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Derivative Litigation

Court of Chancery Grants Special Litigation Committee's Motion To Dismiss Derivative Claims Premised on Alleged Insider Trading

Diep v. Sather, C.A. No. 12760-CM (Del. Ch. July 30, 2021)
View the opinion.

The Court of Chancery granted a motion to dismiss derivative claims filed by a special litigation committee of the El Pollo Loco (EPL) board of directors formed to investigate derivative breach of fiduciary duty claims arising out of alleged insider trading.

In 2015, EPL held an earnings call during which it announced lowered guidance for the second quarter that allegedly downplayed certain factors that may have led to the decline in guidance. According to the plaintiffs, after this earnings call but before second quarter results were announced, certain company insiders sold large amounts of stock in a "Block Trade." EPL stockholders asserted insider trading claims in the U.S. District Court for the Central District of California and breach of fiduciary duty claims in the Court of Chancery. After the Court of Chancery denied the defendants' motion to dismiss the breach of fiduciary duty claims, the company formed a special litigation committee (SLC) to investigate the claims. The SLC produced a 377-page report, which attached 408 exhibits and contained nearly 2,500 footnotes, concluding that the information on which the insiders allegedly traded was immaterial and the insiders lacked the scienter to support the claims, and moved to dismiss the complaint.

The court explained that under *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981), the court must (i) "review[] the independence of SLC members and consider[] whether the SLC conducted a good faith investigation of reasonable scope that yielded reasonable bases supporting its conclusions;" and (ii) apply the court's "own business judgment to the facts to determine whether the corporation's best interests would be served by dismissing the suit." As to the first prong, the court concluded that the SLC members were independent, noting that "[n]one of the three SLC members sat on EPL's board at the time of the Block Trade, and none have any financial interest in the transactions at issue." The court rejected the plaintiffs' challenge to the independence of two of the three members of the SLC, finding that the SLC members had not "prejudged" the merits of the litigation because one had served on the board at the time the defendants initially moved to dismiss the claims, and certain alleged professional and personal relationships did not create a material question of fact as to the SLC members' independence.

The court further concluded that the SLC had conducted a reasonable investigation and generated a report that "considered each allegation contained in the Complaint and evaluated the facts and law relevant to those allegations." In addition, the court found that the SLC had "reasonable bases for reaching its conclusions" in "good faith," and explained that "[t]he SLC's investigation and report is not rendered unreasonable merely because Plaintiff disagrees with its conclusions."

As to the second prong, the court concluded that the SLC's recommendation fell "within a range of reasonable outcomes," explaining that "a disinterested and independent decision-maker for the Company, not acting under any compulsion and with the benefit of the information available to the SLC, could reasonably accept the SLC's recommendation to dismiss Plaintiff's claims." Specifically, the court explained that the claim raised in the litigation required a showing of scienter and the SLC had "directly addressed the facts on which Plaintiff relies to support a finding of scienter and concluded that they offered little support" because "innocent explanations for the timing of the trade and the disclosures issued in May 2015 were more plausible than the insider trading theory set forth in the Complaint." As a result, the court granted the SLC's motion to dismiss.

Court of Chancery Dismisses *Caremark* Claim

Pettry v. Smith, C.A. No. 2019-0795-JRS (Del. Ch. June 28, 2021)
View the opinion.

The Court of Chancery granted a motion to dismiss a claim for breach of fiduciary duty alleged under a *Caremark* theory of liability against FedEx's board of directors, as well as a fiduciary duty claim against certain officers based on the same underlying facts.

The stockholder plaintiff alleged that FedEx's directors and officers had breached their duty of loyalty by consciously failing to oversee FedEx's compliance with state and federal laws governing the transportation and delivery of cigarettes. Dating back to 2004, FedEx had been the subject of multiple investigations and enforcement actions brought by the city and state of New York relating to the alleged illegal shipment of cigarettes. Each of these actions had been settled, with the most recent settlement in December 2018. The complaint further alleged that the FedEx board was aware of the purportedly illegal conduct since at least July 2012, when the company's general counsel presented the results of an internal investigation commissioned by the board regarding the company's cigarette shipping practices. Yet, the plaintiff alleged, the board "did nothing" to address the allegedly unlawful practices, which persisted until April 2016 when the company announced it was banning nearly all cigarette shipments.

Also, in June 2014, the FedEx board created a committee to investigate allegations contained in a demand letter sent by a different stockholder requesting that the company bring claims against FedEx directors and officers arising from the allegedly illegal cigarette shipping practices. The 2014 demand committee released a report in 2019 detailing its findings and ultimately concluded it was not in the best interests of FedEx to bring a lawsuit against its directors and officers.

Analyzing demand futility under *Rales v. Blasband*, 634 A.2d 927 (Del. 1993), the court noted that the plaintiff was required to plead particularized facts sufficient to create a reasonable inference that a majority of the demand board faced a "substantial likelihood of liability" for his or her role in the alleged corporate wrongdoing. In order to plead a derivative claim for director oversight liability under *Caremark*, a plaintiff must sufficiently allege either that (i) the directors utterly failed to implement any reporting or information system or controls; or (ii) having implemented such controls, the directors consciously failed to monitor or oversee their operation.

The plaintiff focused on the second prong of *Caremark* and alleged that the board consciously ignored "red flags" related to the illegal cigarette shipments. The court found that the plaintiff's "conclusory allegation" ignored other facts alleged in the pleading, including that (i) the board was kept apprised of ongoing enforcement actions from inception through settlement, having been updated on at least 11 separate occasions in a two-year period; (ii) the board formed the 2014 demand committee and deferred to its conclusions; (iii) company personnel were reprimanded by management for issues related to the illegal shipments; (iv) the company banned nearly all tobacco shipments by at least April 2016; and (v) the company introduced a training program and implemented measures to increase detection of illegal shipments following the December 2018 settlement of the New York litigation.

Among other things, the court found that the 2014 demand committee's decision to defer its final recommendation until after the conclusion of the New York litigation was a matter of business judgment and fell "well short" of supporting an inference of bad faith. The court also rejected the argument that the 2016 and 2018 remediation measures came too late, observing that it was appropriate for boards to take into account the implications of board-level decisions on the company's defenses in ongoing litigation. Accordingly, the board's decision to allow the investigations and litigations to play out prior to making any determinations regarding remediation measures was also a matter of business judgment. The court further noted that the lack of detail in board minutes specifically discussing remediation measures was "not surprising given the Board's appreciation that the Company was defending, not admitting, the claims and that subpoenas … were inbound on a regular basis." The court concluded that "[d]oing anything more … could have easily put at risk FedEx's defense in the ongoing enforcement actions."

