December 2021 / Volume 13 / Issue 4

Skadden

Inside the Courts
An Update From Skadden Securities Litigators

2 / **Appraisal Rights**

Manti Holdings, LLC v. Authentix Acquisition Co., Inc. (Del. Sept. 13, 2021)

2 / **Class Certification**

Ark. Tchr. Ret. Sys. v. Goldman Sachs Grp., Inc. (2d Cir. Aug. 26, 2021)

In re Allergan PLC Sec. Litig. (S.D.N.Y. Sept. 8, 2021)

3 / **Cryptocurrency**

In re Tether and Bitfinex Crypto Asset Litig. (S.D.N.Y. Sept. 28, 2021)

Berdeaux v. OneCoin Ltd. (S.D.N.Y. Sept. 20, 2021)

Rensel v. Centra Tech, Inc. (S.D. Fla. Sept. 10, 2021)

5 / **Derivative Litigation**

United Food and Com. Workers Union and Participating Food Indus. Emp'rs Tri-State Pension Fund v. Zuckerberg (Del. Sept. 23, 2021)

Brookfield Asset Management, Inc. v. Rosson (Del. Sept. 20, 2021)

In re Boeing Co. Derivative Litig. (Del. Ch. Sept. 7, 2021)

7 / **Securities Fraud Pleading Standards**

Materiality

IWA Forest Indus. Pension Plan v. Textron Inc. (2d Cir. Sept. 17, 2021)

Misrepresentations

Emps.' Ret. Sys. of City of Baton Rouge v. MacroGenics, Inc. (D. Md. Sept. 29, 2021)

Plymouth Cnty. Ret. Ass'n v. ViewRay, Inc. (N.D. Ohio Aug. 25, 2021)

Omissions

Kuebler v. Vectren Corp. (7th Cir. Sept. 13, 2021)

Plumber & Steamfitters Local 773 Pension Fund v. Danske Bank (2d Cir. Aug. 25, 2021)

In re Philip Morris Int'l Inc. Sec. Litig. (S.D.N.Y. Sept. 10, 2021)

Scienter

Veal v. LendingClub Corp. (9th Cir. Sept. 21, 2021)

Pamcah-UA Loc. 675 Pension Fund v. BT Grp. PLC (3d Cir. Aug. 5, 2021)

In re 3M Co. Sec. Litig. (D. Minn. Sept. 30, 2021)

In re Farfetch Ltd. Sec. Litig. (S.D.N.Y. Sept. 29, 2021)

13 / **Standing**

Pirani v. Slack Techs., Inc. (9th Cir. Sept. 20, 2021)

14 / **Statutes of Limitations**

Woods v. Michael (11th Cir. Aug. 3, 2021)

15 / **Statutes of Repose**

SEPTA v. Orrstown Fin. Servs. Inc. (3d Cir. Sept. 2, 2021)

© Skadden, Arps, Slate, Meagher & Flom LLP. All rights reserved.

Appraisal Rights

Delaware Supreme Court Enforces Sophisticated Investors' Waiver of Appraisal Rights

Manti Holdings, LLC v. Authentix Acquisition Co., Inc.,
No. 354, 2020 (Del. Sept. 13, 2021)

The Delaware Supreme Court affirmed the Court of Chancery's decision to enforce a waiver of appraisal rights included in a stockholders agreement that was executed by "sophisticated parties" and accounted for all shares of the corporation.

In connection with a 2008 transaction, Authentix Acquisition Company, Inc. entered into a stockholders agreement with all holders of the company's shares (the Stockholders Agreement). The Stockholders Agreement provided that the common stockholders would "refrain from the exercise of appraisal rights with respect to [a board and controller approved] transaction" (the Refrain Obligation). In 2017, a third party acquired Authentix. Under the merger agreement, the petitioners' stock was canceled and converted into a right to receive merger consideration which, for common stock, was little to no compensation. The petitioners sent timely appraisal demands to Authentix. Authentix reminded the stockholders of the Refrain Obligation and requested withdrawal of the demands. The petitioners refused and filed an appraisal petition in the Court of Chancery. The court granted summary judgment for defendant Authentix and, in a case of first impression, held that Authentix stockholders waived their appraisal rights by consenting to the Stockholders Agreement and that such appraisal waiver was valid under Delaware law.

The Delaware Supreme Court affirmed the lower court's decision. First, the Supreme Court held that, by signing the Stockholders Agreement, petitioners agreed to a clear waiver of their appraisal rights. In doing so, the court rejected each of the petitioners' contractual arguments, including the argument that the termination provision in the Stockholders Agreement eliminated all contractual obligations upon a sale of Authentix. This provision, petitioners argued, freed them of any post-termination duty to refrain from seeking appraisal. The court concluded this was a "commercially unreasonable" interpretation of the termination provision because stockholders can only exercise appraisal rights after a transaction closes. The court also refused to credit petitioners' attempt to distinguish between an agreement to "refrain" from exercising appraisal rights and an agreement to "waive" those rights.

Second, the court found the Refrain Obligation enforceable as a matter of Delaware law and public policy. While the court noted that "there are certain fundamental features of a corporation that are essential to that entity's identity and cannot be waived," it also reiterated that the Delaware General Corporation Law (DGCL) is a "broad and enabling statute" that allows for freedom of contract. The court found that certain provisions of the DGCL contain express prohibitions against waivers, highlighting the DGCL's prohibition on charter provisions shifting attorneys' fees for internal corporation claims or eliminating monetary liability for a director's breach of the duty of loyalty. While even certain of those provisions are not absolute, the majority found that Section 262 did not contain similar language prohibiting a waiver. Thus, while stating that "there are other contexts where an *ex ante* waiver of appraisal rights would be unenforceable for public policy reasons," the court "held that sophisticated and informed stockholders could preemptively relinquish their appraisal rights for valuable consideration," and that such a waiver did not contravene Delaware public policy.

Class Certification

Second Circuit Vacates and Remands Class Certification Following the Supreme Court's Guidance on Generic Misstatements and Their Impact on a Stock's Price

Ark. Tchr. Ret. Sys. v. Goldman Sachs Grp., Inc., No. 18-3667
(2d Cir. Aug. 26, 2021)

A Second Circuit panel vacated class certification for a group of Goldman Sachs investors in light of the Supreme Court's recent directive in *Goldman Sachs Grp., Inc. v. Ark. Tchr. Ret. Sys.*, 141 S. Ct. 1951, 1958 (2021) for lower courts to consider whether a company's alleged misstatements are too generic to be relied upon by an entire class of investors when deciding on class certification. This case was initially brought by a putative class of investors against Goldman Sachs and several of its executives for violations of Sections 10(b) and 20(a) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder. Investors alleged that Goldman had made certain misstatements about its conflicts of interest policies and business practices — including "[w]e have extensive procedures and controls that are designed to identify and address conflicts of interest" and "[w]e are dedicated to complying fully with the letter and spirit of the laws" — that were later revealed to be false by reports of government investigations into Goldman's conflicted role in certain transactions, causing the company's stock price to drop. Investors argued that the positive statements had fraudulently inflated Goldman's stock price. In response, Goldman submitted expert testimony that claimed, among other things, that the price drops were due to news of enforcement activities rather than Goldman's alleged conflicts.

The district court first certified a class in 2015, which the Second Circuit vacated and remanded in 2018 upon finding that it was unclear whether the district court had applied the preponder-

ance-of-the-evidence standard in determining whether Goldman had rebutted the presumption that investors rely on all of a company's public misrepresentations when trading stock in an efficient market. On remand, the district court again certified the class because it found that Goldman had failed to establish by a preponderance of the evidence that its alleged misrepresentations had no price impact. This time, the Second Circuit affirmed. It disagreed with Goldman's argument that "general statements, like those challenged here, are incapable of impacting a company's stock price as a matter of law," and instead held that the proposal to exclude general statements as a matter of law too closely resembled the materiality inquiry, which was inappropriate at the class certification stage.

