal litigation arose from Sibanye Gold Limited's acquisition of Stillwater in 2017.

In determining that the deal price of $18 per share was the best indicator of fair value, the Court of Chancery looked to recent decisions, including the Delaware Supreme Court's ruling in *Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd.*, 177 A.3d 1 (Del. 2017), and found that "objective indicia" present in the sale process "provide[d] a cogent foundation for relying on the deal price as a persuasive indicator of fair value," at least as an initial matter. Specifically, the court observed that: (1) "the Merger was an arm's-length transaction with a third party," not a controlling stockholder; (2) "the Board did not labor under any conflicts of interest," as "[s]ix of the Board's seven members were disinterested, outside directors"; (3) "Sibanye conducted due diligence and received confidential information about Stillwater's value"; (4) "Stillwater negotiated with Sibanye and extracted multiple price increases"; and (5) "[m]ost importantly, no bidders emerged during the post-signing phase."

The petitioner raised several arguments in an effort to show that the deal process was flawed and deal price was an unreliable factor for determining fair value. The court agreed that "[t]he sale process was not perfect" for a variety of reasons, including that the Stillwater CEO "began deal discussions without board authorization, engaged for months without formally reporting to the board," and negotiated favorable compensation and post-closing employment terms for himself and the CFO. Despite those flaws, the court found that "the facts of this case, when viewed as a whole, compare favorably or are on par with the facts in" several recent cases where the Delaware Supreme Court and Court of Chancery found that flawed processes ultimately produced fair results.

Sibanye unsuccessfully argued that the deal price should be reduced to account for the premium it paid because "it willingly paid more than fair value" for certain strategic reasons. The court also refused to make "any downward adjustment to the deal price to compensate for combinatorial value," finding that each reason Sibanye had for paying a premium "identifie[d] a valuable aspect of Stillwater based on its operative reality as a going concern."

In addition to arguing in favor of deal price, Sibanye argued that Stillwater's unaffected trading price, as adjusted by its expert, was also a reliable indicator of fair value. The court rejected this argument and refused to give any weight to the adjusted trading price, finding that "[t]he reliability of the adjusted trading price depended on the reliability of the unaffected trading price, and the record provides sufficient reason for concern about incorporating a trading price metric."

The court also rejected the parties' respective discounted cash flow (DCF) analyses, observing that "[t]he experts disagreed over many inputs, with small changes producing large swings in value." It further noted that "[i]f this were a case where a reliable market-based metric was not available, then the court might have to parse through the valuation inputs and hazard semi-informed guesses about which expert's view was closer to the truth. In this case, there is a persuasive market-based metric: the deal price that resulted from a reliable sale process. *Dell* and *DFC* teach that a trial court should have greater confidence in market indicators and less confidence in divergent expert determinations."

Court of Chancery Holds That Deal Price Is Best Indicator of Fair Value

In re Appraisal of Columbia Pipeline Grp., Inc., Consol. C.A. No. 12736-VCL (Del. Ch. Aug. 12, 2019)
Click here to view the opinion.

In a 112-page post-trial opinion, Vice Chancellor J. Travis Laster awarded stockholder plaintiffs seeking appraisal of shares of Columbia Pipeline Group, Inc. the merger price of $25.50 per share, plus interest. The appraisal litigation arose from TransCanada Corporation's acquisition of Columbia in 2016.

In determining that the $25.50 per share deal price was the best indicator of fair value, the Court of Chancery cited several "objective indicia" of the reliability of the deal price, including: (1) the merger was an arm's-length transaction with a third party; (2) the board had no conflicts of interest; (3) TransCanada conducted due diligence and received confidential insights about Columbia's value; (4) during the pre-signing phase, Columbia contacted other potential buyers, but no other party pursued a merger; (5) Columbia extracted multiple price increases from TransCanada through negotiation; and (6) no bidder emerged for Columbia during the post-signing phase, despite a suites of deal protections that "fell within the norm."

The court rejected the petitioners' challenges to the reliability of the deal process, including alleged management conflicts and claims of favoritism during the pre-signing process. The petitioners argued that two executives engineered a fire sale to obtain personal benefits before retiring. The court "considered [this argument] seriously" but ultimately rejected it, concluding that the executives "wanted to retire, [but] were professionals who took pride in their jobs and wanted to do the right thing" and "were not going to arrange a fire sale for below Columbia's standalone value, and the Board would not have let them." The court also rejected the petitioners' claims of favoritism. It concluded that while "[i]t is true that Columbia began to favor TransCanada over time, that was because a deal with TransCanada offered higher and more certain value than the alternatives." Therefore, the court held that the evolution from a targeted pre-signing process to a focus on a single bidder did not ultimately undermine the deal price as an indicator of fair value.

The court also rejected the petitioners' contention that evidence that Columbia had allowed only TransCanada to breach its standstill provisions undermined the deal price. The court noted that even after the standstills were waived for all parties during the post-signing phase, no other party bid, despite their ability to do so. Further, the court did not credit the petitioners' assertion that management created an informational vacuum that undercut the reliability of the deal price. The court concluded that the petitioners had not proven that the board was "misled or deprived of material information," but only that "management at times knew more about the sale process," a fact that was "inevitable because directors do not run companies on a day-to-day basis." Finally, the court rejected the petitioners' argument that the suite of deal protections undermined the sale process, holding that under Delaware Supreme Court precedents, "the deal protections did not have that effect."

The court also held that both parties failed to prove their proffered adjustments to the deal price. For the respondent, the court held that the evidence presented did not allow it to credit TransCanada's position that Columbia received 100% of synergies. For the petitioners, the court rejected their argument that the court should make an upward adjustment to account for the value increase between signing and closing.

The court considered unaffected market price as an indicator of fair value but ultimately concluded that it "regarded the deal price as a more reliable indicator of value." Finally, the court considered the parties' DCF-based arguments but held that because there was a reliable market-based metric available in this case, "the DCF technique is necessarily a second-best method to derive value." Therefore, the court did not use the DCF analyses of the parties and gave full weight to the deal price as the most reliable indicator of fair value.

Delaware Superior Court Denies Insurer's Motion for Summary Judgment, Finding Policy May Cover Appraisal Claims

Solera Holdings, Inc. v. XL Specialty Ins. Co., C.A. No. N18C-08-315 AML CCLD (Del. Super. July 31, 2019)
Click here to view the opinion.

The Delaware Superior Court denied a motion for summary judgment filed by an insurer seeking to dismiss a claim by Solera Holdings for the $13 million it spent defending against an appraisal claim, as well as the interest payments it made pursuant to the appraisal statute.

The court held that, under the insurance agreement, an appraisal claim constituted a securities claim, which was defined as any violation of any law regulating securities. The court rejected the argument that a "violation" of law had to involve allegations of wrongdoing.

The court further held that the definition of "loss" extended to interest paid on an appraisal award. The parties agreed that the appraisal payment itself was not a "loss," but the interest payments nevertheless were covered because the contract applied to interest on a judgment. The court reasoned that if the contract had provided for coverage of "interest on a covered judgment," the outcome may have been different.

The court did not grant judgment in favor of Solera because it had not moved for summary judgment and because factual disputes regarding mitigation and notice required further factual development.

Court of Chancery Relies on Unaffected Market Price as Best Indicator of Appraisal Value

In re Appraisal of Jarden Corp., Consol. C.A. No. 12456-VCS (Del. Ch. July 19, 2019)
Click here to view the opinion.

