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Skadden

Inside the Courts
An Update From Skadden Securities Litigators

Class Certification

Central District of California Denies Class Certification in Securities Fraud Action Concerning Company's Purchase of ADRs

Stoyas v. Toshiba Corp., No. 2:15-cv-04194 (C.D. Cal. Jan. 7, 2022)

Judge Dean D. Pregerson denied class certification in a securities fraud case alleging that Toshiba Corp. committed accounting fraud and made material misrepresentations.

The plaintiffs were pension funds that utilized the services of professional investment managers to purchase and sell Toshiba American depositary receipts (ADRs) — securities listed on U.S. exchanges that represent ownership of shares in foreign companies — between May 8, 2012, and November 12, 2015. Typically, financial institutions hold the common stock of foreign companies and issue ADRs. The ADRs can then be bought and sold by the investing public in the same manner that other domestic securities trade. In this case, however, brokers in New York purchased Toshiba common stock on the Tokyo Stock Exchange for the purposes of ADR conversion on behalf of the plaintiffs' investment managers. After the brokers purchased the common stock, the shares were converted to Toshiba ADRs for the plaintiffs to purchase at a previously contracted price.

The plaintiffs alleged that Toshiba deliberately used improper accounting practices in an attempt to inflate its pre-tax profits and conceal financial impairment. Based on these alleged misrepresentations, the plaintiffs brought a putative class action against Toshiba under Section 12(a)(1) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 thereunder and Article 21-2 of the Financial Instruments and Exchange Act of Japan. Because the plaintiffs were pursuing monetary relief, they moved for class certification under Federal Rule of Civil Procedure 23(b)(3).

The district court denied the plaintiffs' motion for class certification for failure to satisfy the typicality requirement. In reaching this decision, the court found that the plaintiffs incurred irrevocable liability to take and pay for the ADRs in Japan, unlike members of the proposed class who acquired "Toshiba securities" in the United States. The court found that the moment the broker completed the transaction for Toshiba common stock on the Tokyo Stock Exchange, the plaintiffs became legally bound to perform their contractual obligations to pay for the ADRs once the brokers converted the stock into ADRs. The court held that under the U.S. Supreme Court's 2010 decision in *Morrison v. National Australia Bank*, 561 U.S. 247 (2010), and its progeny, because the most significant aspects of the plaintiffs' ADR purchases occurred outside of the U.S., they lacked standing to seek relief under U.S. securities laws and therefore could not represent an investor class.

The court rejected the plaintiffs' argument that the broker was not acting on the investment manager's behalf, but instead as a "riskless principal." A broker-dealer acts in a "riskless principal" capacity when he or she purchases securities in the marketplace for purposes of selling them back to another purchaser at the same price. The plaintiffs argued that liability could not have attached until the ADRs were sold in the separate transaction, post-conversion. The court rejected this argument, reasoning that if the broker acted as a "riskless principal," that fact would undermine the plaintiffs' argument because it would further support the notion that the investment manager (and by extension, the plaintiffs) was bound to complete the trade as soon as the broker purchased the underlying common stock.

District of Utah Grants Class Certification to Biotechnology Company Investors

In re Myriad Genetics Sec. Litig., No. 2:19-cv-00707-DBB (D. Utah Dec. 13, 2021)

Judge David Barlow certified a class of biotechnology company investors in a suit alleging that the company and certain of its officers violated Sections 10(b) and 20(a) of the Exchange Act, and Rule 10b-5 thereunder, by misrepresenting developments of certain biotechnology.

In opposing the lead plaintiff's motion for class certification, the defendants disputed only the adequacy element of Rule 23(b), which requires that "the representative parties will fairly and adequately protect the interests of the class." In principle, the defendants contested that the proposed plaintiff lacked "sufficient knowledge about the class action" and abdicated its duties to counsel. The defendants also argued that the plaintiff's deposition testimony showed that duties such as reviewing the complaint and analyzing potential legal claims were actually conducted by the plaintiff's counsel. The court rejected these arguments because (i) the plaintiff's board had a solicitation process in place in the event of litigation; (ii) the plaintiff made the ultimate decision of whether to initiate legal action; and (iii) the plaintiff chose the firm to represent it in the class action. Cutting in favor of the lead plaintiff's adequacy, the court also noted that the plaintiff reviewed the complaint before it was filed, collected documents for production in the litigation and had ultimate authority over the law firms in the litigation.

Similarly, the court rejected the defendants' argument that the plaintiff would not adequately represent the interests of the class because it lacked sufficient knowledge about the class action. The court found that the plaintiff's testimony showed a knowledge of the alleged misstatements that gave rise to the action, discussed the nature of the claims against the defendants and demonstrated the ability to explain specifically which statements in the defendants' press release were false or misleading.

Derivative Litigation

Court of Chancery Dismisses Derivative Suit for Failure To Plead Demand Futility

Equity-League Pension Trust Fund v. Great Hill Partners L.P., C.A. No. 2020-0992-SG (Del. Ch. Nov. 23, 2021)

Vice Chancellor Sam Glasscock III dismissed all claims, including breach of fiduciary duty claims, against Wayfair's directors in connection with the company's issuance of $535 million in convertible debt (the Transaction) to The Spruce House Partnership and subsidiaries of Charlesbank Capital Partners, LLC and Great Hill Partners, L.P.

Amid the "economic maelstrom" in the early stages of the global pandemic, Wayfair negotiated a private investment in public equity (PIPE) transaction to raise $500 million through the issuance and sale of convertible notes, culminating in the Transaction. The audit committee charged with reviewing conflicted deals approved the Transaction, with the full board's approval shortly thereafter. The plaintiff, a Wayfair stockholder, filed suit, alleging that the Transaction was conflicted because certain board members purportedly "participated on the buy-side."