The Supreme Court vacated the Second Circuit's decision since it determined that it was unclear whether the appellate court had properly considered the generic nature of Goldman's alleged misrepresentations in reviewing the district court's price impact determination. It instructed on remand that the Second Circuit take into account all record evidence relevant to price impact. The Second Circuit therefore vacated class certification and remanded the matter to the district court because it determined that the lower court had not considered the generic nature of Goldman's alleged misrepresentations during its price impact analysis, and that these fact-intensive issues were better evaluated by the district court in the first instance.

SDNY Grants Class Certification to Investors of Pharmaceutical Company

In re Allergan PLC Sec. Litig., No. 18-civ-12089 (S.D.N.Y. Sept. 8, 2021)

Judge C.J. McMahon certified a class of investors in a pharmaceutical and medical products company in a suit alleging that the company and certain of its officers violated Sections 10(b) and 20(a) of the Securities Exchange Act, and Rule 10b-5 thereunder by failing to disclose information in publicly filed documents about a potential link between the company's breast implants and a rare form of cancer. Specifically, the plaintiffs alleged that the defendants made several statements downplaying the risk that the breast implants would be recalled on the basis of that link. The plaintiffs further alleged that a recall of the company's breast implants ordered by France's National Agency for the Safety of Medicines & Health Products (ANSM) functioned as a corrective disclosure, causing the company's stock price to drop.

Opposing the plaintiffs' motion for class certification, the defendants disputed only the predominance element of Rule 23(b), which requires that "questions of law or fact common to class members predominate over any questions affecting only individual members." In principal, the defendants contended that individualized questions relating to potential plaintiffs' reliance on the company's alleged misrepresentations and to measuring the economic loss associated with those statements would predominate over common issues. The defendants argued that the market did not rely on their alleged misstatements because there was no relationship between any of those statements and the company's share price. The court rejected this argument because the complaint alleged that the misstatements helped maintain an artificially inflated stock price.

The court similarly rejected the defendants' argument that because there were 15 days on which incidence reports about the possible link between the cancer and the implants were published and there were subsequently "no statistically significant price fluctuations" of the company's stock, the market was indifferent to reports of the link between the company's breast implants and cancer. Observing that "none of the fifteen" incident reports "focused on the likelihood of a recall," the court held that the "presence or absence of a statistically significant price decline following any of the" dates other than the ANSM announcement, when there was indisputably a price decline, "is thus meaningless to the certification analysis." The court also rejected the defendants' argument that the plaintiff's economic loss model was incapable of isolating the loss attributable to challenged statements downplaying the risk of recall, finding that at the class certification stage, the plaintiff need not "disaggregate any legitimate confounding factors to prove economic loss." The court thus concluded that "common questions of law and fact predominate over individualized ones in this case."

Cryptocurrency

SDNY Allows Claims of Anticompetitive Conduct in Cryptocurrency Market To Proceed While Dismissing Civil RICO Claims

In re Tether and Bitfinex Crypto Asset Litig., No. 19 Civ. 9236 (KPF) (S.D.N.Y. Sept. 28, 2021)

Judge Katherine Polk Failla granted in part and dismissed in part a motion to dismiss a complaint brought by a proposed class of cryptocurrency buyers that allegedly purchased Bitcoin, Ether and other cryptocurrencies at artificially inflated prices before they dropped in 2018. The plaintiffs alleged that the defendants — various cryptocurrency companies and exchanges and certain of their executives and officers — were liable under Sections 1, 2 and 3 of the Sherman Act, as well as under Section 1962 of the Racketeer Influenced and Corrupt Organizations Act (RICO) because they engaged in a scheme to manipulate cryptocurrency markets by strategic purchasing to create a false "bubble" and control cryptocurrency pricing.

The court dismissed the claim brought under Section 2 of the Sherman Act and the claim brought under Section 1962 of RICO. Under Section 2, a plaintiff must allege a conspiracy to monopolize by showing (i) a combination or conspiracy; (ii) an overt act in furtherance of the conspiracy; and (iii) a specific intent to monopolize. The court determined that the complaint merely alleged a shared monopoly theory (*i.e.*, that defendants lacked a specific intent to monopolize because they did not aim to confer monopoly power upon a single entity), which "cannot support a Section 2 claim." Similarly, under the civil provisions of RICO under Section 1962, a plaintiff must allege that it suffered injuries "in his business or property by reason of a violation of [S]ection 1962" and must prove that the violation caused the injury in order to establish standing. The court found that the plaintiffs were harmed by the "decisions of independent market participants to purchase cryptocommodities (thereby artificially inflating prices)" and not by the defendants directly. The court determined that the connection between the defendants' alleged activities — the establishment of price floors and increased market demand — and the purported injury was "intricate, uncertain, and contingent on numerous independent decisions made by other market participants." The court thus found that the "causal connection between [the d]efendants' purported racketeering and [the p]laintiffs' injury [was] insufficiently 'direct' and 'straightforward' to satisfy the proximate cause requirement."

On the other hand, the court declined to dismiss claims under Sections 1 and 3 of the Sherman Act. Under Section 1, the plaintiffs must show (i) a combination or form of concerted action between at least two legally distinct economic entities that (ii) unreasonably restricts trade. Section 3 "extends the reach of Section 1 to trade or commerce involving U.S. Territories and the District of Columbia." The court rejected the defendants' arguments that these claims were insufficiently pleaded under Federal Rule of Civil Procedure 9(b) because the plaintiffs pleaded sufficient circumstantial evidence, "including charts, graphs, and specific examples illustrating how and when Defendants" purchased a certain cryptocurrency "to inflate cryptocurrency prices," to plausibly infer an agreement between the defendants sufficient to survive a motion to dismiss, and price fixing schemes are "*per se* unreasonable" restrictions on trade.

SDNY Dismisses Investor Suit Alleging Cryptocurrency Scam on Jurisdictional Grounds

Berdeaux v. OneCoin Ltd., No. 19-CV-4074 (S.D.N.Y. Sept. 20, 2021)

Judge Valerie Caproni dismissed a putative class action complaint alleging that an attorney, his business partner and their lawyer violated Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder by perpetrating a fraudulent cryptocurrency offering. The court also dismissed the plaintiffs' claims against the bank that allegedly aided and abetted the fraud. Specifically, the complaint alleged that the offering was actually "a multi-level marketing scheme promoting and selling a fake cryptocurrency" which was never traded on an actual cryptocurrency exchange or blockchain. The complaint alleged that the defendants laundered the proceeds of the fraudulent scheme. The individual defendants moved to dismiss for lack of personal jurisdiction pursuant to Federal Rule of Civil Procedure 12(b)(2), and all defendants moved to dismiss for failure to state a claim under Rule 12(b)(6).

The court determined that it lacked personal jurisdiction over the individual defendants because they resided in Florida during the course of the alleged fraud. The court rejected the plaintiffs' argument that because one of the three defendants was licensed to practice law in New York, had been arrested and tried in a criminal case in the Southern District of New York — and that wire transfers to the defendant's consulting company had been routed through a New York bank account — this was sufficient to find personal jurisdiction over all three individuals. The court determined that those facts did not show that any of the defendants actually transacted any business in New York sufficient to trigger specific jurisdiction under N.Y. C.P.L.R. § 302(a)(1). The court also noted that while the plaintiffs purported to represent a nationwide class, the complaint did not allege any injury in New York sufficient to exercise jurisdiction. Finally, the court dismissed the aiding and abetting claims against the bank that allegedly routed proceeds from the fraud to offshore accounts, finding that merely transferring funds was "patently insufficient to plead substantial assistance," and the plaintiffs failed to plead that the bank had any actual knowledge of the alleged fraud.

