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Inside the Courts
An Update From Skadden Securities Litigators

Class Certification

Seventh Circuit Vacates and Remands Class Certification in Securities Fraud Action

Carpenters Pension Tr. Fund for N. Cal. v. Allstate Co.,
No. 19-1830 (7th Cir. July 16, 2020)
Click here to view the opinion.

In a securities fraud case against Allstate Corporation, the Seventh Circuit vacated certification of a plaintiff class for legal error and remanded the case for further consideration.

In early 2013, Allstate announced it would be "softening" underwriting standards for its auto insurance business in an effort to attract new customers and increase profitability, but it acknowledged the softer standards held the risk of increasing auto claims frequency. The company's CEO said the company would monitor claims frequency and adjust business practices as necessary. Two years later, Allstate announced that the growth strategy had indeed increased claims frequency and that it would be retightening underwriting standards. Its stock immediately dropped by more than 10 percent.

The plaintiffs, purchasers of Allstate securities after its 2013 announcement, brought a securities fraud class action against Allstate under SEC Rule 10b-5, alleging that claims frequency had increased almost immediately once the softened underwriting standards were implemented but that Allstate withheld this information until its announcement two years later.

As required by Rule 23(b)(3), the plaintiffs introduced evidence at the certification stage that questions of law or fact common to all the class members predominated over any questions unique to individual members. To show they could use common evidence to prove reliance, an element of a securities fraud claim, the plaintiffs invoked the *Basic* fraud-on-the-market presumption of reliance. Under *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988), if plaintiffs prove that the securities at issue were traded in an efficient market, such that the security price reflected all public information (including the alleged misrepresentations), reliance is presumed.

Allstate offered rebuttal evidence that the alleged misrepresentations did not actually affect the price of the securities at issue, which the district court declined to examine. The district court concluded that the issue of price impact was too intertwined with the merits and so could not be decided at the class certification stage.

The Seventh Circuit remanded with instructions that the district court was to engage with Allstate's evidence on price impact for the purpose of assessing whether the plaintiffs properly invoked the *Basic* presumption. The district court was not permitted to draw even obvious inferences about topics forbidden at the certification stage, materiality and loss causation, despite the conceptual overlap.

The Seventh Circuit acknowledged that the same evidence may ultimately be relevant to proving all three issues but concluded that this bifurcated analysis was required by U.S. Supreme Court precedent in *Erica P. John Fund, Inc. v. Halliburton Co.*, 563 U.S. 804 (2011), *Amgen Inc. v. Connecticut Retirement Plans & Trust Funds*, 568 U.S. 455 (2013), and *Halliburton Co. v. Erica P. John Fund, Inc*., 573 U.S. 258 (2014).

Cryptocurrency – Definition of a Security

SDNY Holds That Cryptocurrency Is a Security

SEC v. Kik Interactive, Inc., No. 19 Civ. 5244 (AKH)
(S.D.N.Y. Sept. 30, 2020)
Click here to view the opinion.

Judge Alvin K. Hellerstein granted summary judgment to the Securities and Exchange Commission (SEC) on its claims against a cryptocurrency coin issuer, alleging it violated Sections 5(a) and 5(c) of the Securities Act by offering and selling securities without a registration statement or an exemption from registration. The coin issuer argued that its coins were not securities, and even if they were, the coins sold during a private presale, before its public offering, and thus were exempt from registration requirements under Regulation D.

The court held that the company's coins were securities under the U.S. Supreme Court's decision in *SEC v. W.J. Howey Co*., 328 U.S. 293 (1946). Under *Howey*, an investment contract is a security where there is "(i) an investment of money (ii) in a common enterprise (iii) with profits to be derived solely from the efforts of others." The court determined that the SEC adequately alleged a "horizontal commonality" in which the funds raised through purchases of the company's coins were pooled together to develop the company's blockchain technology, and the success of that technology would raise the value of the purchasers' coins. The court also clarified that in the Second Circuit, the expectation of profits need not literally be "solely" from the efforts of others, but rather that "the scheme was being promoted as primarily as an investment or as a means whereby participants could pool their own activities, their money and the promotor's contribution in a meaningful way." The court determined that the coin issuer promoted the coin as an investment.

The court rejected the coin issuer's argument that transactions from a private presale were exempt under Regulation D, finding that the presale was integrated with the public offering. Under

Regulation D, the court must consider these factors to determine if the transactions are actually one integrated transaction: "(a) Whether the sales are part of a single plan of financing; (b) Whether the sales involve issuance of the same class of securities; (c) Whether the sales have been made at or about the same time; (d) Whether the same type of consideration is being received; and (e) Whether the sales are made for the same general purpose." Giving more weight to the first and fifth factors, consistent with precedent, the court held that the presale and public offering "were part of a single plan of financing and made for the same general purpose," as evidenced by, for example, the fact that the success of the presale relied on the public offering, that the purchasers all "received the same class of securities" and that the two sales "took place at about the same time."

Derivative Litigation – Demand Futility

Eastern District of Missouri Dismisses Derivative Action Alleging Securities Violations

Carpenters Pension Fund of Ill. ex rel. Centene Corp. v. Neidorff, No. 4:18 CV 113 CDP (E.D. Mo. Sept. 15, 2020)
Click here to view the opinion.

Judge Catherine D. Perry granted the directors and officers of Centene Corporation's motion to dismiss a derivative action filed by several of its shareholders. The derivative action alleged that the board of directors issued or approved false and misleading statements related to Centene's acquisition of Health Net. Specifically, the proxy statement and prospectus issued to shareholders prior to their approval of the merger failed to disclose Health Net's financial problems and liabilities. Once these issues were disclosed, the plaintiffs alleged, Centene's stock price dropped more than 8%.

The defendants moved to dismiss, arguing that the shareholders failed to state a claim upon which relief could be granted and failed to demonstrate demand futility. Among other allegations, the shareholders contended that the directors violated the Securities Act and the Securities Exchange Act by issuing false and misleading SEC statements that concealed Health Net's financial issues.

The shareholders argued that demand was excused for their securities claims because making false and misleading statements in violation of securities laws is not protected by the business judgment rule. While the court agreed that such conduct would excuse demand, it held that the complaint failed to plead particularized facts supporting the allegation that the board acted with conscious awareness of illegality.

The complaint generally alleged the board faced liability for making false statements but only identified specific knowledge or conduct by one director and two audit committee members. The court found the board's general approval of the SEC filings insufficient to infer knowledge of falsity, absent specific allegations of directors' personal involvement in the preparation of the filings. Further, the complaint failed to plead that outside directors had sufficient knowledge of the day-to-day workings of Centene to impute knowledge of allegedly false statements made by the president and CEO. Finding no likelihood that the majority of the board faced personal liability for securities law violations, the court held that the complaint failed to plead particularized facts to cast reasonable doubt on the disinterest or independence of the majority of the board.

The court likewise found that the plaintiffs' allegations related to breach of fiduciary duties, insider trading and unjust enrichment failed to demonstrate demand futility. Accordingly, the court granted the defendants' motion to dismiss.

An appeal of this decision was filed with the Eighth Circuit on October 22, 2020.

Fiduciary Duties

Delaware Court of Chancery Denies Motion To Dismiss 'Paradigmatic *Revlon* Claim' Alleging Fraud on the Board

In re MINDBODY, Inc., Stockholders Litig., No. 2019-0442-KSJM (Del. Ch. Oct. 2, 2020)
Click here to view the opinion.