The defendants moved to dismiss pursuant to Court of Chancery Rule 23.1, arguing that the plaintiff failed to make a demand or adequately plead with particularity that demand would have been futile. The court granted the motion to dismiss. Rejecting the plaintiff's allegation that the audit committee members faced a substantial likelihood of potential liability in connection with their approval of the transaction, the court explained that, in light of the Section 102(b)(7) exculpatory provision in Wayfair's certificate of incorporation, the plaintiff would have to plead facts showing bad faith. The court emphasized this high pleading standard, noting "where (as here) there is no adequate pleading of conflicted interests or lack of independence on the part of the [members of the Audit Committee], the scienter requirement compels that a finding of bad faith should be reserved for situations where the nature of [the Audit Committee members'] action[s] can in no way be understood as in the corporate interest." Rejecting the plaintiff's argument that the audit committee's actions supported an inference of bad faith, the court noted that the audit committee considered the Transaction with potential conflicts in mind and was aware of the terms offered by other arm's length bidders.

Court of Chancery Dismisses Derivative Suit Challenging Stock Repurchases and Dividends for Failure To Plead Demand Futility

In re Chemours Co. Derivative Litig., C.A. No. 2020-0786-SG (Del. Ch. Nov. 1, 2021)

Vice Chancellor Sam Glasscock III dismissed derivative claims arising from stock repurchases and corporate dividend payments allegedly made in violation of certain provisions of the Delaware General Corporation Law (DGCL) that generally require such payments to be made out of a corporation's surplus.

The Chemours Company was born from a corporate spin-off in 2015. As part of the spin-off, Chemours' former corporate parent transferred certain liabilities, including environmental liabilities, to Chemours. Chemours later sued its former parent, alleging that the size of the liabilities had been understated, and therefore Chemours would have been insolvent at its creation. Before and during that dispute, however, Chemours made stock repurchases and issued dividends. Chemours' board justified these payments based on a calculation of corporate surplus using generally accepted accounting principles (GAAP), as explained to it by external advisers and corporate officers. The plaintiff contended that the expenditures resulted from negligence or willful wrongdoing by the directors — exposing the directors to liability — because Chemours' own allegations in its lawsuit against its former parent demonstrated that the directors were aware that Chemours had no surplus, and that to rely on GAAP was improper because it failed to take into account the contingent environmental liabilities.

On the statutory claims, the court held that a majority of the director defendants did not face a substantial likelihood of liability for the stock repurchases and dividend payments. Section 174 of the DGCL states that "[i]n case of any wilful or negligent violation of § 160 or § 173 of this title, the directors under whose administration the same may happen shall be jointly and severally liable … to the full amount of the dividend unlawfully paid, or to the full amount unlawfully paid for the purchase or redemption of the corporation's stock …." Therefore, in the event of a willful or negligent violation of Section 160 or Section 173, which respectively set out the requirements for approving a stock repurchase and dividend payment, Section 174 imposes liability upon the directors serving at the time of the violation. The court noted, however, that Section 174 is "tempered" by Section 172, which provides that in the event of a violation, directors are "fully protected" if they rely "in good faith" upon the corporation's records, officers and employees; committees of the board; or experts in determining that the corporation has adequate funds to repurchase stock or pay dividends.

The court concluded that the plaintiff did not allege with particularity that the stock repurchases and dividend payments violated Sections 160, 170 or 173, or that the director defendants were negligent under Section 174. With respect to the standard to be applied to the Chemours board's determination of Chemours' surplus, the court held that it will defer to a board's surplus calculation "so long as [the directors] evaluate assets and liabilities in good faith, on the basis of acceptable data, by methods that they reasonably believe reflect present values, and arrive at a determination of the surplus that is not so far off the mark as to constitute actual or constructive fraud." Having determined that the plaintiff failed to adequately plead that the Chemours directors' surplus determinations failed to meet that standard, the court held that the plaintiff failed to plead noncompliance with Sections 160, 170 and 173, and therefore there was no "willful or negligent" violation to hold the directors liable for under Section 174. Furthermore, the court held that beyond the failure to allege a statutory violation, the directors were also "fully protected" from liability under Section 172, a defense that could be considered at the pleadings stage similar to Section 141(e) because they relied "'in good faith upon the records of the [Company] and upon' the Company's officers and financial advisors."

The court also dismissed the breach of fiduciary duty claim against the Chemours directors after noting that, pursuant to a Section 102(b)(7) provision, the directors were exculpated for breaches of the duty of care, which the plaintiffs failed to plead. Because a majority of the Chemours board did not face a substantial likelihood of liability as to any of the claims, the court also dismissed the breach of fiduciary duty claims against the Chemours officers, as demand was not excused.

Forum Selection Bylaws

Seventh Circuit Declines To Enforce Forum Selection Bylaw

Seafarers Pension Plan v. Bradway, No. 20-2244 (7th Cir. Jan. 7, 2022)

This Exchange Act Section 14(a) derivative suit arose out of the Federal Aviation Administration's grounding of the Boeing 737 MAX airliner in 2019 and 2020 in response to 737 MAX airliner crashes. A Boeing shareholder filed suit on behalf of Boeing under Section 14(a) in the Northern District of Illinois, where Boeing is headquartered. Boeing moved to dismiss on the grounds of *forum non conveniens*, pointing to a corporate bylaw stating that all derivative suits must be brought in the Delaware Court of Chancery unless the company consents to a different forum. Boeing conceded that enforcement of the bylaw would foreclose the suit entirely because the Exchange Act gives federal courts exclusive jurisdiction over actions under it, but it argued that Delaware law offered a sufficient substitute. The district court agreed and dismissed the suit.

On appeal, the Seventh Circuit reversed in a 2-1 decision. The court held that the bylaw was not authorized by Section 115 of the DGCL, which provides that "bylaws may require, consistent with applicable jurisdictional requirements, that any or all internal corporate claims shall be brought solely and exclusively in any or all of the courts in this State." Specifically, the majority held that the Boeing bylaw was not "consistent with applicable jurisdictional requirements" because the Exchange Act limits jurisdiction to federal courts. It further found that the bylaw's restriction to the Court of Chancery went further than Section 115 allows. According to the majority opinion, Section 115 permits suits to be limited to courts "in" Delaware — including federal courts in Delaware — whereas the Boeing bylaw excluded all federal courts. The Seventh Circuit supported its argument by looking at the legislative history of the DGCL.