Southern District of Florida Grants Class Certification in Securities Fraud Action Concerning a Company's Initial Coin Offering

Rensel v. Centra Tech, Inc., No. 17-24500 (S.D. Fla. Sept. 10, 2021)

Judge Robert N. Scola Jr. granted class certification in a securities fraud case alleging that Centra Tech, Inc. violated securities laws through the unlawful sale of its cryptocurrency.

The plaintiffs were purported investors in Centra Tech's initial coin offering (ICO) that took place from July 23, 2017, to October 5, 2017. The plaintiffs alleged that Centra Tech made several misrepresentations to investors in its attempts to promote the ICO. Based on these alleged misrepresentations, the plaintiffs brought a putative class action against Centra Tech under Section 12(a)(1) of the Securities Act, Section 10(b) of the Securities Exchange Act and SEC Rule 10b-5. Because the plaintiffs were

pursuing monetary relief, they moved for class certification under Federal Rule of Civil Procedure 23(b)(3).

The district court initially denied the plaintiffs' motion for class certification for failure to satisfy the ascertainability requirement; however, on appeal, the Eleventh Circuit found that the plaintiffs had "easily" shown that the proposed class was ascertainable. Thus, the panel vacated the district court's order and remanded for further proceedings.

On remand, the district court granted the plaintiffs' renewed motion, certifying a class that includes all persons and entities who purchased Centra Tech's cryptocurrency during its ICO. In reaching this decision, the court found that all of Rule 23's requirements for class certification had been satisfied. The court first adopted the Eleventh Circuit's holding that the plaintiffs had "easily" satisfied the ascertainability requirement, which serves as an implied prerequisite of Rule 23.

The court then found that the plaintiffs had satisfied all four prerequisites set out in Rule 23(a) for class certification — numerosity, commonality, typicality and adequacy. First, numerosity was satisfied, as it was undisputed that thousands of individuals had invested in Centra Tech's ICO. Second, commonality was established insofar as the class members shared issues of law and fact relating to Centra Tech's alleged misrepresentations. Third, typicality was met because the claims of the class representatives and of the class arose from the same event and were premised on the same legal theory. Fourth, adequacy was satisfied because the class representatives possessed the same interests in litigating the case as the other class members, and did not have any conflicts that would preclude them from adequately representing the class.

Finally, the court found that the plaintiffs had satisfied the two additional requirements — predominance and superiority — under Rule 23(b)(3). With respect to predominance, the court found that individualized issues of reliance would not preclude certification because (i) Section 12(a)(1) claims do not require a showing of reliance; and (ii) with respect to the Section 10(b) claim, the plaintiffs could rely on the fraud-created-the-market presumption of reliance. As to superiority, the court reasoned that "[c]lass treatment is often the best method for resolving securities fraud claims predicated on public misrepresentations."

Derivative Litigation

Delaware Supreme Court Simplifies Standard for Analyzing Demand Futility

United Food and Com. Workers Union and Participating Food Indus. Emp'rs Tri-State Pension Fund v. Zuckerberg, No. 404, 2020 (Del. Sept. 23, 2021)

The Delaware Supreme Court adopted a new three-part test for evaluating demand futility, "blending" and replacing the tests formerly set out in the seminal cases *Aronson v. Lewis* and *Rales v. Blasband*. Going forward, this will be the "universal test for assessing whether demand should be excused."

Plaintiff stockholders filed a derivative action seeking to recover nearly $90 million that Facebook had spent defending and settling an earlier consolidated class action challenging a reclassification that was ultimately abandoned. The Court of Chancery noted that under the facts of the case — which included board turnover and certain board member recusals — it was unclear whether the test articulated in *Aronson* or *Rales* applied for purposes of assessing demand futility. The court instead applied a three-prong standard derived from both *Aronson* and *Rales*, and dismissed the complaint for failure to plead that demand was futile.

The Delaware Supreme Court adopted the Court of Chancery's new three-part test for demand futility, explaining that although *Aronson* "made sense" at the time it was decided, "[s]ubsequent changes in the law have eroded the ground upon which that framework rested. Those changes cannot be ignored, and it is both appropriate and necessary that the common law evolve in an orderly fashion to incorporate those developments." Going forward, in determining whether demand is futile, the court will consider whether the director (i) "received a material personal benefit from the alleged misconduct that is the subject of the litigation demand"; (ii) faces "a substantial likelihood of liability on any of the claims that are the subject of the litigation demand"; and (iii) "lacks independence from someone who received a material personal benefit from the alleged misconduct that is the subject of the litigation demand or who would face a substantial likelihood of liability on any of the claims that are the subject of the litigation demand." If the answer to one of these questions is "yes" for at least half of the members of the demand board, then demand is excused as futile.

As part of its ruling, the Delaware Supreme Court rejected Tri-State's argument that demand was "automatically excused under *Aronson*'s second prong" because Mark Zuckerberg, Facebook's controlling stockholder, stood on both sides of the challenged transaction, implicating the entire fairness standard of review. The Delaware Supreme Court further explained that

claims for breach of the duty of care that are exculpated by a charter provision adopted pursuant to 8 *Del*. C. § 102(b)(7) do not expose directors to a substantial likelihood of liability and cannot satisfy this standard.

Delaware Supreme Court Overrules *Gentile*, Holding Corporate Overpayment/Dilution Claims Are Exclusively Derivative

Brookfield Asset Management, Inc. v. Rosson, No. 406, 2020 (Del. Sept. 20, 2021)

The Delaware Supreme Court overruled *Gentile v. Rossette*, 906 A.2d 91 (Del. 2006), holding that corporation overpayment/dilution claims — including those resulting from a transaction that transfers economic value and voting power from minority stockholders to a controlling stockholder — are "exclusively derivative."

In 2004, the Delaware Supreme Court issued its decision in *Tooley v. Donaldson, Lufkin & Jennette, Inc.*, in which it "undertook to create a simple test of straightforward application to distinguish direct claims from derivative claims" by asking "(1) who suffered the alleged harm, the corporation or the stockholders, individually, and (2) who would receive the benefit of any recovery or other remedy, the corporation or the stockholders, individually." Two years later, in 2006, the Delaware Supreme Court decided *Gentile*, holding that although claims for overpayment are typically derivative, claims involving "a controlling stockholder and transactions that resulted in an improper transfer of both economic value and voting power from the minority stockholders to the controlling stockholder" present an exception to the *Tooley* test and are "dual-natured," *i.e.*, both derivative and direct.

In *Brookfield*, plaintiff stockholders challenged TerraForm Power, Inc.'s private placement of stock to its controlling stockholder. The plaintiffs alleged that TerraForm undervalued the stock and the transaction diluted both the financial and voting interests of the minority stockholders. After the plaintiffs filed their complaint, the controlling stockholder acquired TerraForm's remaining shares in a merger. The defendants moved to dismiss the complaint for lack of standing, arguing that dilution claims are "quintessential derivative claims" under the *Tooley* test and the derivative claims had been extinguished by the merger. The Court of Chancery agreed that the plaintiffs failed to state direct claims under *Tooley*, but nevertheless denied the motion to dismiss because the plaintiffs stated a direct claim under *Gentile*.

On interlocutory appeal, the defendants-below/appellants argued that the plaintiffs' claims were derivative under *Tooley*, and that *Gentile* should be overruled because it "contradicts and undermines long-standing case law, complicates real-world commercial transactions, and is superfluous given existing legal remedies." Addressing the importance of stare decisis and emphasizing that "precedent should not be lightly cast aside," the Delaware Supreme Court nevertheless agreed with the defendants-below/appellants. It recounted the detailed history of the court's decisions concerning direct and derivative claims and ultimately concluded that "the corporation overpayment/dilution *Gentile* claims … are exclusively derivative under *Tooley* and that *Gentile* … should be overruled." It therefore reversed the Court of Chancery's decision, "not because the Court of Chancery erred, but rather, because the Vice Chancellor correctly applied the law as it existed, recognizing that the claims were exclusively derivative under *Tooley*, and that he was bound by *Gentile*."