The Delaware Court of Chancery denied a motion to dismiss breach of fiduciary duty claims against both the chairman/CEO and the chief financial officer/chief operating officer of MINDBODY, Inc. (Mindbody) arising from the sale of Mindbody to Vista Equity Partners (Vista). The court granted the motion to dismiss as to an outside director of Mindbody, who was nominated to the board by a venture capital stockholder.

Richard Stollmeyer founded Mindbody in 2001, and the company went public in 2015. In 2018, Mindbody made two strategic acquisitions and told stockholders that these acquisitions positioned Mindbody for growth in 2019. Despite Mindbody's anticipated growth, Stollmeyer was personally motivated to force a sale of Mindbody due to his need for liquidity. Stollmeyer's wealth was concentrated in Mindbody stock, and he analogized his ability to liquidate his holdings through a Rule 10b5-1 plan as "sucking through a very small straw."

In late 2018, Vista expressed interest in Mindbody. Stollmeyer informed members of management of Vista's interest but did not immediately disclose this information to the Mindbody board and instructed members of management not to discuss a sale of Mindbody with the board. On a November 2018 earnings call, management lowered earnings guidance for the fourth quarter, which seemed inconsistent with the company's prior bullish tone on growth, causing a drop in the company's stock price.

The board formed a Transaction Committee to consider the sale of Mindbody. However, throughout the process, Vista received more information and in a more timely fashion than other potential acquirers. On December 23, 2018, the board unanimously approved the sale of Mindbody to Vista for $36.50 per share. The merger agreement provided for a 30-day go-shop period, but the go-shop data room contained less diligence than Vista received and Stollmeyer was on vacation for most of that period. During the go-shop period, Mindbody received its fourth quarter results, which exceeded the company's lowered guidance for the fourth quarter. These results were provided to Vista during the go-shop period but not to other potential bidders. The results were also not disclosed to stockholders before the vote on the merger. The merger closed on February 15, 2019.

In denying the motion to dismiss the breach of fiduciary duty claim against Stollmeyer, the court explained that the "cash-for-stock Merger was a final-stage transaction presumptively subject to enhanced scrutiny under *Revlon*." The court held that the allegations of the complaint supported a reasonable inference that Stollmeyer was conflicted because he had an interest in near-term liquidity and an expectation that he would receive post-merger employment. The court also concluded that the complaint adequately alleged that Stollmeyer tilted the sales process in Vista's favor by: "(a) lowering guidance to depress Mindbody's stock and make it a more attractive target at a time Vista was looking to acquire Mindbody and (b) providing Vista with timing and informational advantages over other bidders." The court also held that the plaintiffs had adequately alleged that Stollmeyer was "a conflicted fiduciary [who] failed to disclose material information to the board," namely, Stollmeyer's alleged conflicts in the sales process and communications with Vista.

The court rejected an argument by the defendants that dismissal was appropriate under *Corwin v. KKR Financial Holdings LLC*, 125 A.3d 304 (Del. 2015), because the stockholder vote was not fully informed.

The court also denied the motion to dismiss as to Mindbody's CFO/COO, concluding that the plaintiffs adequately pleaded a claim for breach of the duty of care in his capacity as an officer because he allegedly acted with gross negligence and was at least recklessly indifferent to the steps Stollmeyer had taken to tilt the sales process in Vista's favor. Finally, the court granted the motion to dismiss fiduciary duty claims against an outside director appointed by a venture capital stockholder due to the lack of allegations that the outside director was conflicted because the venture capital firm was seeking to exit its investment or that the outside director had taken any action to tilt the process toward his personal interest.

Court of Chancery Dismisses Fiduciary Duty Claims Against Directors

In re USG Corp. Stockholder Litig., No. 2018-0602-SG
(Del. Ch. Aug. 31, 2020)
Click here to view the opinion.

The Delaware Court of Chancery dismissed breach of fiduciary duty claims against directors, rejecting a *Corwin* defense but holding that the complaint failed to state a nonexculpated claim for breach of the duty of loyalty.

The decision addressed a post-closing claim for money damages arising out of Gebr. Knauf KG's acquisition of USG Corporation. At the time of the transaction, Knauf owned 10.6% and Berkshire Hathaway owned 30.4% of USG's common stock. In January 2017, Knauf approached USG about a potential transaction, and in March 2017, Knauf reached out to Berkshire Hathaway to determine if it would be willing to sell its shares. Knauf made a proposal to acquire USG for $40.10 in November 2017, which the board rejected. In March 2018, Knauf made another proposal to acquire USG for $42 per share, which the board also rejected. Knauf then initiated a withhold campaign, soliciting proxies from USG's stockholders against USG's four director nominees in connection with the company's 2018 annual meeting. Berkshire Hathaway publicly supported Knauf's bid and campaign. The USG board vigorously opposed the withhold campaign, but Knauf nevertheless prevailed. The board reengaged with Knauf and, in June 2018, reached an agreement on an acquisition at $44 per share.

The stockholder plaintiffs filed suit, seeking to preliminarily enjoin the transaction. The court denied that motion, and the transaction closed in April 2019. The plaintiffs then amended their complaint to seek money damages, alleging that USG's stockholders "did not receive the highest available value for their equity interest in USG" and "suffered the injury of an uninformed stockholder vote."

The court rejected the defendants' defense under *Corwin v. KKR Financial Holdings LLC*, 125 A.3d 304 (Del. 2015), which held that where a transaction is approved by the fully informed vote of

unaffiliated stockholders in the absence of a controller, fiduciary duty claims are subject to dismissal under the business judgment rule. The court held that the complaint failed to adequately allege that Knauf was a controller, noting that Knauf's 10.6% stake in USG was "far below the 50% threshold" and pointing to Knauf's withhold campaign, in which Knauf "fought tooth-and-nail" to prevent nominees from being elected to USG's board. However, the court held that the stockholder vote was not fully informed, rendering *Corwin* inapplicable. Specifically, the plaintiffs alleged that the board believed USG's intrinsic value was $50 per share. Citing 15 references in the proxy to the board's focus on intrinsic value, the court held that the complaint adequately alleged that the board "had a belief as to the precise intrinsic value of USG," which was not disclosed and conceivably rendered the proxy materially misleading. As a result, *Corwin* could not apply.

Although the court declined to dismiss the claims under *Corwin*, it held that the complaint failed to state a nonexculpated claim for breach of fiduciary duty against the directors. The court rejected the plaintiffs' argument that after Knauf succeeded in its withhold campaign, the board abandoned its stand-alone plan for USG and acceded to an acquisition despite its "misgivings" about the deal, explaining, among other things, that the allegation that the board acted out of "fear" of Knauf was undercut by the fact that the board had "vigorously contested" the withhold campaign. The court also rejected allegations that certain director and officer positions at other public companies and board positions at nonprofit organizations rendered the directors interested because a proxy fight loss would damage the board members' reputations.

In addition, the court held that the complaint failed to adequately allege that the directors acted in bad faith, explaining that the material nondisclosure of the board's view of intrinsic value (which rendered *Corwin* inapplicable) did not automatically give rise to an inference of bad faith.