The Seventh Circuit then reviewed related Delaware case law and found that Delaware courts have not authorized forum bylaws that regulate whether, rather than where, shareholders may file suit. In fact, it found that the Court of Chancery had suggested that bylaws such as Boeing's would be invalid in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013). The court also distinguished certain Supreme Court and Seventh Circuit precedent cited by Boeing to support the enforceability of forum-selection clauses. It explained that the decisions in those cases hinged on "the international character" of the disputes, a factor not present in this case. Accordingly, the Seventh Circuit reversed the district court's judgment and remanded the case for further proceedings.

Judge Frank Easterbrook dissented, noting that nothing in Boeing's bylaws prevents the shareholders from bringing a direct suit under Section 14(a) in federal court. He explained that derivative suits — even those based on alleged violation of federal securities laws — arise under state law, and that Section 14(a) ensures only the right to a direct claim, not a derivative one. Thus, the bylaw did not prevent the plaintiff from exercising its federal rights. Judge Easterbrook also disagreed with the majority's reading of Section 115 of the DGCL. Under his reading, the provision's phrasing "any or all of the courts in this State" forbids bylaws that block litigation in Delaware but allows those that limit the courts "in" Delaware in which a suit may be brought.

Loss Causation

District of Colorado Denies Summary Judgment Against Cryptosecurity Firm for Failure To Plead Loss Causation

Arslani v. UMF Grp., Inc., Civil Action No. 19-cv-1117-WJM-KLM (D. Colo. Jan. 7, 2022)

Judge William J. Martinez denied a plaintiff's motion for summary judgment in a suit alleging violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 thereunder against a cryptocurrency firm and its attorney. Specifically, the plaintiff alleged that between January 2017 and September 2017, the defendants falsely announced that the company would be transitioning from the oil and gas business into the medical marijuana business, and then into the cryptosecurity business. The plaintiff alleged that those fraudulent representations by defendants induced him to purchase securities. After the company failed to respond to the complaint, the plaintiff obtained default judgment against the company and moved for summary judgment against the attorney.

Although the attorney did not respond to the plaintiff's motion for summary judgment, the court found that the plaintiff failed to meet its burden as to loss causation under Rule 10b-5 sufficient to support summary judgment. The plaintiff failed to present evidence that "information correcting [the] alleged misrepresentations was revealed before the stock price dropped." Without such evidence, the court noted that concluding that the misrepresentation caused the price drop would be "entirely speculative," and the court denied the motion.

SEC Enforcement Actions

Ninth Circuit Affirms Disgorgement Order, Holds That *Liu* Does Not Apply to Relief Defendants

SEC v. Berkeley Healthcare Dynamics, LLC, No. 20-16754 (9th Cir. Jan. 5, 2022)

The Ninth Circuit affirmed the denial of a motion for relief from a judgment ordering disgorgement as a remedy for securities law violations, concluding that the Supreme Court's 2020 decision in *Liu v. SEC*, 140 S. Ct. 1936 (2020) did not require deduction from the disgorgement order of a relief defendant's legitimate expenses.

The case arose out of an action initiated by the Securities and Exchange Commission (SEC) against a defendant alleged to have operated a wide-ranging scheme to defraud investors. The original complaint also named Berkeley Healthcare Dynamics, LLC, a company that owned a warehouse leased to the defendant, as a "relief defendant"— an entity not accused of having directly committed any legal violations but alleged to be holding the proceeds from the alleged fraud. In late 2018, the Northern District of California granted summary judgment to the SEC, finding that the relief defendant, together with the primary defendant, were liable for disgorgement of $23.9 million. The relief defendant objected to the disgorgement order and argued that some of the funds were appropriately paid by the defendant as a tenant for expenses required under the lease. However, the district court overruled this objection on the grounds that the relief defendant failed to show that there was any factual dispute that those funds were commingled with the ill-gotten funds. The relief defendant did not appeal.

Subsequently, on June 22, 2020, the Supreme Court decided *Liu*, which held that a disgorgement award cannot "exceed a wrongdoer's net profits," and therefore, "courts must deduct legitimate expenses before ordering disgorgement[s]." After the *Liu* decision, the relief defendant moved for relief from judgment, arguing that, after *Liu*, it could not be required to disgorge its "legitimate business expenses." The district court denied the relief defendant's motion, concluding that *Liu* did not change the governing law.

The Ninth Circuit affirmed on the basis that *Liu* applied only to disgorgements ordered against primary wrongdoers. The panel determined that, in contrast to a primary wrongdoer, a relief defendant is not subject to disgorgement of "profits," but only ill-gotten funds that they lack a legitimate claim to receive (as opposed to, for example, compensation for rendered services). Because *Liu* provides that primary wrongdoers must disgorge all profits less legitimate expenses, it cannot apply to relief defendants. The court emphasized that this approach is consistent with *Liu*'s reasoning that an equitable remedy "should be designed to restore the status quo and avoid being transformed into a penalty." The panel affirmed that the relief defendant's failure to appeal the district court's summary judgment order is not excusable under *Liu*.

Securities Fraud Pleading Standards

Materiality

Second Circuit Reverses Dismissal of Proposed Class Action Claiming Internet Company Misled Shareholders About Relisting Plan

Altimeo Asset Mgmt. v. Qihoo 360 Tech. Co., No. 20-3074 (2d Cir. Nov. 24, 2021)

The Second Circuit reversed the dismissal of a class action lawsuit brought by a putative class of investors against a Beijing-headquartered internet company incorporated under the laws of the Cayman Islands and its controlling officers. The complaint alleged that the defendants violated Sections 10(b), 20(a) and 20A of the Exchange Act and Rule 10b-5 thereunder by, among other things, concealing from investors their plan to relist the company in the Chinese public market when they had 16 months earlier represented in certain proxy materials that the company was being taken private. These proxy materials allegedly contained misleading statements that indicated there were no "current plans, proposals or negotiations" for an "extraordinary corporate transaction," and that in the future the company "may propose or develop plans and proposals" to relist on another internationally recognized stock exchange. The district court dismissed the complaint in its entirety, finding that it did not plausibly allege a misstatement or omission of material fact sufficient to state a claim for securities fraud.