Court of Chancery Denies Motion To Dismiss *Caremark* Claim

In re Boeing Co. Derivative Litig., C.A. No. 2019-0907-MTZ (Del. Ch. Sept. 7, 2021)

The Court of Chancery sustained a *Caremark* claim at the pleadings stage, holding that stockholder plaintiffs had adequately pled that a majority of the Boeing board of directors faced a substantial likelihood of liability for failing both prongs of *Caremark*'s two-part test. The *Caremark* test imposes liability under two "prongs," where (i) the directors either utterly failed to implement any reporting or information system or controls; or (ii) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention.

According to the plaintiffs, in 2017, global aerospace company Boeing began to fulfill customer orders for its new Boeing 737 MAX airplanes, which Boeing had aggressively designed, developed, marketed and produced. In the development and marketing of the 737 MAX, Boeing "prioritized (1) expediting regulatory approval and (2) limiting expensive pilot training required to fly the new model." Boeing's "frenetic" pace for the 737 MAX program led, in part, to undisclosed safety issues with the airplanes. These safety issues ultimately led to two separate airline crashes, each killing between 150-200 passengers. By 2020, Boeing estimated that these airline disasters, the resulting grounding of the 737 MAX fleet and other fallout had already caused Boeing to incur $22.5 billion in total costs.

In describing the *Caremark* standard, the court emphasized that a well-pled oversight claim "requires not only proof that a director acted inconsistently with his fiduciary duties but also most importantly, that the director knew he was so acting." Because

the test is rooted in concepts of bad faith, "a showing of bad faith is a *necessary condition* to director oversight liability." Notwithstanding the high bar for pleading bad faith, however, the Court of Chancery held that the plaintiffs adequately pled a claim for breach of the duty of loyalty predicated on lack of oversight under both prongs of the *Caremark* test.

Turning to the plaintiffs' allegations, on prong one, the court concluded that airplane safety was "essential and mission critical" to Boeing's business, yet the board (i) had no committee charged with direct responsibility to monitor airplane safety; (ii) did not monitor, discuss or address airplane safety on a regular basis; (iii) had no regular process or protocols requiring management to update the board of airplane safety and instead only received *ad hoc* management reports that included only positive information; (iv) never received information on yellow and red flags that management saw; and (v) made statements that demonstrated they knew they should have had processes in place to receive safety information. On prong two, the court concluded that the board ignored the red flags of the first plane crash and consequent revelations about the unsafe 737 MAX. For these reasons, the court denied the defendants' motion to dismiss the *Caremark* claim.

Securities Fraud Pleading Standards

Materiality

The Second Circuit Partially Reverses Dismissal of Proposed Class Action Claiming Manufacturing Company Misled Shareholders About Inventory

IWA Forest Indus. Pension Plan v. Textron Inc., No. 20-2746-cv (2d Cir. Sept. 17, 2021)

A split Second Circuit panel partially reversed the dismissal of a proposed class action lawsuit brought by a putative class of investors against a manufacturer of aircraft and recreational vehicles and two of its executives. The complaint alleged that the defendants violated Sections 10(b) and 20(a) of the Securities Exchange Act and Rule 10b-5 thereunder by making four material misstatements between January and December 2018 relating to the company's new acquisition of a manufacturer of snowmobiles and off-dirt vehicles. Those statements concerned (i) the acquired company's inventory levels; (ii) the integration of the acquired company's business; (iii) the acquired company's performance and prospects; and (iv) the possibility of a goodwill impairment charge. The district court dismissed the complaint in its entirety, finding that the complaint failed to adequately allege any actionable misstatements.

On appeal, the Second Circuit agreed with the district court's findings relating to the acquired company's integration, expected performance and goodwill, but determined that some of the CEO's statements about clearing out the acquired company's old inventory could have misled investors. Specifically, the Second Circuit focused on three statements made by the company's CEO in 2018: (i) the acquired company had seen "improved demand in the snow retail channel, allowing dealers to clear older inventory and drive 2018 model sales"; (ii) that "through the course of the year" there had been "pretty significant reductions in that aged inventory"; and (iii) that the "older inventory ha[d] been moved off [dealers'] books," and that "last year was great, in terms of burning down a lot of the inventory." The plaintiffs claimed that these statements were false because from early 2017 through the summer of 2018, the acquired company consistently had a substantial inventory backlog of vehicles from model years 2015 to 2017.

The Second Circuit held that the complaint had sufficiently alleged that the CEO's 2018 statements regarding inventory were materially misleading. The Second Circuit rejected the company's argument that the CEO's earlier statements in 2017 — which disclosed the significant challenges presented by the acquired company's backlog of aged inventory — were enough for a reasonable investor to recognize that the "older inventory" problem mentioned by him in his 2018 statements related to vehicles that were at least model year 2016 and older, and had nothing to do with model year 2017 vehicles. The Second Circuit noted that since the company generally launches new model year products in the fall of the prior calendar year, the 2017 models were not current as of August or September 2017. Thus, the inventory-related statements the CEO made in 2017 viewed "in the light most favorable" to the plaintiffs must be inferred to have referred to models from 2016 or earlier, not to models from 2017.

Misrepresentations

Maryland Federal District Court Dismisses Shareholder Suit Against Biopharmaceutical Company for Failure To Adequately Plead Falsity and Scienter

Emps.' Ret. Sys. of City of Baton Rouge v. MacroGenics, Inc., No. GJH-19-2713 (D. Md. Sept. 29, 2021)

Judge George J. Hazel granted biopharmaceutical company MacroGenics's motion to dismiss a securities fraud class action. The case arose from defendant MacroGenics's statements about the clinical trials of its new cancer treatment product Margetuximab.

MacroGenics began developing Margetuximab and conducted a Phase III trial for the drug. This trial compared the performance of the new Margetuximab treatment to the performance of an existing treatment called Trastuzumab, which was considered the "market-leading" standard biologic treatment for breast cancer. The trial first attempted to establish a "meaningful benefit" to patients taking Margetuximab as opposed to Trastuzumab in terms of "progression free survival" (PFS). The trial further attempted to establish a "meaningful benefit" to patients taking Margetuximab compared to Trastuzumab in terms of "overall survival" (OS). According to the complaint, OS is considered a "critically important endpoint" in evaluating a new treatment for a disease with a high mortality rate and "critical to the commercial prospects of a drug like Margetuximab."

On February 6, 2019, MacroGenics released results from its initial review of the trial. MacroGenics announced that the data showed a statistically significant PFS benefit to Margetuximab treatment but stated only that the OS data was still "maturing." The stock price of the company increased by 130% that same day. MacroGenics then announced that it would be holding a secondary public offering on February 13, 2019, at an offering price of $20 per share. The company raised $126.5 million in gross proceeds from that secondary offering. Over the next few months, MacroGenics continued to publicize its positive PFS data while declining to comment on its OS data except to mention the data was still maturing. The plaintiff allegedly purchased common stock in MacroGenics after the February 6, 2019, release of initial results.

On May 15, 2019, MacroGenics disclosed initial interim OS data for the first time. On June 4, 2019, MacroGenics presented interim trial data at a conference and, for the first time, presented graphs of OS data showing that the clinical trial data was *not* on track to demonstrate that Margetuximab would result in a meaningfully higher overall survival rate than Trastuzumab. Two days after the conference, the price of MacroGenics stock fell more than 21%, representing an overall 43% decline since its February 6, 2019, high.