Thus, the court found that the plaintiff had failed to plead that demand was excused and dismissed the claims under Rule 23.1.

The case is currently on appeal before the Delaware Supreme Court.

Court of Chancery Dismisses Derivative Claims for Lack of Standing

In re SmileDirectClub, Inc. Derivative Litig., C.A. No. 2019-0940-MTZ (Del. Ch. May 28, 2021)
View the opinion.

The Court of Chancery dismissed breach of fiduciary duty claims, concluding that the plaintiffs did not have standing to bring derivative claims challenging a transaction the terms of which were established before the plaintiffs purchased stock.

From September 11 through September 16, 2019, SmileDirectClub (SDC) held an initial public offering (the IPO). The plaintiffs acquired their shares through the IPO on September 12. In connection with the IPO, SDC's prospectus (the Prospectus) disclosed that SDC intended to use the IPO proceeds to repurchase the earlier investments of the board members and their affiliated entities at the IPO price (the Insider Transactions) and doing so would dilute its public stockholders. The Prospectus explained that the Insider Transactions would occur automatically if the IPO raised sufficient funds. The IPO was successful, so on the day it closed, SDC used most of the IPO's proceeds to execute the Insider Transactions. The plaintiffs asserted derivative claims alleging that the members of SDC's board of directors breached their fiduciary duties by causing SDC to pay an excessively high price to consummate insider transactions that benefitted the board members. The defendant board members moved to dismiss, arguing that the plaintiffs lacked standing to pursue their derivative claims.

The court preliminarily noted that "Section 327 [of the Delaware General Corporation Law] is clear that stock ownership at the time of challenged conduct is a prerequisite to maintaining a derivative action." Thus, to have standing to assert their derivative claims, the plaintiffs must have been SDC stockholders at the time of the challenged conduct. The defendants argued that the plaintiffs could not challenge the Insider Transactions, including the price at which they were carried out, because their terms were determined before the IPO through which the

plaintiffs bought their stock and were implemented automatically upon the IPO's closing, as fully disclosed in the Prospectus. The plaintiffs contended that SDC's repurchase of the insider's equity did not take place until September 16, 2019, and they "became stockholders four days before the crucial event giving rise to [their] claims."

The court observed that Delaware Supreme Court case *7547 Partners v. Beck*, 682 A.2d 160 (Del. 1996), articulated the general rule that "when the terms of a transaction are established — not when the transaction is carried out — is the proper time for assessing whether a breach of fiduciary duty occurred." Thus, the court measures standing from the board's approval of a transaction when the board's post-decision actions "were simply a matter of implementing a transaction with previously fixed terms." The court concluded that the Insider Transactions fell squarely within *Beck*, as SDC did exactly what it said it would do in the Prospectus — consummate the Insider Transactions at the predetermined price. Thus, the alleged breach occurred upon approval of the Insider Transactions, before the plaintiffs became stockholders. As a result, the court granted the defendants' motion to dismiss for lack of derivative standing.

The case is currently on appeal before the Delaware Supreme Court.

Extraterritoriality

Second Circuit Reverses Dismissal of Breach of Contract Case Arising From Delisting of Cryptocurrency

Barron v. Helbiz, Inc., No. 21-278 (2d Cir. Oct. 4, 2021)
View the opinion.

In a summary order, the Second Circuit reversed the Southern District of New York's dismissal of a putative class action lawsuit brought under New York common and statutory law alleging that, in connection with an initial coin offering, a cryptocurrency company and several of its founding executive officers participated in a "pump and dump" scheme and misled investors. The offering was for a new cryptocurrency, which the defendants claimed would be the sole currency used on a new transportation rental platform. The platform was ultimately never created, and the value of the currency dropped until the defendants announced they were delisting the currency from cryptocurrency exchanges and offering repayment in a different cryptocurrency. The plaintiffs alleged that the defendants breached promises that induced the proposed class of investors to participate in the offering.

The Southern District of New York dismissed the complaint, relying upon *Morrison v. National Australia Bank Ltd*., 561 U.S. 247 (2010), because the case involved "neither securities listed on a domestic exchange nor domestic purchases of securities" and therefore Section 10(b) of the Securities Exchange Act did not reach the conduct at issue. However, the Second Circuit unanimously held that the lower court erroneously applied *Morrison* because the plaintiffs did not allege any Section 10(b) violations. The Second Circuit rejected the defendants' argument that the plaintiffs' claims were substantively federal securities claims. The Second Circuit found that the complaint, read in the light most favorable to the plaintiffs, alleged that the defendants made certain promises that induced the plaintiffs to buy the cryptocurrency "and regardless whether those promises were known to the Defendants to be false at the time they were made, Defendants ultimately did not fulfil them." The Second Circuit also determined that the lower court erroneously failed to analyze the plaintiffs' claims arising under state law. Finally, the Second Circuit concluded that the lower court abused its discretion by not granting leave to amend the complaint to establish that a purchase was made domestically, which "could cure potential jurisdictional defects or federal and state law extraterritorial concerns."

Loss Causation

Ninth Circuit Affirms Dismissal of Securities Fraud Action, Holds Plaintiff Did Not Adequately Plead Loss Causation

Irving Firemen's Relief & Ret. Fund v. Uber Techs., Inc., No. 19-16667 (9th Cir. May 19, 2021)
View the opinion.

The Ninth Circuit affirmed the dismissal of a securities fraud action against Uber and its founder Travis Kalanick, holding that the plaintiff failed to adequately plead loss causation.

The plaintiff, a purported Uber shareholder, brought securities fraud claims under California's Corporate Securities Law, alleging that Uber and Kalanick misled investors by concealing material risks to their business, including the employment of illegal business practices, which allowed them to sell Uber securities at inflated prices before the resulting scandals surfaced. The district court dismissed the plaintiff's complaint, concluding that the plaintiff had failed to adequately allege a false or misleading statement, or loss causation.

The Ninth Circuit affirmed the dismissal on loss causation grounds. The court first noted that because the parties failed to cite the appropriate standard for pleading loss causation under California law, the court would apply the federal standard. Under that standard, the court determined that the complaint failed to adequately allege that Uber and Kalanick's alleged misstatements caused the plaintiff's alleged losses. The court explained

that even assuming the alleged corrective disclosures — news articles, a lawsuit and the disclosure of government investigations — revealed the truth about Uber's alleged illegal business practices, the plaintiff failed to link the year-long decline in Uber's valuation to any of those disclosures.

SDNY Grants Computer Hardware Company's Motion To Dismiss for Failure To Plead Loss Causation

Boluka Garment Co. v. Canaan Inc., No. 20-CV-7139 (JPO) (S.D.N.Y. July 8, 2021)
View the opinion.