On appeal, the Second Circuit disagreed with the district court's findings. Specifically, the Second Circuit focused on the plaintiffs' allegation that, at the time the proxy materials were sent to the shareholders, the company's officers had "already planned to relist Qihoo at a far-higher valuation in China post-transaction." In support, the Second Circuit credited several allegations in the complaint, including (i) that according to "[a]n expert in Chinese and United States M&A and capitals market transactions," it "typically takes companies at least a full year on the quickest possible timeline and usually longer, from the time they first start to consider a backdoor listing until they reach agreement with a shell company to conduct a reverse merger"; and (ii) two recent news articles reporting that the privatization plan provided to investors involved in taking the company private included the option of relisting the company on the Chinese stock market.

The Second Circuit inferred from these allegations, taken together, that the statements in the proxy materials that there were "no current plans" to relist the company, as well as its omission of any such plan, were materially misleading. The panel determined that because the relisting was announced 16 months after the proxy materials were issued, it is likely that negotiations for relisting were already underway at that time, a fact that would have been material to a reasonable investor.

EDNY Grants Motion To Amend Complaint To Resolve Inadequate Pleadings

Gordon v. Tencent Music Entm't Grp., 19-cv-5465 (LDH) (TAM) (E.D.N.Y. Dec. 27, 2021)

Judge Taryn A. Merkl granted a motion for leave to amend brought by a putative class of investors alleging violations of Sections 11 and 15 of the Securities Act, Sections 10(b) and 20(a) of the Exchange Act, and Rule 10b-5 thereunder against the "largest online music entertainment platform in China" — which had an initial public offering (IPO) in 2018 — certain of the company's officers and directors, and certain financial firms and advisers that assisted with the IPO. The first complaint alleged that, in SEC filings related to the IPO, the company failed to disclose that it was the subject of an "anti-monopoly investigation" being conducted by the Chinese government. The court dismissed that complaint, agreeing with the defendants that the complaint failed to plead that any misrepresentations were made at the time of the SEC disclosures since no investigation had been confirmed at that point. The plaintiffs moved to amend.

The court granted the motion for leave to amend because the proposed amendments addressed the issues with the original complaint raised in the motion to dismiss. In particular, the court determined that the proposed amendments were not futile because they provided "facts and additional context," including about a meeting that the defendants had with Chinese authorities before the Chinese government commenced its investigation, sufficient to give rise to a reasonable inference that the SEC filings were misleading. The court also noted that the misleading filings were not "so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance," and therefore could serve as the basis of the plaintiffs' claims.

Southern District of Ohio Dismisses Securities Fraud Claim Against Power Company Connected to Lobbying Scandal

Nickerson v. Am. Elec. Power Co., No. 2:20-cv-4243 (S.D. Ohio Dec. 20, 2021)

Judge Sarah D. Morrison dismissed a putative class action for securities fraud against public utility holding company American Electric Power Company, Inc. (AEP) for failing to plead any actionable misrepresentations or omissions.

The plaintiffs alleged AEP made material misrepresentations and omissions concerning its involvement in passing a piece of Ohio legislation, House Bill 6. While AEP initially opposed the bill, it lobbied for the inclusion of a provision that would benefit it. The final version of the bill ultimately included the provision. AEP also gave financially to an organization that in turn contributed to other entities involved with passing the bill. An alleged large-scale bribery scheme behind the bill's passage later came to light. AEP's shares fell after its alleged connection with the scheme through which political contributions became known. The plaintiffs sued, alleging, in relevant part, one count of securities fraud under the Exchange Act.

The plaintiffs alleged that several statements made in AEP earnings calls, responses to analyst questions, corporate accountability reports, public filings and AEP's regulatory newsletter were materially false or misleading. In broad strokes, the plaintiffs alleged AEP was not transparent about its lobbying efforts related to the bill and the company's political contributions. The plaintiffs alleged AEP's statements gave the false impression the bill was legitimately passed and that AEP was not actively involved in lobbying for the bill. AEP argued the alleged misrepresentations or omissions were not actionable, and the court agreed.

Applying the heightened pleading standards for fraud under the Federal Rule of Civil Procedure 9(b) and the Private Securities Litigation Reform Act of 1995 (PSLRA), the court noted deficiencies under each category of statements the plaintiffs identified. In part, the court found that comments made on earnings calls regarding AEP's failure to state why it initially withheld support for the bill were not material. It noted AEP's intentions were apparent from its public actions and statements, and the comments would not have significantly altered the total mix of information available to investors. The court further found AEP's statements discussing the bill in its initial form and the positive elements from the bill as passed too generic and innocuous to have misled any reasonable investor.

With respect to a statement that the company was still analyzing the impact of the bill on AEP, the court found no reasonable investor would draw from this statement the misleading impression that AEP did not back the provision that benefited it, as the plaintiffs contended. As to the statements in the regulatory newsletter, which the plaintiffs did not allege were factually inaccurate, the court found them merely descriptive and neither false nor misleading. Finally, the court agreed with AEP that the language in the corporate accountability reports concerning AEP's commitment to transparency and public disclosure of lobbying activities and political contributions were unactionable puffery — corporate aspirations upon which no reasonable investor would rely. Because none of the identified statements could form the basis for a claim under the PSLRA, the court dismissed the plaintiffs' claim for securities fraud with prejudice.

Misrepresentations

Eighth Circuit Affirms Dismissal of Securities Fraud Class Action

City of Plantation Police Officers Pension Fund v. Meredith Corp.,
No. 20-3510 (8th Cir. Oct. 18, 2021)

The Eighth Circuit affirmed the dismissal of a putative class action alleging securities fraud against Meredith Corp. and several of its executives. The plaintiff's claims arose from Meredith's acquisition of Time, Inc. Meredith's share price dropped three times in 2019 after information emerged indicating difficulties integrating the companies following the acquisition. The plaintiff's complaint identified 138 allegedly false or misleading statements made by Meredith executives regarding the acquisition and integration. Meredith moved to dismiss the complaint for failure to state a claim. The district court granted the motion to dismiss and denied the plaintiff's request for leave to amend. The plaintiff appealed to the Eighth Circuit.