In a 144-page post-trial opinion, Vice Chancellor Joseph R. Slights III awarded petitioners seeking appraisal of shares of Jarden Corporation $48.31 per share, representing the shares' unaffected market price. The appraisal litigation arose from Newell Rubbermaid, Inc.'s acquisition of Jarden in 2016.

In determining that unaffected market price was the best indicator of fair value, the Court of Chancery relied on "credible, unrebutted expert testimony" presented by Jarden, including an event study that analyzed the market's response to earnings and other material announcements, as well as the facts that Jarden had no controlling stockholder, its public float was 93.9%, it was well covered by numerous professional stock analysts, its stock was heavily traded, it enjoyed a narrow bid-ask spread and there was no credible evidence that material information bearing on Jarden's fair value was withheld from the market at the time of the merger.

Despite recent rulings deferring to the merger price as the best evidence of fair value, the court declined to follow that approach. It acknowledged that it was "mindful of our Supreme Court's guidance in *Dell*, where the Court observed that certain factors, including 'fair play, low barriers to entry, [and] outreach to all logical buyers,' are reflective of the kind of 'robust sale process' that will discover a company's fair value," but it found that "the sale process left much to be desired." Among other things, Jarden's lead negotiator "acted with little to no oversight by the Board," suggested a price range within which the board would accept to sell the company before negotiations began in earnest, made counteroffers unauthorized by the board and negotiated change-in-control compensation without authorization from or the knowledge of the board. The court concluded that "these flaws in the sale process, coupled with the fact that there was no effort to test the Merger Price through any post-signing market check, raise legitimate questions regarding the usefulness of the Merger Price as an indicator of fair value."

The court also considered comparable companies and DCF analyses proffered by the parties' respective experts but ultimately concluded that a comparable companies analysis was not credible because Jarden had no reliable comparables, while the experts' DCF analyses "yielded results that were solar systems apart" and adopted inputs "that were not justified and that skewed the results." While the court declined to afford any weight to the comparable companies analysis, it did undertake its own DCF analysis, which generated a per-share appraisal value of $48.13. The court concluded that "the Unaffected Market Price is the best evidence of Jarden's fair value on the Merger Date," and "the DCF valuation corroborate[d] the most persuasive market evidence and provide[d] comfort that [the Court] [had] appraised Jarden as best as the credible evidence allows."

Disclosures in Offering Documents

EDNY Dismisses Securities Act Claims Against Mutual Fund Company

Emerson v. Mut. Fund Series Trust, 2:17-cv-02565 (ADS)(GRB) (E.D.N.Y. June 25, 2019)
Click here to view the opinion.

Judge Arthur D. Spatt dismissed putative class action claims against a mutual fund and its adviser alleging that the adviser violated the Securities Act by investing the fund's assets in complex derivatives that were inconsistent with the fund's stated investment objective of capital preservation. The plaintiffs argued that the derivative trades were inconsistent with statements in the fund's offering documents, prospectuses and fact sheets that represented that the fund was low-volatility, not tied to movements in the equity markets and had strict risk management procedures to mitigate losses. The plaintiffs claimed that these statements were materially false because the fund's "investment in naked call options rendered the Fund susceptible to large losses in rapidly rising equity markets."

The court held that statements outlining the fund's investment objective and risk management procedures were inactionable because they were "general and indefinite statements" that "reasonable investors would consider unimportant." The court similarly rejected the plaintiffs' argument that the defendants failed to "adequately disclose[] that the Fund could and did write uncovered call options" because the fund's "Offering Documents [were] replete with disclosures regarding the Fund's investment in uncovered call options and the associated risks" and "the Fund issued a public disclosure every quarter publishing an itemized list of every single investment in its portfolio." The court finally held that "the Fund adequately disclosed the material differences between the Fund's [previous] operation as [a hedge fund] and [its current operation] as a larger mutual fund," where the fund's prospectus disclosed that "the Fund was subject to different legal requirements than [its previous operation as a hedge fund]."

Fiduciary Duties

Court of Chancery Declines To Dismiss Claims Under *Corwin* Based on Inadequate Disclosures

Chester Cnty. Emps.' Ret. Fund v. KCG Holdings, Inc.,
C.A. No. 2017-0421-KSJM (Del. Ch. June 21, 2019)
Click here to view the opinion.

In resolving motions to dismiss claims challenging Virtu Financial Inc.'s acquisition of KCG Holdings, Inc., Vice Chancellor Kathaleen S. McCormick found that alleged disclosure deficiencies defeated application of the so-called *Corwin* defense and declined to dismiss breach of fiduciary duty claims against the company's directors, and aiding-and-abetting and civil-conspiracy claims against the company's financial advisor and the acquirer.

In July 2017, Virtu acquired KCG for $20 per share. KCG stockholders filed suit, alleging, among other things, that in the months leading up to the transaction, KCG's longtime financial advisor provided Virtu with confidential information about KCG's bond-trading platform, BondPoint, which it planned to divest, and advised KCG on an alternative restructuring plan while "pressur[ing] the Board to pursue a transaction with Virtu."

The plaintiffs also alleged that once Virtu made its best and final offer of $20 per share, the company's CEO indicated that he believed the price was "too low" but would support the merger if he could negotiate a satisfactory compensation and retention pool for himself and his management team, which the board authorized. In addition, according to the complaint, the night before the board approved the $20 per share price, the CEO and his management team revised KCG's financial projections to be more pessimistic, and after the board approved those revisions over email, KCG's new financial advisor based its fairness opinion on the more pessimistic projections, causing the deal price to fall in the middle of its discounted cash flow analysis.

The court held that the defendants could not invoke a defense under *Corwin*, which requires dismissal of post-closing challenges to mergers approved by a fully informed, uncoerced stockholder vote (absent a conflicted controller), because the plaintiff had identified "significant deficiencies" in the proxy statement that rendered the stockholder vote uninformed.

The court found that the plaintiffs had adequately alleged that the proxy statement failed to disclose: detailed information about the BondPoint divestiture strategy; that the CEO initially indicated that the $20.21 per share counteroffer was "too low" but later supported the $20 per share deal price while negotiating a compensation pool for himself and his management team; and "the more optimistic, earlier projections presented during the merger negotiations and the circumstances surrounding the creation of the later revised projections."

The court evaluated the transaction under the enhanced scrutiny standard of review and explained that, because KCG's charter contained an exculpatory provision pursuant to 8 Del. C. § 102(b)(7) barring money damages for breaches of the duty of care, the plaintiff was required to plead a breach of the duty of loyalty to avoid dismissal. The court held that the plaintiff sufficiently alleged that the board acted in bad faith by "knowingly plac[ing] [the CEO] in a position to extract compensation for management at the expense of the per share merger price received by the stockholders" and approving "last-minute revisions to the company's projections that made the deal price more reasonable relative to the company's discounted cash flow valuation."

The court also sustained aiding-and-abetting claims against the financial advisor and Virtu, holding that the complaint had adequately alleged that the financial advisor knowingly participated in the board's breach of fiduciary duty by misleading the board and creating an informational vacuum. With respect to Virtu, the court found that the complaint stated a claim by alleging that Virtu "worked with" the financial advisor "to pressure the Board to approve the Merger for a less-than-value-maximizing price, accepted confidential information concerning BondPoint to develop its acquisition strategy, and exploited [the CEO's] conflict to obtain his support of the merger price." The court also declined to dismiss a conspiracy claim against the financial advisor and Virtu for similar reasons.