The plaintiff brought suit, alleging the defendant made false and misleading representations and omissions in statements about Margetuximab during the class period, which caused them to buy MacroGenics stock at "artificially inflated prices" and suffer losses after the "full truth" about the study emerged. The plaintiff brought their claims under Section 10(b) and 20(a) of the Exchange Act relating to various public statements during the class period, and under Sections 11, 12(a)(2) and 15 of the Securities Act relating to the defendant's February 2019 offering. The defendant moved to dismiss.

The court sided with the defendant and dismissed the action. In so holding, the court first found that heightened pleading standards applied to all the plaintiffs' allegations suit because the claims sounded in fraud. The court grouped the statements at issue into four categories: (i) statements about PFS results; (ii) statements of "superior outcome" or "positive results"; (iii) cautionary statements and risk factors; and (iv) statements about the interim OS data.

The court determined that the defendant's statements about the PFS results were not misleading, reasoning that disclosure is required only when necessary to make statements already made not misleading. The court determined that the plaintiff did not "speak" on the OS data just by virtue of releasing results about PFS data, and further reasoned that no reasonable investor would have been left with a mistaken impression about the OS results. With respect to the defendant's statements about superior and positive outcomes, the court determined that they were inactionable puffery, particularly where the defendant stated that its clinical trial results provided "clinical validation" that the data is "promising" and showed "positive results," as Margetuximab did in fact display positive PFS results. Moreover, the court found these statements were broad enough to be considered "puffing" or were accompanied by caveats that the determination of OS data was ongoing. With respect to the third category, the court determined that the defendant's cautionary statements and risk factors were inactionable. The court determined that the warnings regarding the prospects for Margetuximab did not relate to risks that had already come to fruition since failure was not a certainty for Margetuximab.

Finally, the court disagreed with the plaintiff's assertion that the OS data was vitally important to investors and thus required to be disclosed. The court noted that disclosure of information was not required simply because it may be relevant to a reasonable investor. The court further reasoned that investors were not entitled to "several forms of data or data in a preferred form," and that disagreement with the defendant's failure to release specific types of graphic data until June 2019 was not a material omission.

The court also determined that the plaintiff failed to prove the defendant acted with scienter. The court reasoned that scienter could not be inferred from financial motivations ultimately common to every company, such as the motivation to raise capital or increase compensation. The court also determined that corporate executives' access to information and internal affairs also did not demonstrate scienter in this instance, regardless of the fact that the defendant's corporate executives may have had access to the OS data prior to its release.

Northern District of Ohio Dismisses Putative Class Action With Prejudice

Plymouth Cnty. Ret. Ass'n v. ViewRay, Inc., No. 1:19-cv-2115 (N.D. Ohio Aug. 25, 2021)

Judge J. Philip Calabrese dismissed a putative securities class action against ViewRay, a medical device company. ViewRay's revenues are based on the sales of its Linac MRIdian, an MRI machine paired with a radiation beam to image and treat cancer at the same time. Once an order is placed, it takes nine to 15 months to be fulfilled. As such, the key metric in ViewRay's valuation is its backlog of unfulfilled orders. In March 2019, ViewRay projected that its revenue for the year would be between $111 million and $124 million, based on the backlog. These projections decreased as the year progressed. In January 2020, ViewRay disclosed that its 2019 revenue was below $17 million. As a result, ViewRay's stock price dropped about 23%.

The plaintiffs filed suit under Section 10(b) of the Securities Exchange Act and Rule 10b-5, arguing that ViewRay knowingly issued false statements about its backlog. ViewRay moved to dismiss the claim, arguing that the plaintiffs failed to allege materially false statements or omissions. The court agreed, granting ViewRay's motion to dismiss.

The plaintiffs claimed that the alleged misrepresentations and omissions fell into three categories: (i) statements about orders in the backlog; (ii) statements about the backlog's value; and (iii) ViewRay's 2019 revenue projections.

The plaintiffs argued that ViewRay did not follow its own publicly stated criteria for including orders in its backlog, which rendered its statements false or misleading. The plaintiffs further alleged that ViewRay maintained sham orders in the backlog that would not result in profit. Here, the plaintiffs relied on statements from a confidential witness that a customer decided not to proceed with the purchase of a machine but the order remained in the backlog. The court disagreed on both points. He noted that part of ViewRay's publicly stated criteria involves a subjective judgement about the likelihood of an order contract translating into revenue, thus the company's statements could not be false or misleading. The court added that the plaintiffs' complaint contained no allegations regarding the specific order discussed by the confidential witness, nor did it allege facts sufficient to support the witness' account.

Next, the plaintiffs argued that ViewRay's statements about the valuation of the backlog included orders that were unlikely to come to fruition. The court stated that neither the complaint nor the witness statements offered more than generalities about the backlog, and that they failed to allege facts about specific orders. Further, the plaintiffs did not allege facts showing that ViewRay's calculations underlying valuation of the backlog were incorrect.

The plaintiffs also argued that ViewRay's revenue projections for 2019 were misleading. The plaintiffs claimed that ViewRay's projections in March 2019 were not achievable or accompanied by necessary meaningful cautionary language. The court disagreed, holding that the projections were forward looking, meaning they could not be the basis of the claim. Additionally, the court pointed to appropriate cautionary language, noting that ViewRay stated that its total revenue figures were anticipatory and that actual results may differ. Having found that the plaintiffs' allegations were insufficient to support their claim, the court dismissed the case.

Omissions

Seventh Circuit Affirms Dismissal of Merger Proxy Challenge

Kuebler v. Vectren Corp., 13 F.4th 631 (7th Cir. Sept. 13, 2021)

In 2018, Vectren Corporation filed a preliminary proxy statement for an all-cash merger with CenterPoint Energy, Inc., in which CenterPoint would pay Vectren shareholders $72 per share. The plaintiff shareholders filed suit under Section 14(a) of the Securities Exchange Act to enjoin the shareholder vote based on alleged disclosure defects. After the district court denied a preliminary injunction and shareholders approved the merger, the plaintiffs amended their complaint to ask for damages based on the omission from the proxy statement of two metrics used by the financial adviser to assess the value of Vectren's shares: (i) unlevered cash flow projections, which forecast the gross after-tax annual cash flow for Vectren between 2018 and 2027; and (ii) business segment projections, which show separate financial projections for Vectren's three main lines of business. The District Court for the Southern District of Indiana dismissed the plaintiffs' claims, finding that they failed to adequately allege the materiality of the omissions and resulting economic loss. The plaintiffs appealed, and the Court of Appeals for the Seventh Circuit affirmed the decision on the same grounds.

The Seventh Circuit first addressed a "procedural wrinkle" that arose in the district court. In that court, the plaintiffs attached an affidavit by a financial expert and relied upon it in their opposition to the defendants' motion to dismiss. The district court did not consider the affidavit when ruling on the motion, holding that it was evidence. The Seventh Circuit held that plaintiffs opposing a Rule 12(b)(6) motion to dismiss may submit evidence to illus-

trate their allegations — unlike defendants moving to dismiss a complaint under Rule 12(b)(6), who may not.

Assessing the materiality of the omitted information, the Seventh Circuit held as a matter of law that the information was not material. Specifically, the court held that disclosure of the business segment projections would not have substantially altered the total mix of available information because shareholders did not have the option of selling separate interests in separate lines of business. The court also held that the omission of the unlevered cash flow projections was not material because the proxy statement included a variety of other financial information sufficient to assess the value of the shares, such as projections of net income, depreciation and amortization, EBIDTA and capital expenditures. The court found that the plaintiffs failed to plausibly allege that the omission of the unlevered cash flow projections "could have kept hidden a value in Vectren shares that was not otherwise disclosed." The court emphasized that the materiality standard "requires courts to assess the value of the omitted information in light of all the information made available to shareholders," and that shareholders are not entitled to the disclosure of all data used by financial advisers in order to apprais[e] the "appraiser's appraisal after the fact."