Finally, the plaintiffs also argued that even if the complaint failed to plead a nonexculpated breach of loyalty, it nevertheless pleaded a "freestanding" *Revlon* claim. The court rejected this argument, explaining that "an allegation implying that a Defendant failed to satisfy *Revlon* is insufficient on its own to plead a non-exculpated breach of the duty of loyalty, and a sufficient pleading must reasonably imply that the directors' failure to act reasonably to maximize price was tainted by interestedness or bad faith."

Court of Chancery Declines To Award Damages in Failed $54 Billion Merger

In re Anthem-Cigna Merger Litig., Consol. C.A. No. 2017-0114-JTL (Del. Ch. Aug. 31, 2020)
Click here to view the opinion.

In a lengthy post-trial opinion, the Delaware Court of Chancery awarded no damages to either party with competing damages claims in a trial over the failed merger of Anthem, Inc. and Cigna Corporation. The court concluded that neither party was entitled to recover from the other after holding that: (i) Anthem proved Cigna breached certain covenants to try to close the merger (Efforts Covenants); (ii) the breach of the Efforts Covenants did not lead to causally related damages because the merger had been enjoined, which was a failed closing condition, and Cigna's breach of the Efforts Covenants did not materially contribute to that failed condition; (iii) Cigna failed to prove that Anthem had breached a regulatory efforts covenant; and (iv) Cigna failed to prove that Anthem was liable for a reverse termination fee.

Anthem and Cigna entered into an agreement and plan of merger dated July 23, 2015 (Merger Agreement). Anthem agreed to pay total consideration of over $54 billion, reflecting a premium of 38.4% over Cigna's unaffected market capitalization. At the time, Anthem and Cigna were the second and third largest health insurers in the United States. The Department of Justice (DOJ) concluded that the merger would have anti-competitive effects and sued to enjoin the transaction. In February 2017, the District of Columbia enjoined the closing of the merger. In May 2017, the parties terminated the Merger Agreement and sued each other for breach of contract and billions of dollars in expectation damages.

After trial, the Court of Chancery held that Anthem proved that Cigna breached its obligations under the Efforts Covenants. Specifically, after integration discussions revealed that Anthem intended to treat the merger as an acquisition rather than a merger of equals, Cigna's executive management team "wanted the transaction to fail so they could continue managing Cigna as an independent company." To try to achieve this goal, the court found, Cigna "obstructed Anthem's efforts to line up divestitures," "signaled [to the DOJ] that it opposed the Merger" and "undermined Anthem's defense" of the antitrust litigation.

Although Anthem proved that Cigna breached the contract by breaching the Efforts Covenants, Anthem failed to prove that Cigna's breaches led to causally related damages. The court found that Anthem had proved that Cigna's breaches contributed materially to the injunction, but that Cigna had proved that the transaction would still have been enjoined even if Cigna had complied with its contractual obligations.

The court also found that Cigna failed to prove that Anthem breached its obligations under the regulatory efforts covenant. Although Anthem's strategy could be criticized in hindsight, the court found that it "chose a sound strategy and took all of the actions necessary and appropriate to pursue it." The court also held that even if Cigna had proved that Anthem breached the regulatory efforts covenants, it still could not recover damages because termination of the Merger Agreement extinguished any liability on the part of any party except for "Willful Breach," and although Cigna's breaches "were so strikingly egregious that Anthem would have proved a Willful Breach ... the same is not true of Anthem's conduct." Finally, the court concluded that Cigna was not entitled to a reverse termination fee under the Merger Agreement's provisions because "[b]y the time that Cigna purported to terminate ... Anthem already had terminated the Merger Agreement."

Insider Trading Claims

SDNY Dismisses Section 16(b) Claim Against Holding Company Former Executive

Chechele v. Dundon, No. 19 Civ.10544 (GBD) (S.D.N.Y. Aug. 17, 2020)
Click here to view the opinion.

Judge George B. Daniels dismissed claims brought by a shareholder of a holding company against a former company executive under Section 16(b) of the Securities Exchange Act, alleging that the former executive violated the short-swing profits provision of Section 16(b) through a purchase and sale of the company's common stock within a six-month period. Under Section 16(b), a plaintiff must plead that there was (i) a purchase (ii) and a sale of securities (iii) by a statutory insider (iv) within a six-month period. The shareholder argued that the former executive purchased company shares (through exercising an option) and sold shares on the same date in November 2017 in violation of Section 16(b). The court disagreed, rejecting the shareholder's argument that exercising an option constituted a "purchase." The court instead determined that for purposes of Section 16(b), the former executive's purchase of the shares occurred in January 2014, when he was granted the option to purchase company shares, and the exercise of the option in November 2017 was merely a change from an indirect to a direct form of beneficial ownership. The court concluded that because the purchase of the shares occurred in 2014 and the share sale occurred in 2017, there was no violation of Section 16(b).

Investment Company Act

District of Colorado Rules in Favor of Mutual Funds in 'Excessive Fee' Trial, Finding That Plaintiffs Failed To Meet Burden of Proof Under Investment Company Act

Obeslo v. Great-West Capital Mgmt., LLC, No. 16-cv-00230-CMA-SKC (D. Colo. Aug. 7, 2020)
Click here to view the opinion.

Judge Christine M. Arguello entered judgment in favor of defendants Great-West Capital Management, LLC and Great-West Life & Annuity Insurance Co. following an 11-day bench trial held in January 2020, finding that the plaintiffs had failed to meet their burden of proof under Section 36(b) of the Investment Company Act (ICA).

Great-West, a mutual fund complex that includes approximately 60 mutual funds, was principally distributed through retirement plans under the brand Empower Retirement. Each fund had a total expense ratio (TER), which is the total of all fees charged to shareholders in exchange for the services provided to that fund. The TER included advisory and administrative fees charged by Great-West. The plaintiffs were individuals who acquired shares of certain funds as participants of retirement plans offered by their respective employers. They claimed that both the advisory and administrative services fees charged to the funds at issue were excessive under Section 36(b) of the ICA, "which prohibits fees that are 'so disproportionately large that [they] bear[] no reasonable relationship to the services rendered and could not have been the product of arm's length bargaining.'"

The court found that the plaintiffs had failed to meet their burden of proof with respect to all of the factors from *Gartenberg v. Merrill Lynch Asset Management, Inc.*, 694 F.2d 923 (2d Cir. 1982). Specifically, the court found that (i) the defendants' board was independent, qualified and engaged in a robust process in approving the defendants' fees; (ii) the fees were within the range of fees of comparable funds; (iii) the plaintiffs had failed to quantify any alleged economies of scale or show that those economies were not adequately shared with shareholders; (iv) the defendants' profits were within the range of their competitors'; (v) the defendants had provided extensive, high-quality

services in exchange for their fees; and (vi) the plaintiffs failed to identify any significant fall-out benefits that the defendants acquired. As an independent dispositive ground, the court determined that the plaintiffs had failed to meet their burden to prove that they suffered actual damages due to the defendants' conduct. The court found the plaintiffs' sole witness on this point to be noncredible and his theories regarding the plaintiffs' alleged damages to be legally flawed.

An appeal of this decision has been docketed in the Tenth Circuit as *Obeslo v. Great-Western Life & Annuity Insurance Co.*, No. 20-1310 (10th Cir. appeal docketed Sept. 2, 2020).