Books and Records

Delaware Supreme Court Holds That Books and Records Inspections Are Not Subject to a Presumption of Confidentiality

Tiger v. Boast Apparel, Inc., C.A. 2017-0776 (Del. Aug. 7, 2019)
Click here to view the opinion.

The Delaware Supreme Court, in affirming a Master in Chancery's report that was adopted by the Court of Chancery, held that books and records inspections pursuant to Section 220 of the Delaware General Corporation Law are not "presumptively subject to a reasonable confidentiality order."

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In the case below, the Court of Chancery denied a stockholder's request that there be a time limitation on the confidentiality order entered in connection with the production of company documents pursuant to Section 220, holding that confidentiality of the documents "should be maintained indefinitely, unless and until the stockholder files suit, at which point confidentiality would be governed by the applicable court rules."

The Supreme Court reversed, explaining that "although the Court of Chancery may — and typically does — condition Section 220 inspections on the entry of a reasonable confidentiality order, such inspections are not subject to a presumption of confidentiality." The Supreme Court further held that when a confidentiality order is entered, "the order's temporal duration is not dependent on a showing of the absence of exigent circumstances by the stockholder, but that the Court of Chancery "should weigh the stockholder's legitimate interests in free communication against the corporation's legitimate interests in confidentiality."

Caremark Liability

Delaware Supreme Court Reverses Court of Chancery Dismissal, Holding That Demand on Board Is Excused and Complaint States *Caremark* Claim for Lack of Oversight

Marchand v. Barnhill, C.A. No. 2017-0586-JRS (Del. June 18, 2019)
Click here to view the opinion.

The Delaware Supreme Court issued a decision reversing the Court of Chancery's dismissal of a derivative suit alleging *Caremark* claims. The case arose out of a listeria outbreak in ice cream made by Blue Bell Creameries USA Inc. that sickened many consumers, caused three deaths and resulted in a total product recall.

The Supreme Court held that a majority of the board was interested or lacked independence for purposes of a Rule 23.1 demand. The Court of Chancery had held that seven directors out of the 15-member board were conflicted, one less than a majority. The Supreme Court's analysis focused on whether an additional outside director, who had previously worked for the company, was also conflicted. The Supreme Court noted that even though the director was now retired, he had a "longstanding business affiliation and personal relationship" with the family of the CEO, because the family had been instrumental to the director's career success. The CEO's family had also donated $450,000 to a local university to name a building after the director. The Supreme Court held that these facts suggest "very warm and thick ties of personal loyalty and affection" between the director and the CEO. As a result, the court found that demand was excused, because a majority of the board was conflicted for purposes of a Rule 23.1 analysis.

The Supreme Court also held that the complaint alleged particularized facts that stated a claim for breach of the duty of loyalty based on a lack of board oversight — a so-called *Caremark* claim — because the company's board failed to implement any system to monitor food safety performance or compliance. The complaint alleged that the board had no committee overseeing food safety, no board-level process addressing food safety issues and no system to advise the board of food safety reports and developments. Consistent with this lack of board-level monitoring, the complaint pleaded that during a crucial period, "red" and "yellow" flags about food safety were not presented to the board. Therefore, the alleged facts supported a reasonable inference that the directors "consciously failed to attempt to assure a reasonable information and reporting system existed."

Insider Trading Claims

SDNY Vacates Portfolio Manager's Insider Trading Guilty Plea

United States v. Lee, No. 13-Cr-539 (PGG) (S.D.N.Y. June 21, 2019)
Click here to view the opinion.

Judge Paul G. Gardephe vacated a defendant's guilty plea to charges that he had conspired to engage in insider trading in violation of 15 U.S.C. §§ 78j(b) and 78ff. The defendant, a portfolio manager at an investment advisory firm, pleaded guilty on the basis that he had executed certain trades of an online media company's stock while in possession of material nonpublic information that he had improperly received from sell-side market analysts and other sources. Although his plea was in 2013, his sentencing was in 2017 (delayed on the basis of his cooperation and the parties' agreement to delay sentencing pending *Salman v. United States*, 137 S. Ct. 420 (2016)), and leading up to the sentencing, the government produced certain documents that had not been disclosed prior to his plea. As a result, the defendant moved to vacate the plea on several alternative bases, including (1) that the information belatedly provided by the government demonstrated his innocence, (2) that had he known the information, he would not have pleaded guilty, and (3) recent developments in insider trading law rendered his guilty plea insufficient.

The court rejected the first two arguments, in part, because the belatedly produced documents did not negate the fact that the defendant purchased stock after receiving information relayed by a market analyst from a well-pleaded insider source concerning a pending deal involving the media company. On the other hand, the court agreed with the defendant that his 2013 plea allocution was factually insufficient under *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014), *Salman* and *United States v. Martoma*, 894 F.3d 64 (2d Cir. 2017). Those cases articulate that insider trading violations require proof that a tipper receives a personal benefit by divulging inside information and that the tippee is aware of that personal benefit. The defendant's plea proceeding under Rule 11 of the Federal Rules of Criminal Procedure did not address who the corporate insiders were; whether the defendant knew who they were; to whom the corporate insiders disclosed material nonpublic information; or the nature of the relationship between the tippers and the individuals to whom they disclosed material nonpublic information.

Materiality

Third Circuit Affirms Dismissal of Complaint Against Funeral Services Company, Finding That Company's Affirmative Disclosures Made Alleged Omissions Immaterial

Fan v. StoneMor Partners LP, No. 17-3843 (3d Cir. June 20, 2019)
Click here to view the opinion.

The Third Circuit affirmed the dismissal of a putative class action against a limited partnership, its general partner and related entities alleging violations of Section 10(b) of the Securities Exchange Act.

Defendant StoneMor sells products and services for funerals. State law requires StoneMor to hold in trust a percentage of proceeds from customers who purchase products and services prior to their death. These "pre-need sales" are released to StoneMor when the services are delivered upon the customer's death. Under generally accepted accounting principles (GAAP), pre-need sales that remain in trusts may not be represented as current revenue.

As StoneMor's pre-need sales grew, so, too, did the gap between its overall sales and its available cash, the latter of which was used for quarterly investor distributions. To address this disparity, StoneMor did three things. First, along with its GAAP financials, it issued non-GAAP financials that represented pre-need sales as a portion of current revenue. Second, to fund distributions, it borrowed cash equal to the proceeds from pre-need sales in the same quarter the sales were made, rather than waiting for the cash to be released from trust. Third, it used proceeds from equity sales to pay down the borrowed cash that funded distributions.

On September 2, 2016, StoneMor announced that it would restate three years of financial statements. As a result, under GAAP, StoneMor was temporarily prohibited from selling equity. The plaintiffs allege that this prohibition caused StoneMor's distribution rate to fall by nearly half. Further, once news of StoneMor's reduced distributions became public, its unit price dropped by 45%.