On appeal, the Eighth Circuit summarily concluded that 137 of the 138 statements alleged in the complaint were not actionable as either (i) forward-looking statements accompanied by meaningful cautionary statements; (ii) corporate puffery; or (iii) forward-looking statements, for which the allegations did not raise a strong inference of being made with actual knowledge of their falsity.

The court then considered the one remaining alleged misstatement from Meredith's then-CEO in February 2019. The CEO stated that the company had fully integrated its human resources, finance and legal departments. The complaint alleged that this statement was false on the basis of a confidential statement from a former Meredith employee, who stated that the legacy Meredith employees and legacy Time employees used different finance software systems until August 2019.

Although the court found that this statement came closer to stating a securities fraud claim than the other 137, it concluded this allegation still fell short of giving rise to an inference of scienter. The Eighth Circuit noted the former employee's confidential statement provided no insight into what the CEO knew about the finance software systems. The court also indicated the complaint failed to state with particularity facts supporting the claim that the use of two software systems was so obvious that the CEO would have been negligent to turn a blind eye. Instead, it found more plausible the inference that the CEO lacked insight into the inner workings of the finance department consolidation at the time of his statement.

Having determined that the complaint failed to allege any actionable misstatements, the Eighth Circuit affirmed the district court's dismissal of the complaint. The court also affirmed the denial of leave to amend because the plaintiff's proposed new allegation of securities fraud, raised for the first time in opposition to the motion to dismiss, also would not have survived a motion to dismiss.

Northern District of California Denies in Part Dismissal of Securities Fraud Action, Clarifying Context of Statement Could Mislead Reasonable Investor

In re Vaxart Inc. Sec. Litig., Case No. 20-cv-05949-VC (N.D. Cal. Dec. 22, 2021)

Judge Vince Chhabria denied in part a motion to dismiss securities fraud claims brought against a vaccine development company, its officers and the hedge fund with a majority stake in the company based on allegedly misleading statements regarding the company's ability to mass-produce a successful coronavirus vaccine.

In June 2020, the company published the first in a series of eight press releases about its efforts to develop a coronavirus vaccine, each of which sent the company's shares higher. Within a span of 10 days, the company announced it had initiated a program to develop an oral vaccine, reached an agreement with another company to develop and manufacture 1 billion doses of an oral vaccine and been selected for the U.S. government's Operation Warp Speed. The Department of Health and Human Services (HHS) later confirmed the federal government had not chosen Vaxart as one of its leading vaccine developers; instead, the company had been selected to participate only in a nonhuman primate challenge study organized and funded by Operation Warp Speed. While Vaxart had disclosed that information, it did so only in small print in the press release in question. The clarifying statement by HHS allegedly caused Vaxart's stock price to decline. The plaintiffs, purported investors, brought securities fraud claims under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder against Vaxart, its officers and the hedge fund, alleging that the defendants made misleading statements to the investing public regarding the company's progress in developing a coronavirus vaccine.

The district court denied the defendants' motion to dismiss in part. The court concluded that the complaint failed to sufficiently plead that the hedge fund that sold shares in the wake of the misleading statements was liable for the alleged misstatements, and it determined that the hedge fund did not "make" the statement under *Janus*, nor did it disseminate any of Vaxart's press releases. However, with respect to the company and its officers, the court concluded that the plaintiffs had adequately alleged the defendants knowingly misled the investing public about the company's progress in developing a vaccine.

First, the court concluded that the plaintiffs' complaint adequately alleged that the statements in the press releases would have misled a reasonable investor. The information Vaxart made available to the market in its press releases, within the broader context of the government steadily announcing recipients of Operation Warp Speed, materially misled the investing public that it was pioneering a successful coronavirus vaccine. The court found that the complaint plausibly alleged Vaxart designed its press release with truthful statements that would take advantage of the health care environment in order to mislead investors.

Second, the court found that the complaint had adequately alleged scienter by pleading facts permitting a strong inference that defendants were acting with intent to mislead and elicit an unduly favorable reaction by the market. Specifically, the plaintiffs plausibly alleged that the defendants knew the company had not been selected to receive federal funding through Operation Warp Speed and that its manufacturing company did not have the regulatory capacity nor personnel to produce 1 billion doses of the vaccine.

Particularity

District of Colorado Denies Motion for Reconsideration, Dismissing Alleged Price-Fixing Conspiracy Claims Brought by Putative Class of Investors

Hogan v. Pilgrim's Pride Corp., Civil Action No. 16-cv-02611-RBJ (D. Colo. Nov. 29, 2021)

Judge R. Brooke Jackson denied a motion for reconsideration of the court's order and judgment dismissing a second amended complaint filed by a putative class of investors against a leading broiler chicken producer and certain of its executives. The second amended complaint (SAC) alleged that the defendants violated Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5(a) and (c) thereunder by concealing the company's participation in a price-fixing conspiracy that began as early as 2007 and continued through at least November 2016. The SAC alleged that the defendants instead falsely attributed the company's success to operational improvements, artificially inflating the company's share price.

In March 2018, the court granted the defendants' motion to dismiss the plaintiffs' first amended complaint for failure to "plead the underlying antitrust conspiracy with sufficient particularity." The plaintiffs moved for reconsideration of that order based in part on a Northern District of Illinois case that they characterized as an "intervening change in the law." The court denied the motion but granted the plaintiffs leave to amend their complaint. In June 2020, more than a year and a half after leave to amend was granted, the plaintiffs filed the SAC. They argued that the amended complaint was justified by the "genuinely new fact" of a recent federal grand jury indictment in Colorado of certain broiler chicken-producing company executives for their role in a price-fixing and bid-rigging conspiracy between 2012 through 2017. The court dismissed the SAC, agreeing with the defendants that the Section 10(b) claims were time-barred by the five-year statute of repose for securities fraud actions and that the lead plaintiff lacked standing to bring any remaining claims. The court rejected the plaintiffs' argument that the "continuing fraud exception" or "relation back" claims under Rule 15(c) rendered the complaint timely. The plaintiffs moved for reconsideration.