Judge J. Paul Oetken granted a motion to dismiss investors' claims under Sections 10(b) and Section 20(a) of the Securities Exchange Act and Sections 11 and 15 of the Securities Act against a company that designs and manufactures computer hardware used for mining Bitcoin in connection with its initial public offering. The plaintiffs alleged that the company failed to disclose three related-party transactions: (i) a shareholder's position as a senior executive of the company; (ii) the company's dealings with an entity controlled in part by two of the company's directors; and (iii) the company's $150 million deal it made with another entity controlled by a shareholder.

The court dismissed the plaintiffs' first two claims under Section 10(b) of the Securities Exchange Act for failure to plead loss causation and under Section 11 of the Securities Act because of "negative causation." The court found that the plaintiffs had failed to plead loss causation because the alleged corrective disclosure — a report published a few months after the company's IPO by a short seller that accused the company of deceptive business practices — did not say anything about the shareholder's position as a senior executive of the company or about the company's dealings with an entity controlled in part by two of the company's directors. General accusations that the company failed to disclose related-party transactions were insufficient to adequately allege loss causation. The court also found that these general accusations were not enough to save the plaintiffs' Section 11 claim because their losses could not be tied to the omission of these facts from the offering documents.

The court dismissed the plaintiffs' third claim under Section 10(b) of the Securities Exchange Act and Section 11 of the Securities Act for failure to plead materiality. It found that the agreement in question — a $150 million deal the company made with a third-party entity controlled by one of the shareholders — was nonbinding and therefore the probability of any specific impact on the company's financials at the time of the registration statement's filing was so low or uncertain that it rendered the transaction immaterial.

Merger Litigation

Court of Chancery Grants Motions To Dismiss Stockholder Challenge to Acquisition Under *Corwin*

In re GGP, Inc. S'holder Litig., Consol. C.A. No. 2018-0267-JRS (Del. Ch. May 25, 2021)
View the opinion.

The Court of Chancery granted motions to dismiss breach of fiduciary duty, aiding and abetting and unjust enrichment claims under *Corwin* in stockholder litigation challenging the acquisition of GGP, Inc. by its alleged controlling stockholder, Brookfield.

In 2009, Brookfield acquired 35.3% of GGP's stock as a "friendly bidder." The companies then entered a standstill agreement and an investment agreement giving Brookfield the right to designate three nominees for the nine-member GGP board so long as it maintained at least 20% ownership in GGP. After GGP revised its projections downward in 2017, Brookfield sent an unsolicited offer to acquire the GGP shares it did not yet own, and proposed that (i) an independent committee evaluate the transaction; and (ii) the transaction be approved by a majority of the stock unaffiliated with Brookfield. A special committee composed of five non-Brookfield directors was formed. After 30 meetings and the extraction of several increases, followed by an agreement on price and 12 more meetings to conduct due diligence, the special committee recommended that the GGP board of directors approve the transaction, which it did. The transaction was later approved by approximately 94% of non-Brookfield stockholders. The stockholder plaintiffs obtained books and records through a Section 220 action and then filed suit, alleging that the acquisition was a conflicted, controlling stockholder transaction and that GGP stockholders were coerced and not fully informed.

The court rejected the plaintiffs' characterization of Brookfield as GGP's controlling stockholder. First, the court held that the plaintiffs failed to plead that Brookfield dominated the special committee or exerted control over the transaction, noting that the plaintiffs, at best, pled that two of the five directors on the committee were conflicted. Second, the court found that the plaintiffs failed to adequately plead that Brookfield controlled GGP generally. In reaching this conclusion, the court rejected the plaintiffs' argument that Brookfield should be treated as a controlling stockholder because Brookfield was permitted by the standstill agreement to increase its position to 45%.

The court then applied *Corwin*, holding that the vote of the unaffiliated stockholders was both fully informed and uncoerced,

and thus the business judgment rule was the operative standard of review. In analyzing the defendants' *Corwin* defense, the court rejected a series of alleged disclosure violations, stating that the disclosures in the proxy statement have to be "sufficient," not "perfect." The court held, among other things, that defendants were not required to disclose that the audit committee meeting approving the transaction lasted only five minutes, because the audit committee members were also special committee members involved in negotiating the transaction and disclosing the duration of the meeting would have "misled" stockholders. The court further rejected allegations regarding tax disclosures, noting that the proxy statement directed the stockholders to consult their tax advisers and that Delaware law does not require fiduciaries to provide individualized tax advice. The court also rejected the plaintiffs' concern that the meeting minutes were less detailed than the proxy statement and stated that it would be a "titanic waste of resources" to include such detail in meeting minutes. Additionally, the court found that the proxy statement had accurately disclosed that GGP's CEO was entitled to severance payments and was the beneficiary of post-closing employment, which he had negotiated shortly before the merger agreement was signed.

Because *Corwin* insulated the transaction from attack and the plaintiffs failed to adequately plead waste, the breach of fiduciary duty and related claims failed.

The case is currently on appeal before the Delaware Supreme Court.

PSLRA

Ninth Circuit Vacates Appointment of Lead Plaintiff, Holds District Court Failed To Properly Apply PSLRA's Lead Plaintiff Presumption

In re Mersho, No. 20-73819 (9th Cir. July 23, 2021)
View the opinion.

The Ninth Circuit granted in part a petition for a writ of *mandamus* in a decision that provides additional guidance regarding the Private Securities Litigation Reform Act's (PSLRA) presumption that the plaintiff with the largest financial interest should become the lead plaintiff in a securities fraud class action.

In the underlying action, the plaintiffs, purported shareholders of Nikola Corporation, alleged that they suffered losses from buying Nikola securities in reliance on allegedly false statements contained in the company's advertising materials. Petitioners Mersho, Chau and Karczynski moved for appointment as lead plaintiffs under the name Nikola Investor Group II (Group II). Of the various contenders for lead plaintiff status, Mersho and Chau had the first- and second-largest financial interest, respectively, in Nikola, and Karczynski had the fourth-largest stake.

Despite Group II's sizable financial stake in the lawsuit, the district court rejected Group II as inadequate, citing concerns that (i) Group II was a group of unrelated individuals brought together by counsel; (ii) the group wished to appoint four separate law firms as co-lead counsel; (iii) the group's filings were full of basic errors that suggested counsel was running the litigation rather than the individuals; and (iv) Group II had not shown it was a cohesive group despite its members being geographically diverse and unconnected.