The plaintiffs sued, alleging that the defendant made three categories of false or misleading statements. The Third Circuit affirmed the dismissal, holding that the alleged misrepresentations, which were predicated on purported omissions, were immaterial as a matter of law. First, the plaintiffs alleged that StoneMor misrepresented its financial health in connection with its quarterly distributions because it omitted that its ability to fund distributions was contingent on its access to the capital markets. The court, however, held that any such omission was immaterial because StoneMor disclosed that its "available cash" — which is what funded StoneMor's distributions — consisted of both cash on hand and cash from borrowings. Therefore, a reasonable investor would be informed that the distributions were funded by more than just operating revenue. Second, the plaintiffs alleged that StoneMor failed to disclose that its primary source of liquid cash for distributions was equity proceeds. The court disagreed, holding again that any such omission was immaterial because the defendant issued its GAAP and non-GAAP financials side by side, which clearly showed that it could not fund its distributions from its day-to-day operations. Third, the plaintiffs alleged that StoneMor failed to disclose that its distributions were also funded through borrowings from its credit facility. The court rejected this allegation, too, explaining that the very press releases cited in the plaintiffs' own complaint disclosed this allegedly omitted fact.

SDNY Denies Motion To Dismiss Claims Against Diamond Jewelry Retailer

In re Signet Jewelers Limited Sec. Litig., No. 16 Civ. 6728 (CM) (RWL) (S.D.N.Y. June 11, 2019)
Click here to view the opinion.

Chief Judge Colleen McMahon denied a motion for judgment on the pleadings to dismiss claims brought by a putative class of investors against a jewelry company alleging that the company made certain misrepresentations about compliance with the company's code of ethics. The plaintiff alleged that the company's statements that it was "committed to a workplace that is free from sexual, racial, or other unlawful harassment" and that it requires its senior officials "to engage in and promote honest and ethical conduct" were false or misleading because the company had a "pervasive culture of sexual harassment." The plaintiff pointed to a gender discrimination lawsuit against the company in which former employees of the company claimed that "the ranks of [the company's] executives were filled with ... serial sexual harassers."

Signet had initially filed a motion to dismiss, arguing that the statements made in its code of ethics were immaterial "puffery." Chief Judge McMahon denied that motion. On March 5, 2019, the Second Circuit issued *Singh v. Cigna Corp*., 918 F.3d 57, 63 (2d Cir. 2019), which affirmed the dismissal of a complaint based on statements made in a company's code of ethics, ruling that those statements were immaterial puffery. In light of the Second Circuit's decision, the company filed a motion for judgment on the pleadings.

The court also denied this motion, noting that Cigna "did not rule ... that all statements in codes of conduct qualify as 'puffery.'" In *Cigna*, the statements in the code of ethics at issue "were not actionable ... because they were exceptionally vague and aspirational" and therefore the plaintiffs in that case were improperly seeking "to convert their generalized grievance over corporate mismanagement into a specific claim for securities fraud." The court determined here that the "crux of Plaintiff's securities fraud claim" related to the company's decision to cite to its code of ethics in Securities and Exchange Commission (SEC) filings to "reassure the investing public that [the company] did not, in fact, have a toxic workplace." This context made the statements actionable because a reasonable investor would have relied on them.

Mergers and Acquisitions Litigation

Court of Chancery Holds That Merger Agreement Prevented Acquirer From Using Target Company's Premerger Privileged Communications

S'holder Representative Servs. LLC v. RSI Holdco, LLC, C.A. No. 2018-0517-KSJM (Del. Ch. May 29, 2019)
Click here to view the opinion.

Vice Chancellor Kathaleen S. McCormick held that "broad contractual language" in a merger agreement prevented a buyer from using the acquired company's privileged premerger attorney-client communications in post-closing litigation against the sellers.

In 2016, RSI Holdco, LLC acquired Radixx Solutions International, Inc. As part of the acquisition, RSI obtained possession of Radixx's computers and email servers, which contained approximately 1,200 premerger emails between Radixx and its counsel. The emails were not excised or segregated from Radixx's other communications at the time the merger closed. After closing, a representative of Radixx's stockholders sued RSI, claiming that RSI breached the merger agreement by failing to repay a "holdback amount" withheld from the purchase price. During the litigation, RSI took the position that Radixx had waived the attorney-client privilege as to its premerger emails.

To resolve the dispute, the court looked to its prior decision in *Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP*, 80 A.3d 155 (Del. Ch. 2013), which held that absent "an express carve out [in the merger agreement], the privilege over all pre-merger communications — including those relating to the negotiation of the merger itself — passed to the surviving corporation in the merger" under 8 Del. C. § 259. The court found that the sellers had "heeded the *Great Hill* court's advice" and "used their contractual freedom to secure a provision in the merger agreement, which preserved their ability to assert privilege over pre-merger attorney-client communications." Specifically, the merger agreement provided language that was broad enough to "(1) preserve[] any privilege attaching to pre-merger communications as a result of [counsel's] representation of Radixx in connection with the merger; (2) assign[] to [Shareholder Representative Services LLC] control over those privileges; (3) require[] the sellers and buyer to take steps necessary to ensure that the privileges remain in effect; and (4) prevent[] [RSI] and affiliates from using or relying on any privileged communications in post-closing litigation against the sellers."

Misrepresentations and Omissions

Second Circuit Affirms Jury Verdict and Forfeiture Award Against Former CEO for Securities Fraud

United States v. Shkreli, No. 18-819-cr (2d Cir. July 18, 2019)
Click here to view the opinion.

In a summary order, the Second Circuit affirmed a jury verdict entered against the former CEO of a biopharmaceutical company and the founder of two hedge funds. The jury verdict was for securities fraud and conspiracy to commit securities fraud. At trial, the government alleged that the former CEO misused his hedge fund's assets to pay his own personal debts and made many false representations and omissions to induce investors to invest in his hedge funds. Further, the government alleged that the former CEO attempted to illegally control the price and trading volume of the biopharmaceutical company's stock. The district court sentenced the former CEO to 84 months' imprisonment and ordered him to pay, among other payments, forfeiture of approximately $7.3 million.

The former CEO appealed, arguing that the district court improperly instructed the jury on a "no ultimate harm" instruction as to securities fraud (*i.e.*, that he could be found liable even if he believed at the time of the fraud that the fraud would not ultimately harm investors) and that the award of forfeiture was inappropriate. The Second Circuit rejected both arguments. First, the court decided that the "no ultimate harm" instruction to the jury as to securities fraud was appropriate. It noted that the former CEO's defense at trial was in part that "despite his many misrepresentations and omissions to [the hedge fund] investors, he did not have the requisite intent to defraud those investors because he believed that the investors would ultimately make money from their investments." This defense, the Second Circuit ruled, is "exactly the kind of improper argument that the [no ultimately harm] instruction was designed to address."

Second, the court affirmed the forfeiture award against the former CEO. As an initial matter, the court noted that the "continuing" nature of the former CEO's misrepresentations made appropriate the district court's "factual finding that the money associated with all investors was traceable to [the former CEO's] fraud irrespective whether or not the investors testified." Further, the court rejected the former CEO's contention that "his forfeiture award should be decreased based on the trading activities of his hedge funds, which he argue[d] should be deemed 'direct costs.'" The court rejected this argument because the former CEO failed to meet his burden of explaining precisely how the court should calculate the trading activities as the direct costs. Finally, the court declined to adopt the reasoning of a district court in another circuit, which concluded that the "robust returns received by investors should reduce the forfeiture amount required of the defendant to zero." The court reiterated that "forfeiture is gain based, not based on the losses (or gains) to victims," and the former CEO undisputedly personally profited from the fraud.