The Seventh Circuit also held that the plaintiffs failed to allege loss causation because they failed to purport any economic harm at all, alleging rather that shareholders were unable to determine the extent of their economic harm because of the omitted information. The court noted that the plaintiffs' allegation that Vectren's financial adviser used an inflated discount rate — thereby deflating Vectren's valuation — was "a debate about the merits of the merger terms, not whether the proxy statement was misleading," and that the plaintiffs did not allege the existence of a viable superior offer.

Having found that the plaintiffs failed to adequately allege materiality and loss causation, the Seventh Circuit affirmed the Southern District of Indiana's dismissal of the case.

Second Circuit Upholds Dismissal of Securities Fraud Claim for Failure To Plead Actionable Misstatements

Plumber & Steamfitters Local 773 Pension Fund v. Danske Bank, No. 20-3231 (2d Cir. Aug. 25, 2021)

The Second Circuit affirmed the dismissal of claims brought by a putative class of investors against a bank and certain of its officers under Sections 10(b) and 20(a) of the Securities Exchange Act and Rule 10b-5 thereunder, alleging that the defendants materially misled investors about a money laundering scandal involving the bank's branch in Estonia.

Specifically, the plaintiffs — three pension funds — alleged that they had purchased the bank's American depositary receipts (ADRs) at artificially inflated prices between March and June of 2018 because the defendants misleadingly disclosed year-over-year net profit and revenue while concealing that possible money-laundering at the bank was "baked into the bank-wide numbers." The Second Circuit disagreed, holding that accurate financial statements "do not automatically become misleading" if a company does not disclose suspected misconduct that may have contributed to the financial results. The plaintiffs also alleged that the defendant's 2013 and 2014 corporate responsibility reports (the Reports) which represented that the bank and its employees "strive to conduct [their] business in accordance with internationally recognised principles in the area of … anti-corruption" were misleading in light of the bank's corrupt activity in Estonia. Observing that almost every bank makes such statements, the Second Circuit held that they are "inactionable puffery," because no investor "would take such statements seriously in assessing a potential investment." The Second Circuit held that a reasonable investor — who purchased the bank's ADRs more than three years after the Reports were published and was well aware of the laundering scandal as it was brought to public light in 2016 — would not have considered the challenged statements from the Reports in its "investment calculus."

The plaintiffs also alleged that the defendants made actionably misleading statements in their 2018 second quarter financial results because the defendants knew that the scope of the laundering scandal "far exceeded" what was publicly reported at the time and was "likely to materially undermine its financial position." The Second Circuit disagreed, holding that the timing of the plaintiffs' purchases undermined their claim. The Second Circuit noted that the plaintiffs purchased the defendants' ADRs three weeks before these challenged statements were made. The Second Circuit further noted that the plaintiffs alleging that they were damaged by "purchasing securities at an inflated price cannot maintain a securities fraud claim premised exclusively on statements made *after* the plaintiff's final purchase of securities."

SDNY Grants Motion To Dismiss Complaint Filed Against Tobacco Company

In re Philip Morris Int'l Inc. Sec. Litig., No. 18-cv-08049 (RA) (S.D.N.Y. Sept. 10, 2021)

Judge Ronnie Abrams dismissed claims brought by a putative class of investors under Sections 10(b) and 20(a) of the Securities Exchange Act, and Rule 10b-5 promulgated thereunder against a tobacco company and certain of its officers alleging that the defendants failed to timely disclose material information from four undisclosed studies about known health risks associated with

the company's smokeless cigarette-alternative device for which the company sought FDA approval. The plaintiffs further alleged that the defendants made misleading statements about the results of studies given to the FDA concerning the cigarette-alternative device. The defendants moved to dismiss the complaint, arguing that it failed to sufficiently plead an actionable misstatement or omission and failed to adequately plead scienter.

The court agreed and rejected the plaintiffs' argument that the defendants' positive interpretations of available data concerning the comparative risks between the cigarette-alternative device and conventional cigarettes were misleading because they failed to disclose four scientific studies showing larger amounts of some harmful chemicals in the cigarette-alternative device. Noting that the complaint pleaded that defendants had a reasonable basis for making their challenged statements of opinion about the relative risks of the cigarette-alternative device, the court held that none of the undisclosed studies substantially undermined the defendants' statements. The court further held that the plaintiffs failed to plausibly allege that the defendants' factually accurate statements about the company's clinical trials were rendered misleading by failing to disclose results from a different category of studies. The court found that no reasonable investor in the cigarette-alternative market "would have interpreted the reporting of clinical results as necessarily implying the release of all available, non-clinical, data on the subject."

The court similarly rejected the plaintiffs' argument that the defendants made misleading statements concerning the chemical composition of the cigarette-alternative device. Acknowledging that the plaintiffs and defendants viewed data concerning the chemical composition of the cigarette-alternative device differently, the court held that because the FDA — "after months-long analysis of the data" — reached an opinion about the chemical composition of the cigarette-alternative device that was "substantially similar" to the defendants' view, the defendants' statements were not misleading.

Finally, the court held that the complaint failed to adequately plead scienter because it did not plead with particularity that any defendant was aware of the results of the four studies at the time of their challenged statements. The court rejected the complaint's confidential witness allegation of scienter because "[a]lthough the unnamed former employee may have been familiar in broad strokes with the procedure concerning non-clinical studies, there is no allegation that he or she had any direct conduct with any individual defendant."

Scienter

Ninth Circuit Affirms Dismissal of Securities Fraud Action for Failure To Plead Scienter

Veal v. LendingClub Corp., No. 20-16603 (9th Cir. Sept. 21, 2021)

The Ninth Circuit affirmed the dismissal of securities fraud claims brought against a peer-to-peer lending company and certain of its officers based on an allegedly misleading disclosure regarding the subject matter of a regulatory investigation.

In May 2016, the Federal Trade Commission (FTC) began investigating the company over alleged deceptive practices regarding hidden loan origination fees. In the company's public filings, the defendants disclosed that the company had been contacted by and was cooperating with the FTC on an investigation, but did not disclose the precise subject matter of the investigation. After the FTC investigation came to light, the plaintiffs — purported investors — brought securities fraud claims under Section 10(b) of the Securities Exchange Act and SEC Rule 10b-5 thereunder, alleging that the defendants made misleading statements to investors regarding the FTC investigation that improperly downplayed its risks to the company's revenues. The district court dismissed the complaint, concluding that the plaintiffs had failed to adequately allege scienter.

The Ninth Circuit affirmed, concluding that the plaintiffs' individual allegations failed to establish a strong inference of scienter. Specifically, the plaintiffs did not plausibly allege that the defendants knew the focus of the FTC's investigation at the time the challenged statements were made, or that the defendants sought to hide the focus of the investigation from investors. While the plaintiffs alleged in conclusory fashion that the defendants "knew all along" what the FTC was investigating, the panel explained that knowledge of an issue within a company does not necessarily imply awareness of a government agency's investigation of that particular issue.

Viewed holistically, the allegations still failed to give rise to a strong inference of scienter. The panel noted that none of the individual defendants sold any stock during the alleged class period, and that two of them actually purchased stock during the period. These facts undermined any inference of scienter and instead supported an "inference of innocence."