The court denied the motion, again rejecting the plaintiffs' argument regarding "relation back" because the plaintiffs had failed to raise any new issues that they did not or could not have made in their opposition to the motion to dismiss. The court found that it did not commit "clear error" by ignoring the plaintiffs' second claim, which asserted "scheme liability" under Rules 10b-5(a) and (c), because (i) it was an entirely new argument that was not made in response to the defendants' motion to dismiss; and (ii) "scheme liability" — which generally applies to "deceptive conduct rather than deceptive statements" — was inapposite to the facts of this case.

Scienter

Second Circuit Vacates and Remands Dismissal for Reconsideration of Scienter Pleading

In re Hain Celestial Grp., Inc. Sec. Litig., Docket No. 20-1517 (2d Cir. Dec. 17, 2021)

The Second Circuit vacated and remanded a lower court's dismissal of a securities fraud claim against a health food company and four former or present officers. The complaint alleged violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 thereunder arising from public statements that the company's growth was attributable to increased demand for the company's products, when demand was actually shrinking and sales were maintained through "channel stuffing" ("offering large and unsustainable incentives such as price reductions and an absolute right to return unsold products"). The complaint alleged that the defendants failed to disclose the channel stuffing and how it artificially inflated sales figures, such that when the practice was finally revealed through a series of disclosures — including the company's announcement of an internal investigation into its historical financial results and an SEC investigation — the company's stock price fell. The complaint also alleged that the channel stuffing amounted to a scheme to defraud investors. The lower court dismissed the complaint for failure to allege scheme liability for a violation of Rule 10b-5(a) and (c) and to adequately allege scienter for a violation of Rule 10b-5(b).

The Second Circuit reversed the dismissal because the lower court failed to consider whether the complaint adequately alleged that Rule 10b-5(b) had been violated. The lower court had reasoned that because the channel stuffing practices were not wrongful, there could be no violation of clause (b), as "it would be incongruous for the court to have concluded that it was done with a wrongful state of mind." The Second Circuit found that the lower court erred by failing to assess the "total weight of the circumstantial allegations *together with* the allegations of motive and opportunity" in considering whether scienter had been adequately pled. The Second Circuit therefore remanded the case for the lower court to consider whether scienter had been adequately pled.

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

Lehmann v. Ohr Pharm., Inc., No. 20-4185-cv (2d Cir. Dec. 16, 2021)

In a summary order, the Second Circuit affirmed the dismissal of claims brought by a putative class of investors against a pharmaceutical company and certain of its officers under Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 thereunder, alleging that the defendants made misleading statements about clinical trial results involving the company's experimental drug Squalamine. The clinical trial evaluated whether Squalamine, combined with another drug already approved by the Food and Drug Administration (FDA), Lucentis, would treat "wet" age-related muscular degeneration better than Lucentis alone. These claims had been previously dismissed by the district court in *Lehmann v. Ohr Pharm. Inc.*, 18 Civ. 1284 (LAP), 2019 WL 4572765 (S.D.N.Y., Sep. 20, 2019). The Second Circuit had then affirmed that dismissal and remanded the case to the district court to determine whether to grant leave to file a second amended complaint in *Lehmann v. Ohr Pharm., Inc.*, 830 F. App'x 349 (2d Cir. 2020). On remand, the plaintiffs filed a series of letters, which the district court judge construed collectively as a motion for leave to amend and denied, dismissing the claims for a second time. The plaintiffs appealed, raising procedural and substantive arguments.

The Second Circuit rejected the plaintiffs' procedural argument that the district court had improperly construed its pre-motion letters as a motion for leave to amend. The Second Circuit held that as long as a plaintiff's letters are "sufficiently detailed" and the plaintiff is given the opportunity to respond to a defendant's counterarguments, a district court does not abuse its discretion for construing the letters as a motion. The Second Circuit also rejected the plaintiffs' argument that the district court had improperly determined that any amendment would be futile, ruling that the plaintiffs failed to allege that the defendants "were at least as likely as not" to have acted with scienter. The Second Circuit rejected the plaintiffs' argument that the defendants were reckless in touting the efficacy of Squalamine when they knew that the reliability of the study's control variable (*i.e.*, with Lucentis alone) was uncertain and inconsistent with previous Lucentis-only studies. The Second Circuit determined that, while the plaintiffs interpreted prior studies of Lucentis as inconsistent with the control study, they did not allege any facts suggesting that the defendants "reached or should have reached" the same conclusion. The Second Circuit noted that the plaintiffs failed to point to any reports concluding that previous Lucentis studies had results "inconsistent with or better" than those provided in the defendants' clinical trial and determined that the plaintiffs had failed to adequately allege scienter.

Second Circuit Affirms Dismissal of Proposed Class Action Claiming Pharmaceutical Company Misrepresented FDA Feedback on New Drug

In re Alkermes Pub. Ltd. Sec. Litig., 21-801-cv (2d Cir. Dec. 7, 2021)

A Second Circuit panel affirmed the dismissal of a class action lawsuit brought by a putative class of investors against a pharmaceutical company and several of its officers. The complaint alleged that the defendants violated Sections 10(b) and 20(a) of the Exchange Act by misrepresenting feedback that the company had received from the FDA on the company's new drug and its clinical trial protocols. The complaint alleged that because of those misrepresentations, investors were surprised when the FDA publicly disclosed its concerns and the FDA advisory committee voted against approving the drug. The district court dismissed the complaint for failing to sufficiently plead scienter.

On appeal, the Second Circuit agreed with the district court's finding that the allegations in the amended complaint did not give rise to a strong inference of recklessness, and thus the amended complaint had failed to plead scienter. Specifically, the Second Circuit determined that the defendants' public disclosures did not mischaracterize the FDA's rejection of the company's novel approach to providing evidence of efficacy for a new drug in its Phase 3 clinical trial design. The panel credited several correspondences between the company and the FDA and other public disclosures regarding the company's novel approach, and the risk of FDA inflexibility in accepting the new design. The panel held that this evidence, far from raising a strong inference of scienter, instead supported the more cogent nonfraudulent inference that the defendants were optimistic about the FDA's review.