Group II petitioned for a writ of *mandamus*, arguing that the district court clearly erred by (i) failing to point to evidence supporting its decision to override the PSLRA's presumption that the shareholder group with the largest financial stake in the litigation should be appointed lead plaintiffs; and (ii) relying on Group II's failure to put forward affirmative proof that it was internally cohesive and not dominated by counsel.

The Ninth Circuit granted the writ in part, vacating the district court's appointment of a different shareholder with a smaller financial stake and remanding for the district court to reconsider its lead plaintiff decision.

The Ninth Circuit held that the district court clearly erred by improperly applying the PSLRA's presumption that the movant with the largest financial interest and who has made a *prima facie* showing of adequacy and typicality should be the presumptive lead plaintiff. That presumption can be rebutted "only upon proof by a member of the purported plaintiff class that the presumptively most adequate plaintiff … will not fairly and adequately protect the interests of the class; or … is subject to unique defenses that render such plaintiff incapable of adequately representing the class." The panel held that the district court did not give effect to the presumption when it placed the burden on Group II to prove adequacy rather than shifting the burden to competing movants to show inadequacy. The panel concluded that the district court's "misgivings" were not the type of evidence that cast genuine and serious doubt on Group II's willingness or ability to perform the functions of lead plaintiffs, and that although courts have "latitude" in what kind of information they consider to assess adequacy, their analysis still must hew to the legal standard prescribed by the PSLRA and articulate how the evidence cited proves inadequacy.

Inside the Courts
An Update From Skadden Securities Litigators

Reliance

Ninth Circuit Reverses Denial of Summary Judgment, Clarifies Limits of Affiliated Ute Presumption of Reliance

In re Volkswagen "Clean Diesel" Mktg., Sales Pracs., & Prods. Liab. Litig., No. 20-15564 (9th Cir. June 25, 2021)
View the opinion.

The Ninth Circuit reversed a district court's denial of summary judgment to a defendant in a putative securities fraud class action in a decision that provides further guidance on the limits of the *Affiliated Ute* presumption of reliance.

The plaintiff, a purported Volkswagen bondholder, brought suit under Section 10(b) of the Securities Exchange Act and SEC Rule 10b-5 thereunder alleging that Volkswagen misled investors by concealing its purported installation of so-called "defeat devices" in its diesel vehicles to mask high emissions from regulators and evade emissions tests. Volkswagen moved for summary judgment on the ground that the plaintiff failed to prove that it had relied on any alleged misstatements or omissions. The district court denied Volkswagen's motion, concluding that under the Supreme Court's decision in *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128 (1972), which held that reliance may be presumed when a fraud consists of omissions rather than misstatements, the plaintiff was entitled to a presumption of reliance. Volkswagen sought and received permission to file an interlocutory appeal.

The Ninth Circuit reversed, holding that the district court erred in applying the *Affiliated Ute* presumption to the allegations in the case. The court reasoned that the plaintiff's claims were more properly characterized as "positive misrepresentation" claims rather than omissions claims. The court noted that the plaintiff alleged more than nine pages of affirmative representations made by Volkswagen and claimed that those affirmative representations were rendered misleading because Volkswagen omitted to disclose that it had employed "defeat devices." But the fact that an allegedly false or misleading statement omits the allegedly "true" facts, the court explained, does not transform an affirmative misrepresentation into an omission. After all, all misrepresentations could be characterized as omissions to the extent they fail to disclose the "true" facts that the statement misrepresents. If that were sufficient to characterize a "positive representation" as an omission, then *Affiliated Ute*'s presumption of reliance would apply to all securities fraud claims — both affirmative representations and omissions — a result which the court declined to endorse.

SEC Enforcement Actions

DC Circuit Denies Challenge to SEC Rule Barring Entities Subject To Consent Decrees From Publicly Denying Charges

Cato Inst. v. SEC, No. 20-5054 (D.C. Cir. July 6, 2021)
View the opinion.

The District of Columbia Circuit Court of Appeals held that the Cato Institute lacked standing to bring a constitutional challenge to a Securities and Exchange Commission (SEC or the Agency) rule barring entities that enter into consent decrees with the Agency from publicly denying the charges against them (the no-deny policy). The no-deny policy, codified at 17 C.F.R. § 202.5(e), requires the SEC "not to permit a defendant or respondent to consent to a judgment or order that imposes a sanction while denying the allegations in the complaint or order for proceedings," so as "to avoid creating, or permitting to be created, an impression that a decree is being entered or a sanction imposed, when the conduct alleged did not, in fact, occur."

The plaintiff in this case, Cato, brought suit against the SEC, the SEC's chairman and the SEC's secretary alleging that its practice of including no-deny provisions in its consent decrees violated the First Amendment. Although Cato itself did not enter into any consent decrees with the Agency, Cato entered into a contract to publish a manuscript authored by an individual who was himself subject to an SEC consent decree. Cato alleged that it could not publish the author's manuscript because the manuscript contained statements from the author disputing the allegations the SEC made against him. Such statements were prohibited by the no-deny policy as incorporated in the author's consent decree. Cato also alleged that it had been contacted by other individuals who entered into similar consent decrees with the SEC. But for these consent decrees, Cato claimed, these individuals would have otherwise been willing to participate in Cato's panel discussions addressing the topic of the SEC's prosecutorial overreach or would have allowed Cato to publish their testimonials in articles and blog posts.

Cato sought a permanent injunction against the Agency's enforcement of 17 C.F.R. § 202.5(e) and a permanent injunction prohibiting the SEC from continuing its practice of nondiscretionary use of no-deny provisions in civil and administrative settlements. Cato also sought declaratory judgments holding that (i) 17 C.F.R. § 202.5(e) was unconstitutional under the First Amendment; (ii) the no-deny provision of the consent decree entered into by the manuscript's author was unenforceable as a matter of law; and (iii) all no-deny provisions in the SEC's past consent decrees are unenforceable.

The federal district court dismissed Cato's complaint for lack of standing, concluding that Cato failed to allege an injury in fact because the SEC's no-deny provisions did not directly apply to Cato. The district court also found that Cato failed to adequately allege an "actual impediment" to its exercise of several activities, such as Cato's contractual rights to publish the book, its sponsorship of a panel discussion or its promotional activities. The court further found Cato had not alleged that the SEC threatened or "even contemplated" specific action against it, or that Cato had been denied the right to receive information from others. Cato appealed.

