Reuters Legal News

When saying litigation is 'without merit' risks follow-on securities litigation

By Virginia Milstead, Esq., and Mark Foster, Esq., Skadden, Arps, Slate, Meagher & Flom LLP

AUGUST 21, 2023

It is common for companies to say that litigation claims pending against them are "without merit." If it turns out, however, that the claims had merit and company executives knew it, a viable securities class action could follow. That is what happened in a recent case: *City of Fort Lauderdale Police and Firefighters' Retirement System v. Pegasystems*, --- F. Supp. 3d ---- (D. Mass. July 24, 2023).

Pega highlights the need for companies and their counsel to be mindful of the risk that one type of litigation will lead to follow-on securities litigation.

In *Pega*, a federal court denied a motion to dismiss securities fraud claims predicated on accusations that Pega had misappropriated trade secrets of its competitor, Appian. Stockholders sued Pega and its executives, alleging that Pega's promise to never misappropriate trade secrets was misleading in light of trade secret claims that Appian asserted against Pega in Virginia state court.

The stockholder plaintiffs also alleged that Pega and its executives had repeatedly stated that Appian's claims were "without merit" and that Pega "had strong defenses." However, a Virginia jury subsequently awarded Appian over $2 billion for Pega's willful misappropriation of Appian's trade secrets.

In refusing to dismiss the securities fraud claims, the court concluded that the assertion that the trade secret claims were "without merit" "did not fairly align with the information possessed by the CEO at the time." The court ruled that reasonable investors "could justifiably have understood the CEO's message that Appian's claims were 'without merit' as a denial of facts underlying Appian's claims."

In particular, the court pointed to the plaintiffs' allegations that during the trial on Appian's claims, Appian had introduced documentary and testimonial evidence showing that Pega's CEO allegedly knew about, participated in, and even "personally directed" a campaign of espionage against Appian.

The court concluded that, given his alleged involvement in Appian's misappropriating trade secrets, the CEO would have known that his statement about the merits of the trade secret litigation "posed a substantial likelihood of misleading a reasonable investor." The court was persuaded that a "false denial of Appian's claims' merit posed an obvious danger to mislead investors as to the substantial financial risk Pega was facing" in connection with Appian's claims.

The court contrasted the statement that the claims "are without merit" with the statement that the company has "strong defenses." The statement "without merit," according to the *Pega* court, implied that there was *no factual basis* for the claims. By contrast, the court reasoned that the phrase "strong defenses" implies the existence of strong *legal defenses*.

The *Pega* case may be an outlier. Rarely will a CEO of a publicly traded company be found liable for overseeing a campaign of corporate espionage. Nevertheless, the *Pega* decision does invite critical reflection about how companies respond to and speak about litigation claims, particularly where there is a risk that those claims become fodder for follow-on securities litigation.

When parties are confronted with new litigation claims, there is no duty to confess wrongdoing or for companies to engage in self-flagellation. A company may have good reasons for asserting that the claims are "without merit" and can accurately say that. Even so, *Pega* suggests there may be circumstances where a company might be better positioned to say that it has "strong defenses" and "intends to defend the case vigorously," depending on what the company knows, or does not yet know, about the underlying alleged facts.

If, as the *Pega* court concluded, a statement about the "merit" of a claim implies something about its alleged facts, then the "merit" of a claim may not be known until an investigation is conducted or a litigation record is developed. Legal defenses, however, may be more apparent early on in litigation. Also, the strength of legal defenses is inherently subjective and entails a business judgment or the opinion of counsel who frequently assert viable and strong legal defenses, even when the facts are unclear or unfavorable.

One takeaway from *Pega* is that saying a company has "strong defenses," or "strong legal defenses" may be a safer, more defensible way to publicly respond to an adversary's litigation claims in some instances, particularly when a company is aware of adverse facts or has not had the opportunity to fully assess the evidence at the time that the litigation is disclosed.

The *Pega* case also functions as a reminder that litigation of one type may lead to follow-on securities litigation. Many securities litigation cases are predicated on allegations asserted in the context of other litigation — whether by government agencies such as the SEC, DOJ, or attorneys general, or by other civil litigants. The records developed in those cases may provide fodder for securities litigation plaintiffs. This may happen even where those cases do not reach trial, as in the *Pega* case.

The Pega *case reinforces the importance of companies thoughtfully speaking about litigation claims when disclosing them.*

Civil complaints filed by government agencies, for example, can include excerpts of documentary evidence or testimony developed during the pre-suit investigation of corporate conduct. Similarly, hearings for temporary or injunctive relief could result in evidence becoming part of a public record well before a trial on the merits. Routinely, evidence from civil litigation also becomes part of the public record in connection with discovery motions, class certification, or summary judgment records. The plaintiffs' bar actively monitors litigation and court dockets for such evidence that they can use to assert or bolster securities fraud claims.

Given these risks, *Pega* highlights the need for companies and their counsel to be mindful of the risk that one type of litigation will lead to follow-on securities litigation. Litigation and any public relations strategy need to account for the possibility that allegations, evidence, and disclosures about that litigation could feature in a securities class action complaint later. Even cases that are indeed "without merit" could give rise to securities litigation. *Pega* serves as a reminder for companies to carefully consider the potential for securities litigation when defending against other types of corporate litigation.

The *Pega* case also reinforces the importance of companies thoughtfully speaking about litigation claims when disclosing them. While saying claims are "without merit" may be appropriate in many circumstances, corporate executives should believe that to be the case, preface that type of statement as an opinion with words like "we believe," and have a factual basis for that opinion. It is always best to consult with legal counsel as to what is appropriate under the circumstances.

Thoughtful messaging may help minimize the risk of facing a follow-on securities fraud lawsuit, whether meritorious or not.

Virginia Milstead is a regular contributing columnist on securities law and litigation for Reuters Legal News and Westlaw Today.

About the authors


Virginia Milstead (L) is a litigation partner in **Skadden, Arps, Slate, Meagher & Flom LLP**'s Los Angeles office. She has a broad commercial litigation practice, representing clients in both federal and state courts, with a particular emphasis on securities and M&A litigation, shareholder derivative litigation and related claims. She can be reached at virginia.milstead@skadden.com. **Mark Foster** (R) is a litigation partner in the firm's Palo Alto office. His practice involves representing public companies — and their officers and directors — in securities fraud class actions, shareholder derivative lawsuits and shareholder demands and related investigations, among other matters. He can be reached at mark.foster@skadden.com.

This article was first published on Reuters Legal News and Westlaw Today on August 21, 2023.