Loss Causation

Ninth Circuit Reverses Dismissal, Holds Allegations in Whistleblower Complaint Constitute Corrective Disclosure but Short Seller Report Does Not

In re BofI Holding, Inc. Sec. Litig., No. 18-55415 (9th Cir. Oct. 8, 2020)
Click here to view the opinion.

On October 8, 2020, the Ninth Circuit reversed the dismissal of a putative securities fraud class action in a decision that provides additional guidance concerning the standard for pleading loss causation in the Ninth Circuit.

The plaintiffs, purported BofI shareholders, alleged that BofI and certain of its executives made false or misleading statements touting the bank's conservative loan underwriting standards, its effective system of internal controls and its robust compliance infrastructure. The plaintiffs claimed that the truth was revealed in two supposed corrective disclosures: (i) a whistleblower lawsuit filed by a former midlevel auditor at the company, and (ii) a series of eight blog posts authored by anonymous short-sellers of BofI stock.

The district court dismissed the complaint, holding that neither alleged corrective disclosure could satisfy the loss causation element of the plaintiffs' claim. With respect to the whistleblower complaint, the court held that the allegations were merely "unconfirmed accusations of fraud" and therefore could not have disclosed to the market that BofI's alleged misstatements were actually false. To adequately plead loss causation, the district court explained, the lawsuit had to be followed by "a subsequent confirmation" of the fraud. With respect to the blog posts, the district court held that they could not constitute a corrective disclosure because each of them relied on information already publicly available. As such, they could not have revealed anything new to the market.

On appeal, the Ninth Circuit reversed. With respect to the whistleblower complaint, the court rejected a categorical rule that allegations in a lawsuit, standing alone, can never qualify as a corrective disclosure. The court stated that allegations can constitute a corrective disclosure when the complaint alleges that "the market treat[ed] [the allegations] as sufficiently credible to be acted upon as truth." In reaching this conclusion, the court distinguished two prior Ninth Circuit decisions. First, the court distinguished *Loos v. Immersion Corp.*, 762 F.3d 880 (9th Cir. 2014), where the Ninth Circuit held that the announcement of an internal investigation into purported wrongdoing, without more, cannot satisfy the loss causation element. That decision was premised on the rationale that instituting an investigation can only indicate a risk of fraud and "'speculation' about 'what the investigation will ultimately reveal.'" Here, in contrast, according to the court, the whistleblower alleged facts that, if true, plausibly revealed the falsity of BofI's prior statements.

Second, the court distinguished *Curry v. Yelp Inc.*, 875 F.3d 1219 (9th Cir. 2017), which held that the FTC's disclosure of 2,000 complaints from businesses claiming that their Yelp reviews had been manipulated did not reveal the falsity of Yelp's prior statements that its reviews were authentic. The court reasoned that the complaints in Curry came from "outsiders who lacked any firsthand knowledge of Yelp's practices." In contrast, the whistleblower was "a former insider of the company who had personal knowledge of the facts he alleged."

With respect to the short-seller blog posts, the court also rejected a categorical rule that a disclosure based on publicly available information can never constitute a corrective disclosure. Rather, as the court stated: "The ultimate question is again one of plausibility: Based on plaintiffs' particularized allegations, can we plausibly infer that the alleged corrective disclosure provided new information to the market that was not yet reflected in the company's stock price?" The court went on to reaffirm that whether an alleged disclosure is based only on already-public information remains a key factor in this analysis.

Here, the court concluded that the short-seller blog posts could not constitute a corrective disclosure as a matter of law. The court reasoned that, even if the posts disclosed new information, "it is not plausible that the market reasonably perceived these posts as revealing the falsity of BofI's prior misstatements." That is because the "posts were authored by anonymous short-sellers who had a financial incentive to convince others to sell, and the posts included disclaimers from the authors stating that they made 'no representation as to the accuracy or completeness of the information set forth in this article.'" Under those circumstances, a "reasonable investor reading these posts would likely have taken their contents with a healthy grain of salt."

PSLRA – Safe Harbor Provision

Fifth Circuit Holds That Revenue and EBITDA Projections in Proxy Statement Are Protected Under PSLRA's Safe Harbor Provision

Heinze v. Tesco Corp., 971 F.3d 475 (5th Cir. Aug. 19, 2020)
Click here to view the opinion.

The Fifth Circuit held that revenue and earnings before interest, taxes, depreciation and amortization (EBITDA) projections in a proxy statement are protected by the PSLRA safe harbor provision for forward-looking statements.

Norman Heinze brought a class action on behalf of himself and other shareholders of Tesco Corporation against Tesco, former Tesco board members and Nabors Industries, Ltd. On July 6, 2017, Tesco received an all-stock acquisition offer from Nabors. Tesco's shareholders later approved the transaction. Mr. Heinze alleged that certain omissions in the proxy statement led Tesco shareholders to approve the acquisition, and he filed suit under Sections 14(a) and 20(a) of the Securities Exchange Act and SEC Rule 14a-9. The district court granted the defendants' motion to dismiss as to all claims. Mr. Heinze appealed, and the Fifth Circuit affirmed.

Mr. Heinze alleged that several parts of the proxy statement were misleading, including: (i) a statement that Tesco shareholders would receive a "significant" 19% premium over Tesco's closing price on the last day of trading before the transaction's announcement; (ii) Tesco management's 2017 and 2018 projections for revenue and EBITDA; and (iii) a summary of a fairness opinion written by the investment bank engaged to analyze the offer. The Fifth Circuit rejected all of Mr. Heinze's claims, concluding that Mr. Heinze failed to state a claim upon which relief can be granted under the heightened pleading requirements of the PSLRA.

In rejecting the allegations regarding the first category of statements at issue, the Fifth Circuit concluded that the use of the word "significant" in describing the premium that Tesco shareholders would receive was not material so as to be actionable under SEC Rule 14a-9. The court determined that a reasonable shareholder would have relied on the actual quantity of the premium to assess its significance, rather than the adjective "significant." Thus, the Fifth Circuit held that Mr. Heinze failed to allege a plausible claim with respect to this portion of the proxy statement.

The Fifth Circuit also rejected the allegations relating to the revenue and EBITDA projections. Heinze contended that the projections were rendered misleading because they omitted (i) projections of unlevered free cash flows for the years 2017–22, which allegedly would have reflected an increase in oil prices; (ii) projections for revenue, EBITDA, and other metrics for the years 2019 and beyond, which also allegedly would have reflected an increase in oil prices; (iii) certain "Growth Case" ranges, which allegedly left Tesco shareholders with a pessimistic view of Tesco's future growth potential; and (iv) details of the investment bank's analysis comparing the Nabors-Tesco transaction with similar transactions, which allegedly prevented shareholders from realizing how much more compensation they could have been offered.

The Fifth Circuit rejected Heinze's arguments. The court held that Heinze failed to allege that the projections were misleading, noting that projections need not be based on "rank speculation." Heinze's only affirmative allegation in support of his claim was his "prophecy of oil prices increasing," which the court found not to be viable. Without this allegation, Heinze was left with a "pure-omission" theory "untethered to any specific false or misleading representation in the proxy statement." The court ultimately held that the company did not have an obligation to include "additional *projections* based on potentially inaccurate assumptions about *future* price trends."

In addition, the court rejected Heinze's argument that the PSLRA's safe harbor provision was "intended to encourage companies to fully disclose their projections." The court determined that Heinze's argument based on legislative history was "irrelevant" in the face of the statute's unambiguous text. Importantly, the court found that the PSLRA's safe harbor provision applies not only to forward looking "statements" accompanied by cautionary language, but also projections where the company includes cautionary language around the projections.