SDNY Dismisses Claims Against Express Delivery Company

Nurlybayev v. ZTO Express (Cayman) Inc., No. 17-6130 (S.D.N.Y. July 17, 2019)
Click here to view the opinion.

Judge Laura Taylor Swain dismissed claims brought by a putative class of shareholders against an express delivery company and its underwriters alleging that they violated Sections 11, 12(a)(2) and 15 of the Securities Act by making false or misleading statements in its initial public offering materials. The plaintiffs alleged that the company made materially false and misleading statements and omissions related to decreases in fees, increased transportation costs, attempts to negotiate with competitors and the company's accounting.

The court held that none of the alleged omissions were actionable. The plaintiffs failed to adequately allege that the company's omissions about decreased fees made statements in its offering documents about its revenue and profits misleading. The company included accurate historical financial data such that investors had sufficient information to understand the effects of the fee decrease. The court also held that the company's cautionary language in the offering documents sufficiently warned investors about the fee decreases and potential for increased transportation costs. The court determined that the plaintiffs alleged no facts to support their claim that disclosure of the company's attempted negotiations would have significantly altered the total mix of information already available to investors. Finally, the plaintiffs did not plausibly allege that the company had obligations under Items 303 and 503 of SEC Regulation S-K to affirmatively disclose the fee decreases, increased transportation costs and negotiations for the same reasons.

Pleading Standards

District of Minnesota Denies Dismissal of Claims Related to Fraudulent Revenue Scheme

SEC v. Mack, Civ. No. 19-918 (PAM/ECW) (D. Minn. July 23, 2019)
Click here to view the opinion.

Judge Paul A. Magnuson denied a motion to dismiss brought by a former officer of a defunct corporation facing claims of securities violations. The SEC alleged that two former officers of Digiliti fraudulently inflated the company's revenue to attract investors for its public offering.

After an unsuccessful public offering, defendant Lawrence C. Blaney, Digiliti's former executive vice president of sales, arranged a $400,000 contract with a customer in October 2016 with a side agreement allowing the customer to terminate at any time without penalty. The side agreement was not disclosed to Digiliti's accounting department, and the payment was backdated to appear as revenue in the previous quarter. At Blaney's direction, the customer entered an $870,000 contract in January 2017 with another undisclosed side agreement allowing termination. This contract was also backdated to boost revenues in the previous quarter. Digiliti completed a public offering in March 2017. Thereafter, the customer sought to cancel the October 2016 contract. Blaney and another officer encouraged the customer to postpone the cancellation and not inform the accounting department of its intent. The officers then enticed the customer to enter a third contract worth $550,000 by offering shares of Digiliti. Blaney again backdated the contract to the previous quarter. Digiliti issued financial statements and press releases containing the inflated revenue figures. The company discovered the scheme after the officers were terminated, when it found emails related to the side agreements.

The SEC brought a 15-count complaint alleging securities violations against Blaney and Digiliti's former president and CEO. Blaney moved to dismiss counts alleging violations of Section 17(a)(1)-(3) of the Securities Act, Sections 10(b) and 13(a) of the Securities Exchange Act and accompanying rules. Blaney argued that the complaint contained "group pleading," was a "shotgun" pleading and failed to plead scienter, sufficient knowledge for aiding-and-abetting liability and a Section 17(a)(2) violation.

The court rejected Blaney's argument that "group pleading" prevents him from knowing how he is to have participated in the fraud because the complaint sets forth Blaney's alleged conduct. Likewise, the court found that counts incorporating the factual allegations did not amount to "shotgun" pleading because the factual assertions tied to the securities fraud causes of action. The court found the desire of an officer with stock options to have a company go public and a $30,000 bonus Blaney received following the public offering to be sufficient to establish motive and scienter. The court further held that allegations that Blaney entered into the side deals for the purpose of fraudulently inflating Digiliti's revenue were sufficient to allege knowledge of a securities violation for aiding-and-abetting claims.

Blaney sought to dismiss the claim under Section 17(a)(2), contending that the SEC failed to allege that he made any statement or omission in connection with the stock offering. A Section 17(a)(2) claim requires the person to "obtain money or property by means of an untrue statement" or omission. The court held that the section requires only receiving something by means of the misstatement or omission and does not require that the person actually make the statement or omission. The court rejected Blaney's reliance on *Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. 135 (2011), because that case involved violations of Rule 10b-5, which, unlike Section 17(a)(2), applies to the "maker" of statements.

Scienter

First Circuit Affirms Dismissal of Putative Securities Class Action Against Biopharmaceutical Company

Metzler Asset Mgmt. GmbH v. Kingsley, No. 18-1369
(1st Cir. June 27, 2019)
Click here to view the opinion.

The First Circuit affirmed the dismissal of claims brought under Sections 10(b) and 20(a) of the Securities Exchange Act alleging that a biopharmaceutical company and certain of its officers intentionally misled investors concerning the safety and sales of one of its drugs. Specifically, the plaintiffs alleged, based on 17 confidential witness statements, that the company intentionally misled investors regarding the safety profile of the drug and the negative impact on drug sales resulting from the company's earlier announcement that a patient treated with the drug had died from complications associated with the rare neurological disease progressive multifocal leukoencephalopathy (PML).

The court held that the complaint failed to plead with particularity a strong inference of scienter as required by the Private Securities Litigation Reform Act. The court rejected the plaintiffs' argument that the company's knowledge about a certain doctor's decision not to initiate new patients on the drug because of the drug's safety profile gave rise to a strong inference of scienter. The court "fail[ed] to see how the knowledge that one doctor — whose patients constituted less than 0.2% of all [drug] users — would no longer prescribe [the drug] could ... be at odds with" the company's public statements concerning the drug's efficacy and usage rate.

The court also rejected the argument that optimistic public statements made by an officer concerning the drug's usage rate were intentionally misleading, even though the statements were made in the wake of the PML-related death and news about slowing drug sales. The court found that the plaintiffs failed to plead that those statements were intentionally misleading because the company had already made cautionary disclosures concerning the death and drug sales. The court determined that confidential statements offered by the investors failed to give rise to scienter because they were "imprecise," and their relevance was "diminished by the fact that the complaint does not allege that any of the [confidential witnesses] ever spoke with any of the individual defendants or otherwise shared with them their observations." The court therefore concluded that "nothing in the complaint alleges facts that indicate that anyone in [the company's] management had knowledge that was sufficiently in conflict with ... [its] public statements to permit the conclusion that the company had the requisite intent to deceive" investors.

Inside the Courts
An Update From Skadden Securities Litigators

Southern District of Ohio Grants Motion To Reconsider Court's Order Dismissing Claims for Failure To Plead Scienter

Forman v. Meridian Bioscience, Inc., Case No. 1:17-cv-774 (S.D. Ohio May 20, 2019)
Click here to view the opinion.

Judge Susan J. Dlott granted a motion to reconsider her previous order granting defendant Meridian Bioscience's motion to dismiss claims for violations of Sections 10(b) and 20(a) of the Securities Exchange Act. Lead class plaintiff filed her motion to reconsider based on the court's finding that the plaintiff had failed to plead scienter with respect to a statement Meridian made in its November 2016 Form 10-K filing with the SEC.

In dismissing the plaintiff's claims, the court considered Meridian's November 2016 statement that all of its products marketed in the United States had been cleared by the Food and Drug Administration (FDA). The court assessed whether the defendant, in making that statement, acted with scienter, which it described as including "a knowing and deliberate intent to manipulate, deceive, or defraud, and recklessness."