Inside the Courts
An Update From Skadden Securities Litigators

Third Circuit Upholds Dismissal of Securities Fraud Claim for Failure To Plead Scienter

Pamcah-UA Loc. 675 Pension Fund v. BT Grp. PLC, No. 20-2106 (3d Cir. Aug. 5, 2021)

The Third Circuit affirmed the dismissal of securities fraud claims brought against multinational telecommunications company BT Group and several of its officers and directors regarding the fraudulent accounting that took place for several years at one of its subsidiaries.

In its prior financial statements, BT Group reported profits from its subsidiary — BT Italy — and indicated that it was examining the control environment there. However, in a 2016 press release, BT Group identified prior overstatements of profits due to "historical accounting errors" stemming from inappropriate management behavior at BT Italy. BT Group later confirmed in a 2017 press release that the overstatement of profits exceeded £530 million. After these accounting irregularities were revealed, the plaintiffs — alleged investors — brought securities fraud claims under Section 10(b) of the Securities Exchange Act and SEC Rule 10b-5, arguing that the defendants wrongfully concealed the accounting issues in BT Group's public filings. The district court dismissed the complaint, concluding that the plaintiffs' scienter allegations did not meet the heightened pleading standards imposed by the Private Securities Litigation Reform Act of 1995 (PSLRA).

On appeal, the Third Circuit affirmed, rejecting the two arguments the plaintiffs advanced to defend the sufficiency of their scienter allegations. First, the panel found that the allegations as to the chairman of BT Group's audit committee did not support a strong inference of scienter that could be imputed to BT Group. The panel noted that (i) BT Group's board of directors visited BT Italy at the audit committee's request to review operations; (ii) BT Group repeatedly disclosed concerns about BT Italy to the SEC and reported that it was monitoring the entity's control environment; and (iii) BT Group voluntarily disclosed its prior inaccurate reporting through its 2016 and 2017 press releases. While the panel acknowledged that these allegations provided modest support for the inference that BT Group intended to commit fraud, they provided stronger support for the inference that the company actually intended to detect and prevent fraud.

Second, the panel found that the allegations regarding executives at two subsidiaries of BT Group — BT Global Services and BT Italy — also failed to plead scienter. The plaintiffs sought to impute the alleged mental states of those executives to BT Group by urging the Third Circuit to adopt the "corporate scienter" doctrine used in other circuits. However, the panel declined to apply that doctrine in this case. With regard to the executives at BT Global Services, the panel found that the plaintiffs' allegations — which relied on second- and third-hand accounts contained in news articles — did not create a compelling inference that the executives had an intent to commit financial statement fraud, as required by the PSLRA. With regard to the executives at BT Italy, the panel found corporate scienter did not exist because the plaintiffs made no allegations that BT Group participated in BT Italy's alleged accounting fraud. The panel explained that parent companies cannot be held liable for the acts of their subsidiaries merely by the fact of ownership.

District of Minnesota Dismisses Securities Claims for Failure To Meet PSLRA Pleading Standards

In re 3M Co. Sec. Litig., No. 20-CV-2488 (D. Minn. Sept. 30, 2021)

Judge Nancy E. Brasel granted 3M's motion to dismiss securities claims against the company and certain executives because the plaintiffs failed to meet the heightened pleading standard under the Private Securities Litigation Reform Act (PSLRA).

The plaintiffs allege that 3M materially understated its legal and financial exposure related to PFAS, synthetic chemical compounds which have been linked to cancer. PFAS are used in a variety of products, including foam used in high-temperature firefighting. 3M developed and manufactured PFAS from the 1940s until 2008 after studies demonstrated the harmful effects of the chemicals. 3M has faced tort lawsuits and a suit from the Minnesota Attorney General related to its manufacture and disposal of PFAS. 3M disclosed this litigation in its public filings and accrued liability contingencies related to environmental litigation. 3M ultimately settled the litigation with the Minnesota attorney general for $850 million.

The putative class plaintiffs, who were purchasers of 3M's stock during the relevant period, brought claims for violations of Section 10(b) of the Exchange Act and SEC Rule 10b-5, alleging that 3M and its executives made misleading and inadequate disclosures regarding the PFAS-related liability exposure. 3M moved to dismiss, asserting that the plaintiffs failed to meet the PSLRA pleading standards because the complaint (i) failed to plead an actionable misstatement; and (ii) failed to plead a strong inference of scienter.

With respect to actionable misstatements, the court noted that the plaintiffs took a kitchen sink approach to pleading, alleging that broad sections of 3M's disclosures were false. The critical issue was whether 3M's failure to accrue a greater amount

for PFAS liabilities violated the generally accepted accounting principles (GAAP) requirement to disclose probable and reasonably estimable losses. The court found that the complaint failed to allege facts that would demonstrate that 3M knew of a reasonable estimable amount it should disclose for the PFAS litigation; therefore, the complaint failed to plead any actionable misstatements.

3M also argued that the plaintiffs failed to plead any of the avenues to show scienter: (i) motive to defraud; (ii) intent to defraud; or (iii) severely reckless conduct. The plaintiffs alleged that 3M executives' trading activity suggested motive. The court rejected a finding of motive because the complaint failed to allege that the executives made an unusual amount of profit or sold an unusual portion of their holdings. The court likewise found no allegation of intent to defraud because the complaint failed to demonstrate that 3M knew a reasonably estimable amount it should have accrued for the PFAS liabilities. The plaintiffs argued that 3M's failure to accrue a greater amount for PFAS liabilities was at least reckless because 3M was aware of the GAAP requirement to disclose probable and reasonably estimable losses. However, because the court found that the plaintiffs had pled no underlying GAAP violation, it found that the complaint failed to plead the recklessness to support scienter.

Because the plaintiffs failed to meet the PSLRA's heightened pleading standards for actionable misstatements and scienter, the court dismissed the complaint.

SDNY Dismisses Securities Exchange Act and Securities Act Claims Brought Against Technology Company

In re Farfetch Ltd. Sec. Litig., No. 19-08657 (AJN) (S.D.N.Y. Sept. 29, 2021)

Judge Alison Nathan dismissed putative class claims brought by investors pursuant to Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder, and Sections 11, 12(a)(2) and 15 of the Securities Act against a technology company that focuses on the sale of luxury goods and certain of its officers. The plaintiffs alleged that in offering materials filed with the SEC before the company's initial public offering (IPO), the company made material misstatements or omissions concerning its operating segments by falsely touting itself as a third-party sales entity with less risk than first-party sales entities. The plaintiffs further alleged that after the IPO, the defendants made material misstatements or omissions concerning the company's projected quarterly financial results and acquisition of a first-party sales entity for nearly $675 million.

The court dismissed the Securities Exchange Act claims because the complaint failed to adequately plead scienter. The court rejected the plaintiffs' argument that the defendants' "suspicious" trading activity — ahead of an alleged corrective disclosure concerning the company's poor quarterly financial results and new acquisition of a first-party sales entity — showed motive and opportunity to defraud investors. Noting that even after their sales of company stock, the defendants remained heavily invested in the company, the court reasoned that the "stock sales … were not calculated to maximize the personal benefit from undisclosed inside information." The court also found that the timing of the defendants' stock sales was not suspicious because the trades were made pursuant to Rule 10b5-1 trading plans that were established several months in advance of the corrective disclosure and stock price drop. The court determined that the complaint lacked facts that the defendants knew when the plans were established that the company's subsequent purchase of a first-party sales entity would occur or that it would have a negative impact on the company's stock. Similarly, the court rejected the plaintiffs' argument that the defendants consciously or recklessly hid plans for the first-party sales acquisition from the public "in order to further a false narrative about the nature of [the company's] business." The court determined that the complaint instead showed that the company, through its risk disclosures, "intentionally put the public on notice of [the] risks related to their business model" regarding first-party sales and other potential future acquisitions.