The court affirmed the dismissal of Heinze's claims and held that the district court did not abuse its discretion in denying leave to amend.

SEC Enforcement Actions

Fourth Circuit Holds That Disgorgement in an SEC Proceeding Is Not a Criminal Penalty for Purposes of the Double Jeopardy Clause

United States v. Bank, 965 F.3d 287 (4th Cir. July 14, 2020)
Click here to view the opinion.

The Fourth Circuit held that disgorgement ordered in a prior SEC proceeding would not bar subsequent criminal prosecution for the same underlying conduct under the Double Jeopardy Clause of the Constitution. In so ruling, the Fourth Circuit joined the seven other circuits that have ruled on the issue previously.

In April 2015, the SEC initiated enforcement proceedings in Arizona against Daryl Bank for illegal investment activities. According to the complaint, Mr. Bank and others misled investors by assuring them their investment would yield high returns when they sold Federal Communications Commission licenses to major cellular wireless carriers such as Sprint while knowing the licenses could never be sold or leased to any major wireless carriers.

In 2017, Mr. Bank entered into a consent agreement with the SEC, and a federal district court in Arizona ultimately held Mr. Bank liable for disgorgement of over $4.4 million. A grand jury in the Eastern District of Virginia later indicted Mr. Bank on charges of securities fraud and unlawful sale of securities based on the same underlying conduct. Mr. Bank filed a motion to dismiss the indictment, arguing that the Double Jeopardy Clause prohibited the indictment because he could not be prosecuted twice for the same conduct. Mr. Bank argued that the U.S. Supreme Court's recent decision in *Kokesh v. SEC*, 137 S. Ct. 1635, 1639 (2017), which held that disgorgement is a "penalty" for purposes of the applicable statute of limitations, rendered his disgorgement a "criminal sanction" for purposes of the Double Jeopardy Clause.

The Eastern District of Virginia denied the motion to dismiss the indictment, and Mr. Bank appealed to the Fourth Circuit. The Fourth Circuit affirmed. It first considered whether Mr. Bank's waiver of his right to contest future prosecution on double jeopardy grounds in his consent agreement with the SEC was valid. The court noted that a defendant is ordinarily permitted to waive the constitutional right to assert a double jeopardy defense. However, like the district court below, the Fourth Circuit declined to rely on the waiver in the consent agreement in disposing of the appeal. The court reasoned that the waiver did not specifically bar double jeopardy claims in future proceedings or in criminal proceedings. In addition, though the waiver clause waived challenges to the imposition of a remedy or civil penalty, the Supreme Court had not ruled that disgorgement could be considered a penalty at the time Mr. Bank signed the consent agreement.

Instead, the Fourth Circuit turned to the issue of whether Mr. Bank's disgorgement qualified as a civil penalty, which would not implicate the Double Jeopardy Clause, as opposed to a criminal penalty, which would implicate the clause. Noting that Kokesh held that disgorgement qualified as a "penalty," the Fourth Circuit then turned to the multifactor analysis developed in *Hudson v. United States*, 522 U.S. 93 (1997), to determine whether such a sanction constitutes a criminal penalty for purposes of the Double Jeopardy Clause. Under *Hudson*, a court must first look to the construction of the statute from which the penalty stems and ask whether the legislature intended the penalty to be civil or criminal in nature. Next, if the penalty is intended to be civil in nature, the court queries whether the statutory scheme is sufficiently punitive to effectively transform what was intended to be a civil remedy into a criminal one. With respect to this second inquiry, *Hudson* provides seven factors as "useful guideposts."

The Fourth Circuit first determined that there was "strong evidence" in various provisions of the securities laws and the Federal Rules of Civil Procedure that the penalty at issue was intended to be civil in nature. Next, under the second step of the *Hudson* inquiry, the court ruled that five of the seven factors weighed in favor of treating disgorgement as a civil penalty. In particular, the court determined that disgorgement did not impose an affirmative disability or restraint, was not historically regarded as a punishment, did not require scienter, had a clear rational purpose other than punishment, and was not excessive in relation to Congress' nonpunitive goals. Thus, the court concluded that disgorgement was not a criminal penalty for purposes of the Double Jeopardy Clause, and Mr. Bank's motion to dismiss the indictment had been properly denied.

Securities Fraud Pleading Standards

Misrepresentations

Second Circuit Affirms Dismissal of Claims Alleging Material Misstatements and Omissions Against Tax Preparation Company

In re Liberty Tax, Inc. Sec. Litig., No. 20-652 (2d Cir. Sept. 30, 2020)
Click here to view the opinion.

The Second Circuit affirmed the dismissal of claims brought under Sections 10(b) and 20(a) of the Securities Exchange Act alleging that a tax preparation company made false and misleading statements and omissions regarding purported sexual and other misconduct by the company's founder and former CEO.

The court held that a challenged statement regarding the company's compliance task force and ethical standards was too general and lacked "the specificity required to elevate it beyond mere puffery to an actionable, material misrepresentation." The court also concluded that an alleged omission in a press release about the reason why the company had terminated its CEO was not actionable because the law "does not require investors to be given a reason for terminating corporate officers." The press release disclosing the termination did not falsely mislead investors to believe that the CEO's departure "was pursuant to a 'deliberate succession planning process'" because the company had explained that it had engaged in succession planning in hiring a new CEO, not in firing the former one. The press release had also disclosed the extent of the former CEO's ongoing

control of the company, including through his ownership of Class B shares, and therefore was not materially misleading with respect to the extent to which the former CEO would retain control over the company after his termination.

District Court Dismisses Securities Fraud Complaint, Finding Statements About Marketing Spend and User Growth Were Not Misleading

In re Stitch Fix, Inc. Sec. Litig., No. 18-cv-06208-JD (N.D. Cal. Sept. 30, 2020)
Click here to view the opinion.

The Northern District of California dismissed a putative securities fraud class action brought against Stitch Fix, Inc. and certain of its officers, holding that the plaintiff failed to adequately plead a false or misleading statement in violation of Section 10(b) of the Securities Exchange Act.

Stitch Fix is an online retail fashion subscription service. The company's business model starts with clothing, shoes and accessories that it buys from other manufacturers or makes itself. Stitch Fix then curates these items into personalized shipments, called a "Fix," to customers. Customers can try on the items in their Fix, buy what they like and return the rest. Customers are incentivized to buy all the items in their shipment because they receive a 25% discount if they purchase the entire Fix.

In this case, the plaintiff — a purported shareholder of Stitch Fix — alleged that the company made misleading statements regarding its television advertising and its active client growth.

First, the plaintiff challenged Stitch Fix's statement in the fourth quarter of 2018 (4Q 2018) that "We continue to make strategic and measured marketing investments designed to achieve near-term payback." The plaintiff claimed that this statement was misleading because it failed to disclose that Stitch Fix halted national television advertising for 10 of 13 weeks in 4Q 2018 as a way to measure the efficacy of national TV advertising. The court held that the plaintiff failed to allege that this statement was misleading. The court determined that Stitch Fix's "more general" statements about marketing did not become misleading simply because Stitch Fix had paused one aspect of its marketing campaign — national television advertising — for a period of 10 weeks.