First, the court considered the factors enumerated in *Helwig v. Vencor, Inc*., 251 F.3d 540 (6th Cir. 2001) and found that two factors supported a finding of scienter while the rest did not. Second, the court determined that the defendant's nonculpable explanation for the alleged misstatement was more credible than the plaintiff's overarching theory of liability. In so finding, it agreed with Meridian that the plaintiff's theory that financially troubled Meridian acquired a subsidiary facing regulatory problems to expand its product base in an attempt to ameliorate its perilous financial position was nonsensical. Meridian argued, instead, that it believed the acquisition of the subsidiary would bolster its bottom line and that it did not receive complaints about the products until months after issuing its Form 10-K. The court credited Meridian and held that its purportedly misleading, but literally true, statement was not made with scienter.

In reconsidering its dismissal order, the court found that its original ruling placed too much emphasis on Meridian's nonculpable explanation for its decision to purchase the subsidiary. The court agreed with the plaintiffs that the ruling ignored the fact that Meridian's reason for the acquisition was not directly responsive to the specific issue of whether it acted recklessly in making its November 2016 statement eight months after the acquisition. The court further found that it conflated two factual issues in the scienter analysis that, while overlapping, were not the same, and the court had thus made an erroneous inference leading it to find that Meridian did not act with scienter.

Accordingly, the court found that it misapplied the scienter standard to the narrow question before it, which amounted to either a clear error creating a manifest injustice under Rule 59 of the Federal Rules of Civil Procedure or a substantive mistake of law or fact under Rule 60 of the Federal Rules of Civil Procedure. The court held that the plaintiff adequately pleaded that Meridian acted with scienter in making its November 2016 statement, granted the plaintiff's motion to reconsider dismissal of her claims and denied in part Meridian's motion to dismiss.

Massachusetts District Court Dismisses Charges That Biopharmaceutical Company Misled Investors Concerning Compliance With FDA Regulations

In re Ocular Therapeutix, Inc. Sec. Litig., Civil Action No. 17-12288-GAO (D. Mass. April 30, 2019)
Click here to view the opinion.

Judge George A. O'Toole Jr. dismissed claims brought by a putative class of shareholders against an biopharmaceutical company and certain of its executives alleging that they violated Sections 10(b) and 20(a) of the Securities Exchange Act by making false and misleading statements concerning manufacturing problems that were exposed during applications for regulatory approval of an eye pain treatment. The plaintiffs alleged that the company's attestations that it fabricates devices and drug products for its eye pain treatment candidates "using current good manufacturing practices, or cGMP" were false and misleading because the company was not in compliance with cGMP at the time the representations were made. The plaintiffs pointed to a form issued by an FDA (Form 483) inspector to the company in February 2016 — before the filing of the 2016 Form 10-K — which contained concerning observations regarding the company's noncompliance.

The court held that the FDA form contained findings of only "inspectional observations" by the FDA and "d[id] not represent a final Agency determination regarding ... compliance." The court reasoned that the company's statement that they are using cGMP was "too general" to be materially false and should not be understood as a warranty that there had never been instances of deviation from the standards guiding the company's manufacturing processes.

The court similarly rejected the plaintiffs' contention that the company's CEO statement on a November 2016 earnings call that the company "thinks" they "adequately" addressed the issues the FDA raised was materially misleading and concealed material risks to the company's business. The court determined that the CEO's statement was an opinion and the plaintiffs failed to adequately allege that the CEO omitted material facts that would lead an investor to doubt its reliability. The court likewise rejected the plaintiffs' argument that the company's statements on a May 2017 earnings call that the company "expected" to be able to timely resolve issues identified by the FDA were actionable because they were forward-looking statements "accompanied by appropriate cautionary language." Finally, the court agreed with the defendants that the plaintiffs failed to plead a strong inference of scienter because the plaintiffs "ignore the disclosures about the Forms 483 ... which undermine an inference of an intent to deceive."

SEC Enforcement Actions

Tenth Circuit Affirms That Investment Adviser Had Duty To Correct Firm's False Statements

Malouf v. SEC, No. 16-9546 (10th Cir. Aug. 13, 2019)
Click here to view the opinion.

In the first case by a Court of Appeals to apply the U.S. Supreme Court's recent decision in *Lorenzo v. SEC*, 139 S. Ct. 1094 (2019), the Tenth Circuit affirmed the decision of an SEC administrative law judge that an adviser who worked for an investment advisory firm violated Section 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder by failing to correct the firm's material misstatements. The SEC found that the adviser — who had an arrangement where he received a portion of the commissions collected by a certain brokerage firm (where he previously worked) and directed trades on behalf of his advisory clients through that brokerage firm — had a duty to correct the advisory firm's disclosures that its advisers (including the defendant) had no conflicts of interest. The SEC determined that the failure to correct the advisory firm's "false or misleading statements ... trigger[ed] liability for employment of a fraudulent or deceptive scheme" under Rules 10b-5(a) and (c).

On appeal, the adviser argued that correcting material misstatements is under the ambit of Rule 10b-5(b) (which prohibits making false and misleading statements in connection with securities transactions) and not Rules 10b-5(a) or (c) (which prohibit fraudulent schemes and practices), and that the SEC "obliterated the distinction between the two categories of prohibited conduct." Applying *Lorenzo* — which held that someone who is not a "maker" of a misstatement under Rule 10b-5(b) may still violate Rules 10b-5(a) and (c) by knowingly distributing those misstatements — the court rejected the adviser's argument. The court found that the adviser's awareness "that a conflict existed," his knowledge that his firm "was telling its clients that he was independent," along with his failure to correct the firm's statements or to disclose his conflict," constituted an illegal scheme.

Securities Exchange Act

SDNY Dismisses Excessive Fee Allegations Against Investment Advisory Firm

In re Davis N.Y. Venture Fund Fee Litig., No. 14 CV 4318-LTS-HBP (S.D.N.Y. July 3, 2019)
Click here to view the opinion.

Judge Laura Taylor Swain dismissed on summary judgment an excessive fee claim brought under Section 36(b) of the Investment Company Act against a mutual fund adviser. Section 36(b) imposes a fiduciary duty on investment advisers regarding their compensation for servicing mutual funds. Under Section 36(b), an adviser is prohibited from charging a fee so disproportionately large to the services provided to those funds that it could not have been the result of arm's length bargaining. *Gartenberg v. Merrill Lynch Asset Mgmt., Inc.*, 694 F.2d 923 (2d Cir. 1982). When assessing excessive fee allegations, courts analyze the factors set forth in Gartenberg and endorsed by the U.S. Supreme Court in *Jones v. Harris Associates L.P.*, 559 U.S. 335 (2010), including (1) "the independence, expertise, care, and conscientiousness of the board in evaluating adviser compensation"; (2) "comparative fee structure"; (3) "the nature and quality of services provided to the fund and shareholders"; and (4) "the profitability of the fund to the adviser."

The court dismissed the plaintiffs' excessive fee claim under the *Gartenberg* framework. The court first rejected the plaintiffs' argument that the procedures employed by the investment fund's board in approving the agreement were insufficient to warrant deference. The court determined, for example, that the board conscientiously reviewed substantial materials on the differences in scope, scale and risk of advisory versus subadvisory services. Consequently, the court held that "the Board's review process was sufficiently robust to warrant a significant degree of deference to the Board's decision to approve [the defendant's] advisory fee."