The court also dismissed the Securities Act claims, rejecting the plaintiffs' argument that the company's offering statements hid from the public the amount of revenue generated by a first-party retailer model of the kind to which the company allegedly claimed it was superior. The court instead found that the company's offering materials "stated exactly how much of its revenue came from third-party sales, first-party sales, and in-store sales," and therefore "expressly disclosed precisely what [the plaintiffs'] claim [the company] was trying to hide."

Standing

Ninth Circuit Affirms Partial Denial of Motion To Dismiss, Clarifies Shareholder Standing in Direct Listings

Pirani v. Slack Techs., Inc., No. 20-16419 (9th Cir. Sept. 20, 2021)

The Ninth Circuit held that a shareholder who purchased shares in a direct listing had standing to bring claims under Sections 11 and 12(a)(2) of the Securities Act, despite his inability to prove that the shares he purchased were registered under the company's offering documents.

This case arose from Slack Technologies, Inc.'s use of a direct listing on the New York Stock Exchange (NYSE). In a direct listing, a company does not issue any new shares but instead files a registration statement "solely for the purpose of allowing existing shareholders to sell their shares on the exchange. " However, unlike in a traditional IPO, a direct listing is not underwritten by a bank, meaning that existing shareholders are not subject to any "lock-up" periods restricting the sale of unregistered shares to the public. Thus, from the first day of a direct listing, both unregistered and registered shares may be sold to the public.

In June 2019, Slack went public on the NYSE through a direct listing, releasing 118 million registered shares and 165 million unregistered shares to the public for purchase. During this time, the plaintiff purchased 250,000 Slack shares, but was unable to determine if he had purchased registered or unregistered shares in the direct listing. Subsequently, Slack allegedly experienced service disruptions and its share price dropped. The plaintiff filed a class action suit against Slack and its officers, directors and certain investors, alleging failures to make relevant disclosures in its registration statement and prospectus in violation of Sections 11, 12 and 15(a) of the Securities Act.

At the district court, Slack moved to dismiss on the grounds that the plaintiff lacked standing to sue under Sections 11 and 12(a)(2) of the Securities Act because he could not determine if he had purchased registered or unregistered shares in the directing listing, and therefore could not show that he had purchased "such securities" issued under the registration statement and offering prospectus as required by Sections 11 and 12(a)(2). However, the district court rejected that argument, finding that the plaintiff had standing to pursue his claims.

On appeal, the Ninth Circuit affirmed. The court held that because no stock sales in a direct listing — whether the shares are registered or unregistered — can occur unless the issuer files a registration statement and offering prospectus, all sales in a direct listing are sufficiently traceable to the issuer's offering documents to satisfy the Securities Act's statutory standing requirements. The court expressed concern that if it were to rule otherwise, investors would be left without any private Securities Act remedies in the direct listing context.

Statutes of Limitations

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

Woods v. Michael, No. 21-10818 (11th Cir. Aug. 3, 2021)

The Eleventh Circuit affirmed the dismissal of a securities fraud claim, concluding that the claim was untimely and the doctrine of equitable tolling did not apply to save it.

The case arose out of a series of transactions that occurred between April 2014 and June 2018. The plaintiff alleged that the defendants used misrepresentations to obtain millions of dollars from him as loans to be used in various commercial property developments. For each loan, the defendants promised to give the plaintiff 9% annual interest and an equity share in the entity that owned each property. In June 2018, after failing to fulfill their end of the loan agreements on time, the defendants promised to fully repay the plaintiff's loans by December 2018, as well as provide him with additional interest and equity to compensate for the delay. When this promise also went unfulfilled, the plaintiff initiated litigation in October 2020 and brought several claims against the defendants, including claims under the Securities Act. The district court dismissed the plaintiff's securities fraud claims as untimely.

The Eleventh Circuit affirmed on the basis that the plaintiff had been put on "inquiry notice" of the defendants alleged securities fraud. Under the Securities Act, the one-year limitations period begins to run when the victim of securities fraud is first placed on inquiry notice — when he obtains knowledge of facts that would lead a reasonable person to begin investigating the possibility of fraud. Here, the panel determined that the defendants' failure to repay the loans by December 2018 would have given the plaintiff reason to investigate potential fraud, especially given the defendants' failure to repay multiple times before. Because the plaintiff did not file his Securities Act claims until October 2020, more than one year after he was placed on inquiry notice, the panel concluded that his claims were time-barred.

The court also rejected the plaintiff's argument that the doctrine of equitable estoppel should have tolled the one-year limitations period in this case. Under this doctrine, tolling is appropriate where the parties recognize the basis for suit, but the wrongdoing party convinces the other to forego litigation until after the statute of limitations has expired. The panel concluded that the doctrine was unavailable because the defendants did not make any attempts to prevent litigation after December 2018, the date when the plaintiff was placed on inquiry notice of the potential fraud and when the one-year limitations period began to run.

Statutes of Repose

Third Circuit Affirms District Court's Order Granting Leave To Amend Complaint, Holds That FRCP 15 Permits Relation Back Against Statutes of Repose in Securities Fraud Cases

SEPTA v. Orrstown Fin. Servs. Inc., No. 20-2829
(3d Cir. Sept. 2, 2021)

The Third Circuit affirmed a district court's decision granting leave to amend a securities fraud complaint in a decision that provides new guidance on how the "relation back" doctrine interacts with the three-year statute of repose for Securities Act claims and the five-year statute of repose for Exchange Act claims.

In the underlying action, the plaintiff — a purported investor — alleged that the defendants made material misrepresentations in their financial disclosures. The plaintiff first brought suit in 2012 asserting both Securities Act and Exchange Act claims. After years of motion practice, the district court dismissed all Securities Act claims — leaving only a few Exchange Act claims — and the parties began discovery. In April 2019, the plaintiff moved for leave to file a new amended complaint on the basis that it found further evidence to support its claims through discovery. The plaintiff sought to reassert previously dismissed claims from its original complaint. The defendants argued that the amendment would be futile because the reasserted claims were filed outside the three-year repose period for Securities Act claims and the five-year repose period for Exchange Act claims. However, the district court concluded that the amendment would not be futile and granted the plaintiff's motion.

On appeal, the Third Circuit affirmed, holding that Federal Rule of Civil Procedure 15(c) —which allows plaintiffs to amend their complaint to assert new claims that might otherwise be time-barred if the new claims "relate back" to timely filed original claims — allows amendment of a pleading after the expiration of a repose period. The panel based its conclusion on three grounds.

First, the panel found that relation back complied with the text of the federal securities laws' repose statutes, which provide that an "action" may not be "brought" outside the repose period. The panel emphasized that the plaintiff's previously dismissed claims were first "brought" in the original "action" before the applicable repose periods expired. Under Rule 54(b), reinstatement of dismissed claims cannot constitute the filing of a new action until a court has decided all claims against all parties to the initial action. Thus, none of the plaintiff's claims in the action ended because the district court had not disposed of all claims and all parties when the repose period expired.

Second, the panel found that relation back was consistent with the purpose of repose statutes; namely, to insulate defendants from liability after the prescribed repose period. The panel concluded that this purpose would not be defeated by allowing the plaintiff to amend its pleadings since it had already brought its action before the applicable repose period expired.

Finally, the panel found that relation back complied with the Rules Enabling Act, which prohibits interpretations of federal rules of procedure that would "modify any substantive right." The panel explained that defendants do not have a "substantive" right to repose against plaintiffs who sue before the statutory deadline and whose action remains pending. Because the plaintiff's action had not ended under Rule 54(b), none of the defendants had substantive rights to repose against the plaintiff when the deadline passed.

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

Lara Flath
212.735.3717
lara.flath@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

Chuck Smith*
312.407.0516
charles.smith@skadden.com

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

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

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

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

This communication is provided by Skadden, Arps, Slate, Meagher & Flom LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This communication is considered advertising under applicable state laws.