Second, the plaintiff challenged Stitch Fix's statement from the middle of 4Q 2018 that it had "continued positive momentum" in its "active client growth." The plaintiff alleged that this statement was misleading because Stitch Fix later revealed that active client growth grew only 2% in that quarter. The court held that the plaintiff failed to plead the falsity of the challenged statement with particularity. While the plaintiff certainly pleaded that overall client growth in the quarter was slow, Stitch Fix made the alleged misstatement not even halfway through the quarter, and the complaint "contain[s] no direct allegations about what active client growth was as of" the date of the alleged misstatement.

SDNY Dismisses Complaint Against Bank Alleging Material Misrepresentations in Financial Statements

Plumbers & Steamfitters Local 773 Pension Fund v. Danske Bank A/S, No. 19-CV-235 (VEC) (S.D.N.Y. Aug. 24, 2020)
Click here to view the opinion.

Judge Valerie E. Caproni dismissed claims brought by the plaintiffs, a putative class of investors, against the defendants, a bank and certain of its former officers and directors, alleging that they violated Sections 10(b) and 20(a) of the Securities Exchange Act by making misleading statements about the bank's financial condition that ignored deficiencies in the bank's anti-money laundering controls at its branch in Estonia. The court determined that the complaint failed to plead scienter with the particularity required by Federal Rule of Civil Procedure 9(b) and the PSLRA and failed to plead any material misrepresentation or omission.

The court rejected the plaintiffs' argument that certain of the bank's financial statements improperly reported revenues from its nonresident portfolio (NRP) accounts that included revenue from deposit contracts that had been derived from money laundering transactions. The court held that the plaintiffs did not allege with particularity that at the time the financial statements were published, the defendants knew that those contracts were unenforceable and that the NRP account funds could not be recognized. The court similarly rejected the plaintiffs' argument that the defendants misled investors by stating in their 2015 corporate responsibility report that all whistleblower cases reported in 2014 were concluded. The court determined that there was no plausible allegation that the defendants had not concluded the whistleblower cases, even though a subsequent 2018 internal investigative report published by the defendants noted that the whistleblower allegations concerning money laundering were insufficiently investigated. The court found that while the internal investigation report suggested "mismanagement" of the whistleblower complaints, it did not suggest fraud.

The court declined "to make the inferential leap that because [the bank] failed adequately to investigate and resolve extensive [anti-money laundering] lapses at the Estonian Branch, Defendants must have acted with scienter when they made the various statements touching on Estonia."

An appeal of this decision was docketed in the Second Circuit (No. 20-3231) on September 23, 2020.

Northern District of California Denies Motion To Dismiss, Finds That Vague, Optimistic Statements in Company's Registration Statements Are Actionable 'in Context'

Boston Ret. Sys. v. Uber Techs., Inc., No. 19-cv-06361-RS (N.D. Cal. Aug. 7, 2020)
Click here to view the opinion.

The Northern District of California denied Uber Technologies' motion to dismiss claims brought under Sections 11, 12(a)(2) and 15 of the Securities Act, finding that the complaint brought by a purported shareholder of Uber adequately alleged that certain statements in Uber's April 11, 2019, registration statement were false and misleading.

Notable in the court's decision was its treatment of certain vague, optimistic statements that might otherwise be considered corporate puffery. "In the Ninth Circuit, vague, generalized assertions of corporate optimism or statements of mere puffing are not actionable material misrepresentations under federal securities laws because no reasonable investor would rely on such statements." *In re Restoration Robotics, Inc. Sec. Litig.*, 417 F. Supp. 3d 1242, 1255 (N.D. Cal. 2019). However, "[s]tatements by a company that are capable of objective verification are not 'puffery' and can constitute material misrepresentations." *Or. Pub. Emps. Ret. Fund v. Apollo Grp. Inc.*, 774 F.3d 598, 606 (9th Cir. 2014).

In this case, the court found that the statement "it's a new day Uber" was capable of objective verification and, therefore, not puffery. The court explained that the registration statement elsewhere admitted that Uber had, in the past, failed to comply with local laws and tolerated sexual harassment, and even abuse, of its passengers and employees. Taking that predicate, the court reasoned that the statement "it's a new day Uber" "implied the company had turned a corner" and that "these problems were in the past." Therefore, "[i]t's a new day is not mere puffery when the speaker knows significant remnants of the 'old day' — for example, continuing to launch in markets where Uber was clearly illegal, and paying fines or bribes as a cost of doing business — remain."

The court also found that statements that Uber was "committed to enhancing safety" and "work[ing] tirelessly to earn [its] customers' trust" were not puffery and, therefore, actionable. (alteration in original). The court reasoned that, "when presented in the context of Uber's troubled history and the 'new day' theme," those statements "imply that something has changed." In light of the plaintiff's allegations that Uber was continuing to perform poorly in terms of passenger safety, those statements implying that "something had changed" were misleading.

SDNY Declines To Dismiss Claims That Wrestling Corporation Misled Investors About Negotiations of Material Media Contracts

City of Warren Police & Fire Ret. Sys. v. World Wrestling Entm't, Inc., No. 20-cv-2031 (JSR) (S.D.N.Y. Aug. 6, 2020)
Click here to view the opinion.

Judge Jed S. Rakoff denied a motion to dismiss claims brought by a putative class of investors alleging that the defendants, a wrestling corporation and certain of its officers, had violated Sections 10(b) and 20(a) of the Securities Exchange Act and Rule 10b-5 thereunder by misleadingly representing that a key agreement with a Saudi state-controlled television network would be renewed when it had already been terminated, and that there were agreements in principle for an additional media rights deal when negotiations had, in fact, stalled.

The court found that statements made variously during an earnings call, in press releases and in public presentations were misleading because the term "renewal," as applied to the media contracts, was understood to have its common meaning and was not — as argued by the defendants — a specialized "term[] of art in the broadcasting industry." The court similarly determined that statements during the earnings call regarding an "agreement in principle" for an additional contract were misleading in light of confidential witness testimony confirming that "the parties had not agreed on fundamental terms of a contract." The defendants argued that hedging language that the "understanding [wa]s nonbinding" and that it was "possible" that the agreement would "not occur on expected terms" prevented the statements from misleading investors. However, the court found that these statements did not "warn of the misrepresentation that plaintiff complains of: that there was never an agreement in principle between the parties to begin with." The court determined that the statements were either not opinions but factual statements, or that the opinions contained particular and material facts that rendered the opinions themselves misleading. Finally, the court determined that the complaint sufficiently pleaded scienter, as evidenced by, for example, the company's CEO's sale of millions of shares of stock, for hundreds of millions of dollars, during the class period, which was "unusual in light of [the CEO's] past trading practices."

Omissions

Sixth Circuit Upholds Dismissal of Securities Fraud Case for Lack of Particularity

Iafrate v. Angelo Iafrate, Inc., No. 19-1631 (6th Cir. Sept. 21, 2020)
Click here to view the opinion.