On appeal, in a *per curiam* decision, the D.C. Circuit affirmed the dismissal on the alternative ground that Cato lacked standing because it failed to show that its injury would be redressed by the relief it sought. The court explained that even if it were to enjoin the SEC from enforcing the no-deny provisions, courts would nonetheless still be able to enforce the provisions of consent decrees entered by defendants in SEC actions, as they are judicial decrees. The court highlighted that courts could enforce the no-deny provisions of the consent decrees without the consent of the SEC — meaning that, for example, courts could institute criminal contempt proceedings against defendants who violated no-deny provisions in their consent decrees without the involvement of the SEC. Thus, the defendants Cato sought to protect would ultimately still be unable to publish their speech even if the SEC was enjoined, meaning that Cato's injury was not redressable.

Securities Fraud Pleading Standards

Misrepresentations and Omissions

Seventh Circuit Affirms Dismissal of Putative Securities Class Action

City of Taylor Police & Fire Ret. Sys. v. Zebra Techs. Corp.,
No. 20-3258 (7th Cir. Aug. 10, 2021)
View the opinion.

Zebra Technologies Corporation (Zebra) manufactures commercial electronics, such as barcode scanners. In 2014, Zebra acquired a division of Motorola Solutions, Inc. that manufactured similar products. While Zebra executives announced that the consolidation was "progressing as planned," the plaintiff shareholder alleged that it caused an additional expense of $200 million and led to a decline in Zebra's stock price.

The plaintiff filed suit under Section 10(b) of the Securities Exchange Act and Rule 10b-5, arguing that the defendants knowingly issued false statements about the integration. The district court found that the plaintiff failed to satisfy the pleading requirements of the Private Securities Litigation Reform Act, and the plaintiff appealed. The Seventh Circuit, finding that the plaintiff failed to identify "untrue statement[s] of material fact" and to adequately plead scienter, affirmed the decision.

The plaintiff identified a number of alleged misrepresentations, including a variety of allegedly optimistic projections such as cost-savings estimates and profit margin projections. It further argued that the defendants made misrepresentations by failing to disclose problems with the integration.

The Seventh Circuit held that failure to disclose integration costs when discussing the cost-savings projections did not make the company's statements false because the projected cost savings were unrelated to the one-time costs of integration. Zebra was not required to disclose the costs of integration merely because it had disclosed other projected cost savings. Likewise, the court held that Zebra's profit margin projections, which were off by just over one percentage point, were not fraudulent. The court stated that the Securities Exchange Act "does not demand perfection from forecasts, which are inevitably inaccurate."

Finally, the court affirmed the district court's holding that a Zebra executive's statement that the integration was "progressing as planned" was nonactionable puffery because it did not make "concrete assertion[s]" and merely expressed "vague optimism." Additionally, the statement was not false because Zebra ultimately completed the consolidation.

The Seventh Circuit also found that the plaintiff failed adequately to allege scienter because the inference that the executives' early optimistic statements about the consolidation stemmed from limited information about the Motorola business was at least as compelling as the inference that they had fraudulent intent. The sequence of Zebra's statements about the integration supported an inference that the company was learning about challenges over time rather than intending to defraud investors.

The court noted that "[e]xecutives possess only limited information about the internal workings of other corporations … and the full extent of any roadblocks would take time to come to light." It held that the Securities Exchange Act should not be read to apply the same standards of accuracy to retrospective statements and to ongoing processes. Statements about developing processes are more similar to forecasts than they are to statements about existing facts. The securities laws look more leniently on statements about the unknowable than the known.

Having found that the complaint failed to state a viable claim, the Seventh Circuit affirmed the Northern District of Illinois' dismissal of the case.

First Circuit Affirms Denial of Motion To Amend Securities Fraud Claims Against Pharmaceutical Company

Karth v. Keryx Biopharmaceuticals, Inc., No. 19-1964 (1st Cir. July 9, 2021)
View the opinion.

The First Circuit affirmed the denial of a motion to amend claims brought by a putative class of investors under Sections 10(b) and 20(a) of the Securities Exchange Act, alleging that a pharmaceutical company failed to adequately disclose the risk of supply chain interruptions from the company's reliance on a single contract manufacturer for a necessary component of its drug product. The lower court found that the company had made relevant disclosures in SEC filings before the plaintiff purchased his stocks, and he therefore could neither be a representative of the purported class nor allege that he relied upon misleading statements.

The First Circuit determined that the company's risk disclosures about a potential supply chain interruption were not adequately alleged to be misleading because the plaintiff failed to plead that an interruption actually occurred or that one was close to a "near certainty" or that the production problems that were alleged had in any way impacted the company's revenue. The First Circuit reasoned that a "risk disclosure is not fraudulent simply because a company makes reasonable assumptions that, in retrospect, prove incorrect." The court further determined that the company's risk disclosures specifically identified the risk of using a single manufacturer who could fail to produce enough product to meet demand and warned investors that if such a risk materialized, it could result in a loss of revenue.

Ninth Circuit Reverses in Part District Court's Dismissal of Securities Claims, Holds That Plaintiff Adequately Pled Falsity and Scienter

In re Alphabet, Inc. Sec. Litig., No. 20-15638 (9th Cir. June 16, 2021)
View the opinion.

The Ninth Circuit affirmed in part and reversed in part the district court's dismissal of securities fraud claims brought against Google and its parent company, Alphabet, Inc.

The plaintiff brought securities fraud claims under Section 10(b) of the Securities Exchange Act and SEC Rule 10b-5 thereunder alleging that Google concealed from investors a security glitch that allowed third-party developers to obtain private data from users of Google's Google+ social network. The plaintiff argued that Google's failure to disclose the security glitch made certain public statements that there had been no material changes to Google's risk factors since 2017 false and misleading. The district court dismissed the complaint, concluding that the plaintiff had failed to adequately allege falsity or scienter.

The Ninth Circuit largely reversed. The court held that the complaint adequately alleged that Google's statements in its April and July 2018 Form 10-Qs that there had been no material changes to its risk factors since its 2017 annual report were materially misleading and that the plaintiff had sufficiently pled that Google made these statements with scienter. The court first concluded the statements at issue were material based on the harm to Google's reputation and to users' trust that were both (i) predicted in Google's own risk disclosures and an internal memorandum regarding the security glitch; and (ii) actually occurred after the risk materialized. The court then concluded that the statements were misleading because Google's risk disclosures spoke of as-of-yet unrealized risks and contingencies, despite the fact that the risks had already come to fruition. Finally, the court concluded that the complaint sufficiently alleged scienter, as it contained specific allegations that senior executives were informed about the security glitch and were warned of the consequences of disclosure, and that Google's fully informed leadership intentionally did not disclose the security glitch.

The court did, however, conclude that the complaint failed to adequately allege the falsity of 10 other statements contained in the complaint because those statements involved vague and generalized corporate commitments, aspirations or puffery that were insufficient to support liability under Section 10(b).