The court also rejected the plaintiffs' comparison of advisory and subadvisory fees, which were charged "dramatically lower fees," as inapt. The adviser's comparisons to its fees charged to peer and other retail funds were more apt. "Even if the Subadvised funds could be found to be probative as to the lower end" of the appropriate range, the funds proffered by the defendant "provide[d] an uncontroverted apt comparison, establishing that the range of arm's length fees encompasse[d] those paid by the" fund at issue.

The court next rejected the plaintiffs' argument that the performance of the fund demonstrated that the fees were excessive. Although the plaintiffs "proffered sufficient facts to enable a rational factfinder to conclude that [the fund's] performance was below standard to at least some degree," the plaintiffs failed to proffer "evidence that the Fund's deviation from its benchmark ... was particularly dramatic or unusual." Finally, with regard to profitability, the court concluded that the plaintiffs failed to proffer "evidence to demonstrate that, when viewed holistically in the context of the other Gartenberg factors, [the adviser's] profits [of 73-81%] were out of proportion to the services rendered."

SDNY Denies Motion To Dismiss Market Manipulation Claim Against Stock Exchanges

In re Barclays Liquidity Cross and High Frequency Trading Litig., No. 14-MD-2589 (JMF) (S.D.N.Y. May 28, 2019)
Click here to view the opinion.

Judge Jesse M. Furman denied a motion to dismiss a claim brought by a putative class of shareholders against seven securities exchanges alleging that they violated Section 10(b) of the Securities Exchange Act by providing services to high-frequency trading firms in a way that manipulated the market. The plaintiffs originally brought claims under Sections 10(b) and 6(b) of the Securities Exchange Act against the exchanges and certain high-frequency trading firms. The district court dismissed all of the claims because the conduct did not rise to being unlawfully "manipulative" and the exchanges had immunity as quasi-governmental agencies. The plaintiffs appealed. The Second Circuit vacated the dismissal and held that the plaintiffs sufficiently alleged that the defendants' conduct was manipulative under Section 10(b) and that the exchanges were not immune.

The exchanges again moved to dismiss, arguing that the plaintiffs lacked Article III standing to bring the lawsuit and failed to adequately plead the statutory elements of a Section 10(b) market manipulation claim. The court held that while it was a close call, the plaintiffs adequately alleged an injury in fact to have Article III standing. The plaintiffs sufficiently alleged that the exchanges distorted stock prices through the services they provided to the high-frequency traders and that these distortions were so pervasive and routine that any trader, including the plaintiffs, would be exposed to the distorted prices. The court rejected the exchanges' argument that the plaintiffs may have benefited from the allegedly distorted stock prices, reasoning that the pleading stage was not the time to determine if the plaintiffs' injury may have been outweighed by potential benefits.

The court then held that the plaintiffs sufficiently pleaded the substantive elements of a Section 10(b) market manipulation claim: standing, reliance, loss causation, scienter and particularity. The plaintiffs sufficiently alleged the statutory "standing" element because they were purchasers or sellers of securities. The plaintiffs sufficiently alleged reliance on the defendants' deceptive acts under the presumption that a plaintiff who was injured by "a defendant's failure to disclose material facts reasonably relied on the absence of those facts" (the *Affiliated Ute* presumption). The court determined that use of this presumption at the pleading stage was appropriate where proving reliance on a negative would be nearly impossible. The court further held that the plaintiffs sufficiently alleged loss causation and plausibly alleged that the exchanges' offering products to certain traders was a proximate cause of the alleged economic loss suffered. The court finally held that the plaintiffs sufficiently alleged scienter because their allegations raised a "cogent and compelling" inference that the defendants acted with scienter by understanding how the services they offered could be exploitative.

Securities Fraud Pleading Standards

Court Dismisses Putative Securities Class Action Arising Out of Deadly Fire in London

Howard v. Arconic Inc., No. 2:17-cv-1057 (W.D. Pa. June 21, 2019)
Click here to view the opinion.

Judge Mark R. Hornak dismissed a putative securities class action against Arconic, Inc., a manufacturer of aluminum cladding, and certain of its officers and directors, for alleged violations of Section 11 of the Securities Act and Section 10(b) of the Securities Exchange Act.

One of Arconic's products, an aluminum paneling system, formed the exterior part of the Grenfell Tower in London that was destroyed in a 2017 fire that resulted in 72 deaths and more than

70 injuries. In the wake of the tragedy, some new outlets reported that Arconic's panels contributed to the fire's rapid spread and that the panels should not have been used on buildings that tall. The plaintiffs filed suit, claiming that Arconic's statements in SEC filings, brochures and presentations to investors violated securities laws by failing to disclose the alleged sale of Arconic's products for unsafe uses. The plaintiffs further alleged that a U.K.-based sales employee for one of Arconic's foreign subsidiaries had reason to know that Arconic's product would be improperly used in the tower that caught fire.

The court dismissed both the Section 11 and Section 10(b) claims, explaining that three related and fundamental flaws pervaded both of the plaintiffs' claims. First, the plaintiffs failed to adequately plead that the paneling system that was used in the Grenfell Tower had been sold for inappropriate end uses other than on that one tower. Given that pleading failure, the plaintiffs could not sustain a claim based on an alleged failure to disclose sales for inappropriate end uses. Second, the plaintiffs failed to adequately plead that any Arconic executive knew that its paneling system was being sold for improper purposes. Thus, the plaintiffs did not plead the required mental state for purposes of their Securities Exchange Act claim. Third, while the plaintiffs repeatedly pointed to Arconic's alleged failure to inform investors that the aluminum paneling had been sold for use on the Grenfell Tower, the allegations in the complaint did not plausibly show that a failure to inform investors of a single sale to an end user who would use the product unsafely provided a basis for a securities — as opposed to a products liability — claim.

New Jersey District Court Dismisses Putative Class Action Against Pharmaceutical Company That Failed To Disclose Trial Investigator's Conflicts in Breast Cancer Study

Biondolillo v. Roche Holding AG, No. CV 17-4056 (D.N.J. June 17, 2019)
Click here to view the opinion.

The court granted dismissal in a putative class action against pharmaceutical company Roche Holding AG and four of its executives arising out of an alleged failure to disclose purported conflicts on the part of the trial investigator in the company's breast cancer study.

Roche sponsored a phase III study to test the effects of various treatment options on post-surgery breast cancer patients. While the full study results would not be revealed until a June 2017 conference, on March 2, 2017, Roche issued a press release announcing "positive results" in the trial and claiming that the study found a "statistically significant improvement in invasive disease-free survival" and "met its primary endpoint." When the full results were revealed in June 2017, however, "the consensus by [o]ncologists [was] that the study was a disappointment." Fifteen months later, in September 2018, *The New York Times* published an article revealing that the trial investigator had received over $3 million in payments from Roche for consulting fees and for his stake in a company that Roche acquired.

In the wake of *The New York Times* article, the plaintiffs filed suit, claiming that the March 2, 2017, press release was materially misleading because it failed to disclose the trial investigator's conflict of interest. In ruling on the defendants' motion to dismiss, the court explained that "[t]his case raises the interesting question of whether publishing the results of a study without disclosing conflicts of interests is a misrepresentation." However, the court did not need to answer that question because the plaintiffs failed to plead (1) that the alleged misrepresentation was material (even if it was misleading); or (2) loss causation. The court reasoned that to demonstrate materiality and loss causation, the plaintiffs needed to show that Roche's stock price fell when the trial investigator's conflict was revealed to the public. Here, however, Roche's stock price fell in June 2017, when the disappointing trial results were revealed, not in September 2018, when the trial investigator's conflicts were revealed.