The Sixth Circuit affirmed dismissal of a securities fraud claim brought by the sellers of a construction company. The company, the Angelo Iafrate Construction Company, was owned by Angelo Iafrate Sr. and his children. In 2012, the plaintiffs decided to sell their interests in the company to its employees. To do so, the plaintiffs formed Angelo Iafrate Inc. (AIC) and exchanged their shares in the original company for 30,000 shares of AIC. The plaintiffs additionally furnished AIC with a $36.7 million loan as financing. AIC set up an employee stock ownership plan (ESOP), which used the loan to purchase the 30,000 shares of AIC stock from the plaintiffs. When the sale closed in December 2013, each of the plaintiffs was issued two promissory notes, one senior and one junior, to cover their portion of the loan. Shortly thereafter, the plaintiffs entered into an agreement that if any one of them received payment on a note, they would hold it in trust. The payment would then be applied pro rata to each noteholder.

Each plaintiff also received a warrant, providing the right to purchase a specified amount of AIC shares. Each warrant contained the following limitation: "This Warrant shall terminate on, and may no longer be exercised on or after, the date that is 60 days after the date that the Company has paid in full both the Senior Promissory Note and Junior Promissory [Note] issued by the Company in favor of the Holder."

In November of 2016, the board approved a $5.4 million prepayment to Angelo Sr. In February 2017, AIC fully paid off two other notes. In February 2018, AIC fully paid off all outstanding notes. The plaintiffs allege that each payment was held in trust, honoring the terms of their agreement. Once the last note was paid off, the plaintiffs tried to redeem their warrants. All but one request was denied. AIC only honored the request of the last paid noteholder, claiming that all other noteholders' requests were time-barred by the terms of the warrant. On July 5, 2018, the plaintiffs filed suit against AIC for securities fraud, under Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder. The plaintiffs alleged that AIC wrongfully represented that each note prepayment triggered the noteholders' warrant term limit. AIC filed a motion to dismiss for failure to state a claim, which the district court granted. This appeal followed.

The plaintiffs claimed that AIC represented that non-pro rata payments on a note would not be construed as a warrant-triggering event. As evidence of their clams, the plaintiffs cited a statement by AIC's president, that any non-pro rata payments would not change the "long agreed automatic redemption of the [w]arrants all at one time." However, the plaintiffs alleged that the president omitted new information, namely, both the president's interpretation of the warrants and his prediction of how AIC would handle them. In other words, the plaintiffs alleged that they were not told that AIC's president believed the warrants would be triggered by non-pro rata payments.

The Sixth Circuit classified this omission as "soft information." This is contrasted with "hard information," typically "historical information or other factual information that is objectively verifiable." One reason that the president's omissions were classified as "soft information" was that they were his subjective interpretation of a contract provision. Further, the Sixth Circuit applied its decision in *Omnicare*, where it previously stated "an omission of 'soft information' is only actionable as securities fraud if 'the new information [is] so concrete that the defendant must have actually known that the new information renders the prior statement misleading or false and still did not disclose it.'" *In re Omnicare, Inc. Securities Litigation*, 769 F.3d 455, 471 (6th Cir. 2014).

Here, the plaintiffs failed to allege with any particularity any statements establishing AIC's commitment to only honor the warrants after all notes were paid. Therefore, the president's alleged omission was not actionable, as there was no prior statement that the omission rendered materially false. Accordingly, the Sixth Circuit affirmed the district court's dismissal of the plaintiffs' suit.

SDNY Denies Motion for Reconsideration of Claims Against Tobacco Company Because Alleged Misleading Statements About Electric Cigarettes Were Not Material

In re Philip Morris Int'l Inc. Sec. Litig., No. 18-CV-08049 (RA) (S.D.N.Y. Sept. 21, 2020)
Click here to view the opinion.

Judge Ronnie Abrams denied a putative class of shareholders' motion for reconsideration challenging the court's dismissal with prejudice of their claims against Philip Morris International Inc. (Philip Morris) and several of its executives alleging that they violated Sections 10(b) and 20(a) of the Securities Exchange Act and Rule 10b-5 thereunder by making misleading statements about the sales performance of the company's smoke-free electronic device, which had plateaued in Japan, the only country where the product was widely available. In particular, the plaintiffs asked the court to reconsider its dismissal of their claims that the defendants' SEC filings failed to comply with Item 303 of Regulation S-K, 17 C.F.R. § 229.303(a)(3)(ii), and with Item 503 of Regulation S-K, 17 C.F.R. § 229.503(c).

The court noted that Item 303 requires a corporation to affirmatively disclose "any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations," and that Item 503 "requires a corporation to 'provide under the caption "Risk Factors" a discussion of the most significant factors that make an investment' in a security 'speculative or risky,' and requires each risk factor to 'adequately describe[] the risk.'" The court held that the alleged omissions about the performance of Philip Morris' smoke-free product in Japan were forward-looking statements and were not material, and the Risk Factors provided in the company's public filings were not "boilerplate," as the plaintiffs alleged, but sufficiently specific. The court noted, for example, that the Risk Factors cautioned investors that the company's success "*increasingly*" depended on "*adult smoker willingness to convert to our [smokeless cigarettes]*." The court held that the plaintiffs "failed to establish circumstances warranting the use of the 'extraordinary remedy' of reconsideration with respect to the Court's prior holding that [the defendants] satisfied their disclosure obligations under Items 303 and 503."

Scienter

District of Massachusetts Dismisses Allegations That Data Protection Company Defrauded Investors About New Software Product

Luna v. Carbonite, Inc., No. 19-cv-11662-LTS (D. Mass. Oct. 22, 2020)
Click here to view the opinion.

Judge Leo T. Sorokin dismissed with prejudice claims brought by a putative class of investors against a data protection company and certain of its former executives alleging that they violated Sections 10(b) and 20(a) of the Securities Exchange Act and Rule 10b-5 thereunder by making misleadingly positive statements about a new software product that the company withdrew from the market after nine months. Specifically, the plaintiff alleged that the company launched the product and made statements during the class period touting the product, even though it "never worked, from the time before it was officially launched until it was withdrawn." The plaintiff further alleged that the defendants concealed from investors that the company had dedicated teams of engineers working to fix the product and issued to its customers software patches to address the product's programming bugs. The plaintiff alleged that the individual defendants sold millions of dollars of company stock during the class period and argued that the sales supported a strong inference of scienter.

The court held that the complaint failed to plead scienter with the particularity required by the PSLRA and Rule 9(b). The court found that all of the challenged statements alleged about the new product were made during the product's launch or shortly thereafter, and there was no factual allegation that the statements were not genuinely believed when made. The court discredited the allegation that the individual defendants' class period stock sales were suspicious, noting that (i) they were pursuant to Rule 10b5-1 trading plans or to satisfy tax obligations, and (ii) the overall holdings of company stock by the individual defendants either was approximately the same at the beginning and end of the class period or increased during the class period. The court found that "while [the new product] may not have" worked "before or after release, the totality of allegations fails to support a strong inference of scienter," especially "in light of the substantial efforts to develop or repair [the new product], the disappearance of [product]-specific statements shortly after the launch, the absence of specific operational factual misrepresentations, and the stock sales taken in context." The court also held that the defendants' statements were not alleged to be sufficiently reckless to support scienter because "there is no factual allegation that [defendants] were on notice at any point prior to [the product's] withdrawal from the market that [the product] had no hope of working."

EDNY Dismisses Complaint Against Cosmetics Company Alleging Material Misstatements and Omissions Concerning the Company's Failed Operational Management Software Platform

Lachman v. Revlon, Inc., No. 19-cv-2859 (RPK) (RER) (E.D.N.Y. Sept. 17, 2020)
Click here to view the opinion.