Finally, because the district court erred by *sua sponte* dismissing the plaintiff's scheme liability claims under Rule 10b-5(a) and (c) when Google/Alphabet had not targeted those claims in their motion to dismiss, the court reversed the dismissal of the claims under Section 10(b) and Rule 10b-5(a) and (c) against all defendants and remanded to the district court.

New York Supreme Court Dismisses Investors' Securities Act Claims Against Cannabis Company

Leung v. Hexo Corp., No. 150444/2020 (NY. Sup. Ct. June 3, 2021)
View the opinion.

Judge Andrew Borrok dismissed claims brought by investors alleging violations of Sections 11 and 15 of the Securities Act against a cannabis company, alleging that the company misled investors in connection with its initial public offering regarding one of its key supply agreements with a Canadian government-run dispensary.

The court found that the plaintiffs failed to identify any contemporaneous facts showing that the company "knew at the time of the [offering]" of the issues that came about with respect to the government-run cannabis dispensary's ability to meet its purchase commitments. The court stated that "whether a statement is materially false or misleading is viewed at the time such statement is made – not retroactively, in hindsight." The court also held that that the alleged misrepresentations in the offering documents were barred under the bespeaks caution doctrine because the documents contained "ample cautionary statements." The offering documents warned investors, among other things, that if the government-run cannabis dispensary decided to purchase a lower volume of products from the company than the company anticipated, altered its purchasing patterns or decided not to continue to purchase products at all, the company's revenues could be negatively impacted. Finally, the court determined that the plaintiffs failed to state a claim under Regulation S-K because they failed to allege any facts that "were known or should be known which rendered the offering documents materially misleading at the time they were issued."

A substantially similar case, *In re HEXO Corp. Securities Litigation*, was dismissed by Judge Naomi R. Buchwald of the U.S. District Court for the Southern District of New York in March. For details, see our June 2021 edition of *Inside the Courts*.

D. Mass Dismisses Securities Fraud Class Action Against Pharmaceutical Company

In re: Karyopharm Therapeutics Inc., Sec. Litig., No. 19-11972-NMG (D. Mass. July 21, 2021)
View the opinion.

Judge Nathaniel M. Gorton dismissed claims brought by investors of a pharmaceutical company under Sections 11 and 15 of the Securities Act and Sections 10(b) and 20(a) of the Securities Exchange Act alleging that the company made several misrepresentations and omissions about its leading cancer drug's toxicity, safety and efficacy. The plaintiffs alleged that the company made misleading statements about the results of two clinical trials and the company's submission of a new drug application to the Food and Drug Administration (FDA).

The court dismissed the claims for failure to adequately allege a material misrepresentation or omission. With respect to the first clinical trial, the court found that the company made disclosures that "adequately provided its investors with an overall picture of the safety and efficacy of [the drug] in the context of the [clinical] trial." The disclosure showed that patients who took the drug had a worse overall survival rate compared to the control group and no reasonable investor would have understood the company to be claiming that the trial showed a better overall survival rate for the drug-treated patients. The court also rejected the plaintiff's allegations that the company failed to disclose other trial results, including medial overall survival rates and certain adverse events, reasoning that the company "has no affirmative duty to disclose every piece of information in its possession in which an investor may have an interest" where it provided an overall picture of the safety and efficacy of its drug.

With respect to the second clinical trial, the court found that the company's statements touting the success of the trial were arguably misleading because the company failed to disclose sufficient information about the drug's toxicity, including that 100% of the enrolled patients experienced adverse events, nearly 60% experienced a severe adverse event, more than 25% of patients discontinued the drug and 18 patients had died. Finally, with respect to the plaintiff's claim that the company's disclosures about real world data submitted with the company's nondisclosure agreement were misleading, the court found that any scientific disagreement between the company and the FDA about the interpretation of the new world data was not actionable as securities fraud.

The court also determined that the plaintiffs failed to adequately plead scienter. The plaintiff's reliance on the accounts of four former company employees was insufficient because none of their allegations demonstrated any motive to mislead investors and none of the former employees had any contact with the individual defendants or anyone else involved in preparing the allegedly misleading statements. The court also found that the company did not act with scienter in omitting certain toxicity and safety data from the second clinical trial because a reasonable investor would understand that the use of the drug in a cohort of patients that were very ill would result in adverse events, and thus it was not "so obvious" that the disclosures "posed a danger of misleading the market."

SDNY Dismisses Claims That Clothing Company Misled Investors Regarding Future Demand and Timing of Customer Purchases

Cheng v. Can. Goose Holdings Inc., No. 19-CV-8204 (VSB) (S.D.N.Y. July 19, 2021)
View the opinion.

Judge Vernon S. Broderick dismissed claims brought by a class of investors under Section 10(b) of the Securities Exchange Act against a clothing company known for its cold-weather gear. The plaintiffs alleged that the company made false and misleading statements regarding the timing of customers' purchases and inventory and demand.

The plaintiffs alleged that the company failed to disclose that customers in its "direct-to-customer" channel were purchasing heavier parka jackets earlier in the year, leading to "disproportionately fewer" people purchasing them in the third and fourth fiscal quarters when the company typically generated its most revenue. The court determined that the company disclosed that "significantly more purchasing" occurred earlier in the year and also warned investors that growth in the "direct-to-customer" channel would be slowed for the rest of the fiscal year. The court further determined that, absent allegations that the company possessed but withheld more negative information related to the change in timing of customer purchases sufficient to make their prior disclosures legally deficient, the plaintiffs could not plausibly allege that the company withheld material information about the customer purchases.

The court also found the company's statements regarding inventory and demand nonactionable. The plaintiffs did not allege that any of the financial information that the company disclosed throughout the class period was inaccurate. The plaintiffs failed to allege any plausible facts that the company's statements that it was building demand ahead of supply were misleading or false at the time the statements were made. The "more realistic explanation" was that the company was building demand ahead of supply and then changed course given changing market conditions. The court determined that the company's revenue projections were in line with previous estimates and the plaintiffs did not allege any facts showing that the company knew but did not disclose revenue projections that were smaller than historical trends.

The court also determined that the plaintiffs failed to adequately allege scienter. Allegations of high-ranking positions are not dispositive of scienter. General motives or desire to have a strong direct-to-consumer channel and be perceived as a hyper-growth company were insufficient because those are motives possessed by all corporate insiders. Stock sales that occurred six months before the alleged falsity represented only about 7% of total holdings and sold in a preplanned secondary equity offering were not unusual or suspicious. Finally, the company's decision to change inventory plans in the face of changing market conditions was not probative of scienter because "businesses should be encouraged to innovate and change course when necessary."