The Second Circuit also rejected the plaintiffs' argument that the defendants' omission of the FDA's comments that it "did not agree" with the use of "averaging" to prove the drug's efficacy gave rise to a strong inference of recklessness. Instead, the panel held that the company had appropriately disclosed it would give the FDA "all the data available for … review" so the FDA could "analyze the data however they choose." Finally, the Second Circuit rejected the plaintiffs' argument that the company had mischaracterized the FDA's objection to the company's use of *post hoc* data to show efficacy. The panel determined that because the FDA has publicly declared *post hoc* analysis to be merely "exploratory," and since the company's public disclosures concerning *post hoc* analyses were consistent with that, investors understood that those results were less significant.

Fourth Circuit Affirms Dismissal of Shareholder Suit Against Information Technology Company for Failure To Adequately Plead Scienter

KBC Asset Mgmt. NV v. DXC Tech. Co., 19 F.4th 601 (4th Cir. 2021)

Plaintiffs KBC Asset Management NV, Arbejdsmarkedets Tillaegspension and the City of Warren Police and Fire Retirement System appealed the dismissal of their class action suit against defendants DXC Technology Company (DXC) and two of its executives under Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 thereunder.

The plaintiffs alleged that they bought DXC shares at an inflated price after the defendants made false and misleading statements concerning DXC's financial health. DXC released a press statement on February 8, 2018, announcing positive financial results. Months later, on November 6, 2018, the company decreased its projected revenue guidance to shareholders by approximately

$800 million. The plaintiffs, who bought DXC shares between the February announcement and November revision, alleged that the defendants knew that cost-cutting measures implemented in 2018 undermined the company's ability to generate revenue, but they omitted or mispresented this information. The plaintiffs filed a complaint based on these allegations and the district court dismissed the complaint, holding that the plaintiffs failed to allege the defendants' statements were actionable or that the defendants acted with scienter. The plaintiffs appealed.

The Fourth Circuit affirmed the district court's dismissal, evaluating in turn the different categories of statements challenged by the plaintiffs and ruling that they had failed to allege facts supporting a strong inference of scienter. With respect to allegations a former company executive made in a separate lawsuit that they had warned DXC that cutting costs would harm customer satisfaction, the court found these allegations represented mere business disagreements over an action the former employee was asked to carry out, rather than knowledge amounting to scienter.

With respect to statements of unnamed former company employees who allegedly believed DXC was heading in the wrong direction before and during the class period, the court concluded that the statements were vague and conclusory, and otherwise failed to demonstrate that the witnesses passed their concerns on to the defendants. The court also found that even if the former employees were ultimately correct that the defendants made "unwise business decisions," such mistakes could not support a strong inference of scienter.

The court also concluded that alleged stock sales by the executive defendants during the class period did not sufficiently demonstrate scienter. The court concluded that one executive's stock sales were not large enough to raise a strong inference of scienter, and the other executive's sales were substantially smaller than the amount of stock he sold during a control period where he was not alleged to have engaged in wrongdoing. In light of these mitigating circumstances, the court did not draw a strong inference of scienter.

Regarding the plaintiffs' asserted "core-operations theory," the court ruled that the theory had not been sufficiently presented and lacked specific facts demonstrating the defendants' knowledge of problems within the company. Finally, with respect to the temporal proximity between DXC's positive statements and its ultimate disclosures of revised revenue guidance (allegedly less than three months), the court stated that temporal proximity alone could not support a strong inference of scienter. The court asserted that the plaintiffs, in effect, were improperly attempting to plead fraud by hindsight.

The court also found other mitigating factors existed, effectively weakening the plaintiffs' ability to allege scienter, including (i) the plaintiffs' own allegations offered an innocent and plausible explanation of DXC's financial struggles; and (ii) the defendants previously announced risks and newly discovered weaknesses to investors in a timely manner. After evaluating these factors in conjunction with the plaintiffs' allegations, the court held that the plaintiffs had failed to satisfy the PSLRA's heightened burden for pleading scienter.

SPAC Litigation

Court of Chancery Denies Motion To Dismiss in Novel Application of Fiduciary Duty Principles in SPAC Context

In re MultiPlan Corp. S'holders Litig., C.A. No. 2021-0300-LWW (Del. Ch. Jan. 3, 2022)

Vice Chancellor Lori W. Will denied motions to dismiss claims for breach of fiduciary duty against a special purpose acquisition company's (SPAC) sponsor and its directors, as well as for aiding and abetting breach of fiduciary duty against its financial advisor.

Churchill was a SPAC founded and controlled by Michael Klein through a sponsor entity (the Sponsor). According to the plaintiffs, the SPAC's directors were allegedly hand-picked by Mr. Klein and given economic interests in the Sponsor. Churchill's 2020 IPO was priced at $10 per unit, consisting of one share of Class A stock and a quarter of a warrant. After the IPO, Churchill's equity structure consisted of Class A shares held by public stockholders and Class B "founder" shares purchased by the Sponsor for a nominal capital contribution and convertible to Class A shares if the SPAC closed a transaction. The Class A and Class B shares represented 80% and 20% of the SPAC's outstanding equity, respectively. In the event that a transaction was not accomplished within 24 months, the SPAC would liquidate, and Class A shareholders would receive their pro rata share of the amount from the IPO plus interest, equal to $10.04. In contrast, the Sponsor's Class B shares would expire absent a deal. The warrants held by both Class A and Class B stockholders would also expire without a deal. However, if the SPAC proposed a business combination, Class A stockholders could choose to exercise a redemption right for their Class A shares for $10.04 and would retain their warrants, regardless of whether they voted in favor of the deal.

The SPAC identified MultiPlan as its acquisition target and retained The Klein Group LLC, an entity controlled by Mr. Klein, as its financial advisor. The SPAC did not obtain an independent third-party valuation of MultiPlan or a fairness opinion.