Judge Rachel P. Kovner dismissed claims brought by the plaintiffs, a putative class of investors, against the defendants, an international beauty cosmetics company and certain of its officers, alleging that they violated Sections 10(b) and 20(a) of the Securities Exchange Act and Rule 10b-5 thereunder by making statements downplaying the risks of moving to a new software platform before the transition and the severity of the impact on the company after the transition had occurred. The court held that, although the failure of the software (which was used for managing different areas of the company's operations) created a material weakness in the company's internal controls over financial reporting, the plaintiffs failed to plead scienter with the particularity required by the Private Securities Litigation Reform Act (PSLRA) and Federal Rule of Civil Procedure 9(b).

The court rejected the argument that statements made in the company's 2016 Form 10-K, prior to the transition to the new software platform, were actionable because they did not sufficiently warn about unspecified risks related to the launch of the software platform. The court determined that the plaintiffs did not plead facts supporting the inference that the defendants knew of undisclosed material risks at the time the 2016 Form 10-K was filed. The court noted that when the 2016 Form 10-K was filed, the defendants were still designing and planning the new software platform, and therefore, it was not a risk that "had already materialized." The court also rejected the argument that statements made in the company's 2017 Form 10-K, after the launch of the new software platform, were actionable because they "misl[ed] investors about the severity of the implementation problems and the Company's remediation efforts." The court found that the defendants "detailed service level disruptions" related to the launch "and the negative consequences flowing from those disruptions." The court noted that the defendants made no statements that their remediation efforts were successful but simply made statements that they immediately took action to address problems caused by the launch. Finally, the court held that the company's Sarbanes-Oxley Act certifications stating that the company's internal controls were effective were not misleading, finding that the certifications were statements of opinion, and it was not adequately pleaded that the opinion was not genuinely believed.

District of Massachusetts Dismisses Securities Fraud Claims Against Online Home Goods Retailer

In re Wayfair, Inc. Sec. Litig., No. 19-10062 (DPW) (D. Mass. July 8, 2020)
Click here to view the opinion.

Judge Douglas P. Woodlock dismissed claims brought by a putative class of investors against an online home goods retailer under Sections 10(b) and 20(a) of the Securities Exchange Act, alleging that the company and certain of its executives made false and misleading statements about the company's financial position. The investors alleged that during the putative class period, the company's advertising revenue leverage was worse than in previous years, and that the company and the company's CEO concealed this problem from investors. The investors further alleged that the company's stock price fell on the day that the company made an announcement revealing negative advertising leverage.

The court dismissed the claims, examining three categories of statements the investors alleged were false and determining that the first set of statements alleged to be false by the investors were classic puffery (*e.g.*, "[w]e remain incredibly bullish about our business") and thus not actionable. The court similarly determined that the second set of statements were not actionable because they were forward-looking statements concerning the company's projections and forecasts about what was expected in the company's future. The court noted that these types of forward-looking statements are covered by the safe harbor provision of the PSLRA.

For the third set of statements, which concerned the company's advertising strategies, the court determined that the investors failed to adequately allege they were false when made. The court concluded that the investors failed to allege scienter with particularity as required by Rule 9(b) and the PSLRA, and rejected the investors' argument that "because Defendants said that they paid close attention to their financial position and their financial position ended up being different than Defendants said it was, Defendants must have been lying." The court likewise found that the investors' allegations that the defendants' company stock sales were suspiciously timed and supported scienter was contradicted by the public record, as the defendants' sales were spaced throughout the class period and their stock holdings at the end of the class period were comparable to their holdings at the beginning of it.

Standing

First Circuit Affirms Dismissal of Claims Against Medical Device Company

Yan v. ReWalk Robotics Ltd., No. 19-1614 (1st Cir. Aug. 25, 2020)
Click here to view the opinion.

The First Circuit affirmed the dismissal of claims brought by a putative class of investors against a medical device company, its officers and directors, and the initial public offering (IPO) underwriters, alleging that the defendants concealed material information in the company's IPO registration statement about its failure to comply with the Food and Drug Administration's (FDA) regulations, in violation of the Securities Act. The plaintiff also alleged that after the IPO, the company continued to make material false statements in violation of the Securities Exchange Act.

The plaintiff alleged that the company issued a registration statement in September 2014 that touted the clinical success of the company's medical device, which was intended for long-term use by individuals with spinal cord injuries, but did not disclose that the company was still waiting to receive FDA approval on its proposed study plan. The plaintiff further alleged that the

company failed to disclose a September 2015 FDA warning letter that stated that the device was "currently misbranded under [the Food, Drug and Cosmetic Act]" and threatened sanctions absent corrective action by the company.

As to the Securities Act claims, the First Circuit determined that the registration statement's allegedly misleading statements were true and there were no actionable omissions. For example, the First Circuit found that statements about the safety risks associated with the device were adequate, given that the company disclosed that a "user could experience death or serious injury" were the device to malfunction. The court also determined that the company had adequately disclosed the claimed risk or uncertainty as required under Regulation S-K. The registration statement explained that "'[t]here is no long-term clinical data with respect to the safety or physical effects of [the device]' and that approval for use 'beyond the institutional/rehabilitational setting' required performance of the relevant postmarket study" (alteration in original).

The district court had determined that the lead plaintiff did not have standing to assert claims under the Securities Exchange Act, since he purchased his shares in September 2014 and the relevant alleged omissions were not made until the company's quarterly earnings calls in 2015 and 2016. The First Circuit affirmed, finding that the plaintiff had failed to tie anything misleading in the registration statement to later alleged fraudulent omissions made by the company, and thus the statements made by the company after the plaintiff's share purchase were not made in furtherance of "a common scheme to defraud." The First Circuit also determined that the plaintiff could not cure this deficiency by adding another named plaintiff who would have had standing to prosecute the Securities Exchange Act claims because the complaint's failure to adequately allege scienter was independently dispositive of those claims.

Inside the Courts
An Update From Skadden Securities Litigators

Contacts

New York
One Manhattan West
New York, NY 10001
212.735.3000

Alexander C. Drylewski
212.735.2129
alexander.drylewski@skadden.com

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

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

David Meister
212.735.2100
david.meister@skadden.com

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

Patrick G. Rideout
212.735.2702
patrick.rideout@skadden.com

Susan L. Saltzstein*
212.735.4132
susan.saltzstein@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

Eben P. Colby
617.573.4855
eben.colby@skadden.com

Michael S. Hines*
617.573.4863
michael.hines@skadden.com

Alisha Q. Nanda
617.573.4804
alisha.nanda@skadden.com

Chicago
155 N. Wacker Drive
Chicago, IL 60606
312.407.0700

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

Marcie Lape (Raia)
312.407.0954
marcie.lape@skadden.com

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

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

Kenneth P. Held
713.655.5140
kenneth.held@skadden.com

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

Virginia Milstead
213.687.5592
virginia.milstead@skadden.com

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

Jason D. Russell
213.687.5328
jason.russell@skadden.com

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

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

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

Bradley A. Klein*
202.371.7320
bradley.klein@skadden.com

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

Cliff C. Gardner
302.651.3260
cliff.gardner@skadden.com

Joseph O. Larkin
302.651.3124
joseph.larkin@skadden.com

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

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

Jenness E. Parker
302.651.3183
jenness.parker@skadden.com

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

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

*Editors

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