EDNY Dismisses Securities Fraud Claims Against Car Manufacturer for Failure To Plead an Underlying Violation of Law

Mucha v. Volkswagen Aktiengesellschaft, No. 17-cv-5092 (DLI)(PK) (E.D.N.Y. May 20, 2021)
View the opinion.

Judge Dora L. Irizarry dismissed claims brought by a putative class of investors asserting violations of Sections 10(b) and 20(a) of the Securities Exchange Act, alleging that an automobile manufacturer made certain statements about competition, pricing, manufacturing and compliance that were rendered false or misleading by the company's alleged engagement in unlawful anticompetitive behavior with other automotive manufacturers.

The court determined that the plaintiff failed to adequately allege any false or misleading statement. The plaintiffs failed to identify any specific laws that the company violated or how the alleged cooperation with other automobile manufacturers violated any such laws. The court noted that a federal district court in California had dismissed a complaint alleging the same conduct as insufficient to state a claim under the Sherman Act. The court therefore found that the failure to identify a specific law that was violated was fatal to the amended complaint. The court also found that, even if the underlying allegations of anticompetitive conduct were true, the challenged statements concerning commodity prices and manufacturing inputs, as well as the company's aspirational statements about compliance and ethics, were inactionable general puffery. The court also held that certain internal accounting standards did not require the company to disclose the allegedly unlawful conduct before the initiation of an investigation and the company's statements regarding compliance with International Financial Reporting Standards alone did not create a duty to disclose. The court found, however, that the company had a duty to disclose the alleged anticompetitive conduct when it chose to speak about the competitive environment it was facing and its success in that environment.

The court nevertheless determined that the plaintiff failed to adequately allege scienter. Emails between the manufacturers' employees discussing what aspects of their cooperation could raise issues under competition law did not raise a strong inference of scienter because at most the emails suggested that some individuals of the company of "unknown seniority" were not "completely comfortable" with certain aspects of their cooperation. Allegations of micromanaging were too conclusory to support a strong inference of scienter. The plaintiffs also did not adequately allege that the cooperation among the manufacturers was so pervasive that scienter could be attributed to the company.

Inside the Courts
An Update From Skadden Securities Litigators

Scienter

Sixth Circuit Affirms Dismissal of Putative Securities Class Action

Pittman v. Unum Grp., No. 20-5710 (6th Cir. June 28, 2021)
View the opinion.

The Sixth Circuit affirmed a district court decision to dismiss a putative class action against Unum Group. Unum Group is an insurance company that sells long-term care policies aimed at individuals who may require a residential nursing home. The policies proved to be less profitable than expected and Unum's share price fell. The company's investors filed suit, alleging violations of the Securities Exchange Act.

The plaintiffs' suit focused on Unum's decision to establish a reserve fund to cover liabilities stemming from the long-term care policies. Shortly after the fund was established, Unum increased its reserves by nearly $700 million, concluding that its existing reserves were inadequate. At the same time, Unum announced that it was going to use an interest-adjusted loss ratio to determine whether more reserves were needed. If the ratio exceeded 90% for a "prolonged period," Unum would reassess its reserves. Over the next few years, the loss ratio exceeded 90% in five different quarters. When Unum subsequently announced that it would reassess its reserves, its share price fell nearly 17%. In response, Unum investors filed a putative class action against the company.

Unum filed a motion to dismiss the plaintiffs' suit, which the district court granted. On appeal, the Sixth Circuit affirmed the district court's decision, holding that the plaintiffs were unable to adequately allege scienter.

The plaintiffs' argument on scienter was based upon five allegations: (i) they claimed that Unum executives had extensive knowledge of the long-term care business and paid close attention to the policies; (ii) the plaintiffs asserted that Unum's executives made statements assuring investors that the long-term care business was performing fine, even though they had access to information showing otherwise; (iii) a 2013 lawsuit alleged that Unum improperly calculated benefits for its long-term care policyholders. Unum settled the lawsuit in 2015; (iv) the company's April 12, 2018, proxy statement contradicted Unum's May 2018 statements that it intended to reassess its reserves; and (v) the plaintiffs claimed Unum's executive compensation structure gave executives financial incentives to engage in fraud.

After reviewing the plaintiffs' allegations in their entirety, the Sixth Circuit held that any inference of scienter was not "at least as compelling as an opposing inference of nonfraudulent intent." The most compelling evidence of scienter was the length of time between allegedly inconsistent statements in the April 12, 2018, proxy statement and Unum's May 2018 statement. On that point, the Sixth Circuit noted that a three-week gap between inconsistent statements could provide moderate evidence for scienter. The Sixth Circuit also stated that an executive compensation structure promoting fraudulent metrics would boost scienter, but here, the bonuses were not tied to a single key metric. Further, the court found that all of the plaintiffs' other allegations did not support a finding of scienter. Thus, the Sixth Circuit affirmed the district court's decision to dismiss the suit.

SDNY Grants Beauty Product Company's Motion To Dismiss for Failure To Plead Scienter

Garrett-Evans v. Coty Inc., No. 20 Civ. 7277 (LLS) (S.D.N.Y. Aug. 3, 2021)
View the opinion.

Judge Louis L. Stanton granted a motion to dismiss claims brought by a putative class of investors against a beauty product company for alleged violations of Sections 10(b) and 20(a) of the Securities Exchange Act, alleging that the company made material omissions about the acquisition and integration of a recently acquired beauty business. The plaintiffs alleged that the company misled investors about the company's ill-preparedness to integrate this new business, causing a nearly $4 billion impairment of the value of its goodwill and intangible assets primarily attributable to its consumer beauty division.

The court dismissed the plaintiffs' claims for failure to plead scienter. It found that the defendants had adequately disclosed extant integration-related issues concerning the recently acquired beauty business soon after the acquisition was completed. The court rejected the plaintiffs' contention that the company failed to disclose the magnitude of the problem, reasoning that the company had continued disclosing issues integrating this new business as those problems arose throughout the class period and did not shy away from describing those problems as long term. As to statements about the company's preparation to capitalize on the acquisition using its digital and e-commerce marketing and sales capabilities, the court held that the company had repeatedly disclosed how much it had spent on marketing and its position that such expenditures were adequate because digital marketing had a greater return on investment.

Finally, as to the defendants' knowledge about when and whether the company would need to take the full $4 billon impairment, the court found that the defendants had not delayed the second impairment with conscious recklessness or fraudulent intent. The company's continued underperformance after the first impairment led the company to develop a formal turnaround

plan that included recording the second impairment. The court also rejected the plaintiffs' argument that the company's failure to timely take the second impairment violated GAAP principles and caused the company to understate operating and net loss and overstate goodwill and intangible assets on its balance sheet. The court found that allegations of a violation of GAAP provisions were not sufficient to state a securities fraud claim.