The merger proxy statement sought stockholder approval and also informed Class A stockholders about their ability to redeem their shares. Stockholders overwhelmingly approved the deal. After the merger closed, the newly public MultiPlan's stock dropped significantly based on a report from an equity research firm about MultiPlan's largest customer forming a competitor entity, which was not disclosed in the proxy. The complaint followed, asserting class claims for breach of fiduciary duty against the SPAC directors, Mr. Klein, the SPAC's chief financial officer, and The Klein Group.

The court concluded that the entire fairness standard of review applied for two reasons. First, the court held that it was reasonably conceivable that the de-SPAC (a merger of the target company with the SPAC) was a conflicted controller transaction. The parties agreed that Mr. Klein — through the Sponsor — controlled the SPAC, and the court concluded that "[t]he well-pleaded allegations in the Complaint highlight a benefit unique to Klein," emphasizing that on the date the merger closed, the Sponsor's investment was worth $356 million — "representing a 1,219,900% gain on the Sponsor's $25,000 investment." However, "[t]hese figures would have dropped to zero absent a deal." In contrast, Class A stockholders would have received $10.04 per share if the SPAC failed to consummate a transaction and liquidated, or if they had redeemed their shares. Thus, the court concluded that there was a "potential conflict between Klein [and the Sponsor] and public [Class A] stockholders resulting from their different incentives in a bad deal versus no deal" at all.

Second, the court held that there were reasonably conceivable allegations that the SPAC board was conflicted because the SPAC's directors, through their economic interests in the Sponsor, "would benefit from virtually any merger — even one that was value diminishing for Class A stockholders — because a merger would convert their otherwise valueless interests in Class B shares into shares of Public MultiPlan." The court also held that the complaint adequately pled that a majority of the board was conflicted because its members were not independent from Mr. Klein.

The court then held plaintiffs pleaded that the proxy contained false and misleading disclosures with sufficient particularity to survive a motion to dismiss. The proxy allegedly "did not disclose that MultiPlan's largest customer was UHC and that UHC was developing an in-house alternative to MultiPlan that would both eliminate its need for MultiPlan's services and compete with MultiPlan .... Based on the plaintiffs' allegations, it is reasonably conceivable that a Class A stockholder would have been substantially likely to find this information important when deciding whether to redeem her Churchill shares."

Finally, the court held that the complaint alleged nonexculpated claims for breach of fiduciary duty against the SPAC's directors "because the Complaint alleges that the director defendants failed, disloyally, to disclose information necessary for the plaintiffs to knowledgably exercise their redemption rights." The court also sustained claims against Mr. Klein in his capacity as the SPAC's controlling stockholder and as CEO of the SPAC. However, the court dismissed claims against the SPAC's CFO. The court also sustained an aiding and abetting allegation against The Klein Group.

Standing

Northern District of California Denies Motion To Dismiss, Clarifies Shareholder Standing as Forced Seller

Quinan v. Kleinberg, Case No. 21-cv-05295-JCS
(N.D. Cal. Nov. 26, 2021)

Judge Joseph C. Spero denied a motion to dismiss, holding that a shareholder whose shares were forcibly liquidated in a reverse stock split had standing to bring claims under Rule 10b-5, despite not being a bona fide purchaser or seller of securities who based his purchase or sale on alleged fraudulent activity.

This case involved a company with five shareholders, three of whom were directors and the defendants in this case. Two of the directors wanted to buy out the other three shareholders and reached an agreement to purchase the shares owned by one of the nondirector shareholders. Then, they engaged in negotiations to buy out the third director. The defendants commissioned Stonebridge Advisory Inc. to value the company for "partner buyout purposes" and claimed to use this valuation to determine an offer price to buy the shares of the one remaining nondirector shareholder, who is the plaintiff in the case. The plaintiff refused the purchasing defendants' offer to buy his 50,000 shares. When he refused, the defendants allegedly decided to forcibly purchase the plaintiff's shares through a reverse stock split, which would be put to a shareholder vote. Under the terms of the 1:75,000 stock split, shareholders would receive one share of the company's newly issued stock for every 75,000 shares that they owned. Importantly, all fractional shares would be liquidated. Thus, the plaintiff would own only two-thirds of a share of the newly issued stock, and his fractional share would therefore be liquidated. The defendants, who owned a majority of the shares, voted in favor of the reverse stock split.

The plaintiff sued, alleging that the defendants justified the reverse split on the basis of a valuation that they knew to be inaccurate, using much lower estimates of the company's value to negotiate the buyout price. The plaintiff brought securities fraud claims under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, alleging that the defendants made misleading statements in connection with the company's purchase of the plaintiff's shares.

The defendants moved to dismiss, arguing that the plaintiff lacked standing under Rule 10b-5 because he was not a bona fide purchaser or seller of shares who based his purchase or sale on alleged fraudulent activity. The district court rejected that argument, finding that the plaintiff had standing based on the forced seller doctrine.

Under the forced seller doctrine, a shareholder plaintiff has standing if he or she was forced "as a matter of law to sell" their shares, or forced to fundamentally change the nature of their investment as a result of a fraudulent scheme. Here, the court found that the plaintiff had standing under the forced seller doctrine because the defendants' vote on a reverse split meant that the plaintiff could not continue to hold his shares, which were involuntarily liquidated.

The court also rejected the defendants' argument that the forced seller doctrine did not apply because the plaintiff "had plenty of opportunity to make decisions regarding his investment." The court noted that the defendants failed to cite any authority that a rejection of a previous offer to purchase shares made a subsequent liquidation of his shares volitional. The court similarly found unpersuasive the defendants' arguments that the plaintiff's failure to attend the shareholder meeting where the reverse split vote occurred, or his failure to cash the check that was sent to him when his shares were liquidated, prevented the plaintiff from invoking the forced seller doctrine. The court concluded that the doctrine was available because the plaintiff was required, as a matter of law, to sell his shares as a result of the defendants' allegedly fraudulent scheme.

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