Eastern District of Pennsylvania Declines to Dismiss Securities Suit Against Generic Drug Company Based on Alleged Misstatements Regarding Anti-Competitive Conduct in Industry

Utesch v. Lannett Co., Inc., No. CV 16-5932 (E.D. Pa. May 15, 2019)
Click here to view the opinion.

Judge Wendy Beetlestone denied a motion to dismiss a putative federal securities class action against Lannett Company and two of its officers, alleging violations of Sections 10(b) and 20(a) of the Securities Exchange Act.

Lannett is a pharmaceutical company that derives most of its revenue from the sale of generic drugs. Starting in 2014, multiple state and federal agencies began investigating various generic drug manufacturers, including Lannett, with regard to alleged anti-competitive and/or criminal conduct relating to price-fixing in the industry. In SEC filings, Lannett downplayed the investigations, consistently maintaining that "the generic pharmaceutical industry is highly competitive" and that "we face strong competition in our generic competition business." The plaintiffs alleges that such statements were false or misleading. The plaintiffs further alleged that as information about potential wrongdoing in the generic drug industry and about the investigations into that wrongdoing became public, Lannett share prices fell.

In denying the defendants' motion to dismiss, the court held that the plaintiffs had adequately pleaded falsity, scienter and loss causation. With respect to falsity, the court held that the plaintiffs sufficiently alleged the "who, what, when, where and how" of the alleged misrepresentations. Most plainly, while the defendants maintained that "we face strong competition in our generic produce business," the complaint alleged just the opposite — that the market for the defendants' generic products was riddled with anti-competitive conduct. With respect to scienter, the court explained that the "most powerful evidence of scienter is the content and context" of the misleading statements. Here, the defendants' statements that the market was "highly competitive" and that they faced "strong competition" were made without equivocation, even though there was (1) an ongoing set of investigations into the industry, (2) significant public evidence that price patterns were not following ordinary trends, and (3) ongoing questions in the press about collusive conduct. The defendants' statements denying any anti-competitive conduct — which statements were made with "certitude" — suggested that they were made with the requisite scienter. The court also held that the statements related to "core matters of central importance" to Lannett, which further supported a finding of scienter. Finally, with respect to loss causation, the court held that the plaintiffs had plausibly alleged that Lannett's stock price dropped immediately after the disclosure of information related to the investigation into the pricing of Lannett's drugs.

SLUSA

Ninth Circuit Reverses Dismissal in Action Against Trustee, Holds State Law Claims Are Not Precluded by SLUSA

Banks v. N. Trust Corp., No. 17-56025, 929 F.3d 1046 (9th Cir. July 5, 2019)
Click here to view the opinion.

The Ninth Circuit reversed the dismissal of a putative class action brought against Northern Trust Company for violations of state law involving breaches of fiduciary duty by a trustee, holding that the Securities Litigation Uniform Standards Act (SLUSA) did not bar the plaintiff's claims.

The plaintiff is the beneficiary of an irrevocable trust. The defendant trustee has sole discretion in how to manage the trust's assets. The plaintiff alleged that the defendant breached its fiduciary duty by investing the trust's assets in its own affiliated funds rather than seeking superior investment opportunities outside of the defendant's own funds.

The district court dismissed the claims with prejudice, holding that because the allegedly imprudent investments were in connection with the purchase or sale of covered securities and featured material misrepresentations or omissions, SLUSA precluding the plaintiff from bringing those state law fiduciary duty claims as a class action in federal court.

The Ninth Circuit reversed. The court explained that SLUSA deprives a federal court of jurisdiction to hear (1) a covered class action (2) based on state law claims (3) alleging that the defendants made a misrepresentation or omission or employed any manipulative or deceptive device (4) in connection with the purchase or sale of (5) a covered security. Here, the case turned on the "in connection with" requirement — whether the defendant trustee's alleged activity was "in connection with" the purchase or sale of a covered security. The court noted that, based on U.S. Supreme Court precedent, the "in connection with" requirement should be interpreted broadly, and "it is enough that the fraud alleged 'coincide' with a securities transaction."

However, notwithstanding that the requirement should be interpreted broadly, a misrepresentation or omission is not "in connection with" the purchase or sale of a covered security unless the alleged fraudulent conduct is material to a decision by someone "other than the fraudster" to buy or sell the covered security. Here, the plaintiff did not make any investment decisions based on the defendant's conduct or statements. Rather, the plaintiff alleged that she had not control over how the defendant invested the trust's assets because the plaintiff was only the beneficiary of an irrevocable trust. Thus, "because the trustee can deceive only itself with any alleged misconduct, its misconduct does not require SLUSA preclusion."

Northern District of Illinois Grants Motion To Dismiss State Law Class Action Claims Precluded by SLUSA

Gray v. TD Ameritrade, Inc., No. 18 C 00419 (N.D. Ill. May 13, 2019)
Click here to view the opinion.

Judge Charles P. Kocoras granted a motion to dismiss state law class action claims barred by SLUSA. The plaintiffs were customers of TD Ameritrade, which provided them with an online trading platform for investment and operated a program through which it introduced its customers to investment advisers. Through this program, TD Ameritrade introduced the plaintiffs to advisor Sheaff Brock, which represented to the plaintiffs that its investment strategy — the put options income strategy — was conservative. The plaintiffs alleged that, in reality, the strategy was "aggressive and speculative" and resulted in the plaintiffs suffering "staggering losses." The plaintiffs filed a complaint on behalf of themselves and the putative classes they represented for breach of contract, breach of fiduciary duty, money had and received, and a violation of the Illinois Consumer Fraud and Deceptive Business Practices Act. The defendants TD Ameritrade and Sheaff Brock filed a motion to dismiss the complaint pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure, arguing that the action was precluded by SLUSA.

The plaintiffs argued that SLUSA does not apply because the "in connection with" requirement could not be met where they gave the defendants complete discretion over investment decisions. The court disagreed and emphasized that "a plaintiff need not personally make the investment decision to satisfy the 'in connection with' requirement; rather, the fraud has to coincide with the covered securities transaction." Here, Sheaff Brock's alleged misrepresentations about its conservative investment strategy and expected returns coincided with the covered securities transactions because they were foundational to the claim. Moreover, those representations were the reason the plaintiffs hired Sheaff Brock to engage in securities transactions on their behalf.

Additionally, the court rejected the plaintiffs' argument that the complaint does not involve a "covered security" because it alleged misrepresentations about the defendants' investment strategy, not underlying stocks or options that caused the plaintiffs' losses. The court found that any misrepresentation regarding the success or failure of a trading strategy necessarily involves the underlying securities. Thus, where the underlying securities are traded on national exchanges and regulated by the SEC, and the defendants agreed to be subject to the rules of the Options Clearing Corporation, they are "covered securities" under SLUSA. The plaintiffs conceded that all other preclusion elements were satisfied.

Accordingly, the court held that SLUSA barred the plaintiffs' state law class action claims and dismissed the complaint with prejudice.

Inside the Courts
An Update From Skadden Securities Litigators

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