SLUSA

Eighth Circuit Affirms Dismissal of State Law Class Action as Barred by SLUSA

Knowles v. TD Ameritrade Holding Corp., No. 19-3684
(8th Cir. June 24, 2021)
View the opinion.

The Eighth Circuit affirmed the dismissal of a putative class action alleging claims under state law on the basis of preemption by the Securities Litigation Uniform Standards Act (SLUSA). The plaintiff's claims arise from an optional feature on his TD Ameritrade brokerage account. The plaintiff opted in to an optional tax-loss harvesting tool that TD Ameritrade offers for some of its investment accounts. The tool aims to offset taxes on capital gains by selling certain securities at a loss. The tool works by identifying if the securities in a customer's account have unrealized losses in excess of a set threshold. If the threshold is met, the tool automatically sells the securities at a loss. Typically, the tool promptly reinvests the proceeds of the sale in new securities. The plaintiff alleges that, on one occasion, the tool sold off a significant portion of his account but then failed to reinvest for 18 days. He alleges that this failure to reinvest cost him more than $16,000.

The plaintiff alleged that the failure to reinvest was caused by a glitch in the system designed to avoid violating the wash-sale rule, which prohibits investors from claiming a tax loss if they repurchase the same security within 30 days after selling the security at a loss. The tax-loss harvesting tool was set up to toggle between two groups of securities, so in cases when both groups experienced a loss, the tool lacked another set of securities to purchase after selling off securities at losses. The plaintiff filed a putative class action alleging state law breach of contract and negligence claims. The district court granted TD Ameritrade's motion to dismiss, reasoning that SLUSA preempted the plaintiff's putative state law class action.

On appeal, the Eighth Circuit considered the application of SLUSA to the plaintiff's claims. At issue was whether the plaintiff alleged a misrepresentation or omission by TD Ameritrade, which triggers SLUSA preemption. According to the plaintiff, the district court erred in applying SLUSA preemption because his claims were rooted in a breach of his agreement rather than any misrepresentation. The Eighth Circuit disagreed, noting that, to avoid SLUSA preemption, breach of contract claims must turn on interpretation of the contract and not allegations of misrepresentations or omissions. The court found that the plaintiff failed to demonstrate that his claims were based on a violation of any contractual provision. Instead, the crux of the plaintiff's claim was rooted in TD Ameritrade's alleged omissions regarding the operation of the tax-loss harvesting tool. Accordingly, the Eighth Circuit affirmed the district court's ruling that SLUSA preempted the class action claims.

Statutes of Repose/Statutes of Limitations

Eleventh Circuit Affirms Dismissal of Securities Class Action, Holds Equitable Tolling Does Not Apply to Claims at Issue

Fedance v. Harris, No. 20-12222 (11th Cir. June 21, 2021)
View the opinion.

The Eleventh Circuit affirmed the dismissal of a putative Securities Act class action, concluding that the complaint was untimely and the doctrine of equitable tolling did not apply to save it.

This case arose out of an initial coin offering by FLiKIO (FLiK), a corporation founded by Ryan Felton and co-owned by rapper Clifford Joseph Harris Jr. FLiK was in the business of developing an online viewing platform to connect content creators to consumers and allow creators to sell or rent their projects. To finance the development of the platform, FLiK offered for sale a cryptographic token called a "FLiK token." After launch, these coins could be used on the platform to purchase content. Because of their purported future utility, the tokens were not registered as securities.

The plaintiffs, purported owners of FLiK tokens, brought suit under Sections 12(a)(1) and 15(a) of the Securities Act, alleging that Felton and Harris sold unregistered securities in violation of Sections 5(a) and (c) of the Securities Act, that Harris acted as a "statutory seller" of unregistered securities and that Felton and Harris were liable as controlling persons of an entity that engaged in the sale of unregistered securities. The district court dismissed the plaintiffs' complaint as untimely, concluding that the Securities Act's one-year statute of limitations barred their claims.

The Eleventh Circuit affirmed the district court's dismissal. As a threshold matter, the court concluded that the district court erred by holding that Section 13 of the Securities Act, which governs the timeliness of claims brought under Sections 12(a)(1) and

15(a), foreclosed equitable tolling. The court held that while Section 13 creates a one-year limitations period and a three-year repose period, nothing in the text of Section 13 is inconsistent with the doctrine of equitable tolling. Therefore, the district court erred by holding that equitable tolling is never available to toll claims under Sections 12(a)(1) and 15(a).

Notwithstanding this threshold issue, the Eleventh Circuit held that the plaintiffs did not plausibly allege that fraudulent concealment prevented them from bringing their claims within the one-year limitations period.

The court first concluded that the FLiK tokens were securities under the test outlined in *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946), where the Supreme Court held that a scheme involving the investment of money in a common enterprise with profits to come solely from the efforts of others is an investment contract and therefore a security. The court then determined that the facts that led to the conclusion that the FLiK tokens were unregistered securities were available at the time the plaintiffs purchased the tokens. Because this information was available at the time of purchase, the one-year statute of limitations period to file suit for the sale of unregistered securities began when the plaintiffs bought the tokens. The plaintiffs failed to identify any fraudulent concealment on the part of Felton and Harris that prevented presumptive class members from discovering the predicate facts necessary to file suit and their suit was therefore untimely.

D. Mass Denies Motion To Dismiss Claims Against Venture Capital Firm on Statute of Limitation Grounds

Dahhan v. Ovascience, Inc., No. 1:17-cv-10511-IT
(D. Mass. May 28, 2021)
View the opinion.

Judge Indira Talwani denied a motion to dismiss the claim brought against a venture capital firm for alleged violations of Section 20(a) of the Securities Exchange Act in connection with the company's control over a fertility treatment company. The defendants argued that the two-year statute of limitations under the Securities Exchange Act began to run in 2015, when the fertility treatment company admitted that its sales were lower than expected, which was contrary to earlier statements.

The court stated that the complaint was timely because the statute of limitations did not begin to run with the fertility treatment company's 2015 admission; the statute began to run when the plaintiffs learned that the venture capital firm had actual control over the fertility treatment company. The court noted that while earlier publicly filed documents gave the plaintiffs notice to investigate the connection between the venture capital firm and the fertility treatment company, the statute only began to run once there was evidence that the firm actually controlled the company, and the court was unable to determine that the pleadings were untimely as a matter of law because "evidence of 'actual control' constitutes a necessary element of the violation."

Inside the Courts
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