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Spotlight

Securities Class Actions Show No Signs of Slowing in 2024

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Key Points

While the volume of securities class actions filings has remained consistently elevated over the past several years, the composition of the class actions has changed. In 2024, we expect:

- The Supreme Court will continue to shape securities law jurisprudence.
- Courts will continue assessing short-seller reports underlying securities complaints.
- Defendants will use *Arkansas Teacher Retirement System v. Goldman Sachs Group Inc.* as a roadmap for challenging price impact at class certification.
- "Materialization of risk" will remain in focus after the Ninth Circuit's decisions in *Facebook* and *Glazer Capital Management*.

Plaintiffs asserted securities class actions at elevated levels in 2023 — a sign that filings will remain high in the year ahead. Based on data from Cornerstone Research through Sept. 30, 2023, plaintiffs were on pace to file approximately 216 federal and state securities class actions last year — a slight increase over the 208 suits brought in 2022 and roughly on par with the 218 suits brought in 2021.

While filing levels remained consistent from 2021 to 2023, their composition changed. Through Sept. 30, 2023, for instance, special purpose acquisition company-related suits had fallen 37% as compared to the same period in 2022. This decline may be attributable to a significant decrease in SPAC initial public offerings and de-SPAC transactions since their peak in 2021.

Plaintiffs instead are targeting companies that allegedly have failed to anticipate supply chain disruptions, persistent inflation, rising interest rates and other macroeconomic headwinds.

For instance, in 2023, plaintiffs filed at least seven class actions against financial institutions, accusing them of downplaying liquidity and other concerns stemming from rising interest rates. Amid this ongoing period of economic uncertainty, we expect such filings to persist.

The Supreme Court will continue to shape securities law jurisprudence.

The U.S. Supreme Court is poised to decide at least two securities lawsuits that could change the landscape in both the private and regulatory arenas.

On Jan. 16, the Supreme Court [heard] argument in *Macquarie Infrastructure Corp. v. Moab Partners LP*,[1] a closely followed case that ought to address whether a purported failure to make a disclosure required under Item 303 of U.S. Securities and Exchange Regulation S-K[2] can support a securities fraud claim under Section 10(b) of the Securities Exchange Act, even absent an otherwise misleading statement.[3]

The plaintiffs alleged that Macquarie had issued material misstatements and omissions concerning the potential impact of new international fuel regulations on the company's fuel storage business, in violation of both the Securities Act and the Exchange Act.

In support of their claims under Rule 10b-5, the plaintiffs alleged that, under Item 303, Macquarie had a duty to disclose that the company's most profitable subsidiary stood to lose a significant amount of its fuel storage business as a result of impending regulations, known as IMO 2020.

The U.S. District Court for the Southern District of New York granted Macquarie's motion to dismiss, holding that the plaintiffs had failed to plead an actionable misstatement or omission, a violation of Item 303, and scienter.

In an unpublished summary order, the U.S. Court of Appeals for the Second Circuit reversed in part, holding that the plaintiffs pled adequately that Macquarie made affirmative misstatements in the form of "half-truths" that required disclosure, and that Macquarie violated Item 303.

As to the latter, the panel ruled that failing to make a material disclosure required by Item 303 can serve as a predicate for a Section 10(b) claim, so long as the claim's other elements are well pled.

In the present appeal, the Supreme Court is poised to resolve a circuit split concerning whether an Item 303 violation can serve as a basis for Section 10(b) liability.

The U.S. Court of Appeals for the Ninth Circuit, contrary to the Second Circuit, has held that "Item 303 does not create a duty to disclose for purposes of Section 10(b) and Rule 10b-5."[4] The U.S. Court of Appeals for the Third Circuit and the U.S. Court of Appeals for the Eleventh Circuit have also weighed in and held that an Item 303 violation does not give rise automatically to Section 10(b) liability.[5]

Should the Supreme Court endorse the Second Circuit's framework, shareholders might explore other avenues for asserting 10b-5 claims, citing other SEC disclosure obligations.

We also await the Supreme Court's decision in *SEC v. Jarkesy*. While not a class action, the court has been asked to determine, among other things, whether the SEC's existing statutory and regulatory authority to initiate and adjudicate administrative enforcement proceedings seeking civil penalties violates the Seventh Amendment and the nondelegation doctrine.

The nondelegation claim would likely have consequences for other SEC rulemaking. At oral argument, however, the justices focused on the Seventh Amendment claim.

If the court rules in Jarkesy's favor on his Seventh Amendment claim, the SEC may be required to bring certain civil penalty actions for securities violations in federal court.

The ramifications of this decision could be significant, as the SEC often uses its in-house courts to seek monetary penalties, and studies reveal that the SEC wins cases it brings in its in-house courts at a much higher rate than those it tries in federal court.[6]

[1] The authors would like to thank associate Emily B. Kaplan and law clerks Klara Bieniasz and Carl Wu for their assistance preparing this article.

[2] *Macquarie Infrastructure Corp. v. Moab Partners, L.P.*, No. 22-1165 (2023).

[3] Item 303 obligates a company to describe in its SEC filings "any known trends or uncertainties that have had or that are reasonably likely to have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations." 17 C.F.R. § 229.303. At the time of the alleged violation in this case, Item 303 obligated a company's SEC filings to "[d]escribe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations." SEC Final Rule Release No. 33-10890, *Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information.* The SEC explained that the purpose of the amendment from "reasonably expects" to "reasonable likely to have" was to provide "specific guidance" and "a tailored and meaningful framework" for issuers to "objectively analyze whether forward looking information is required" where the likelihood of "known events or uncertainties" cannot be determined. *Id.*

[4] The Court granted *certiorari* on this exact question in 2017 in *Leidos Inc. v. Ind. Public Retirement Sys.*, No. 16-581 (2017), but the case settled before argument. In *Macquarie*, the government filed an *amicus curiae* brief in support of Moab, requested divided argument, and reframed the question presented as "[w]hether an issuer's submission of a Form 10-K or Form 10-Q that discloses some but not all of the known trends or uncertainties the issuer was required to disclose under Item 303 . . . can give rise to liability under Section 10(b) . . . and SEC Rule 10b-5." *Macquarie Infrastructure Corp. v. Moab Partners, L.P.*, No. 22-1154 (2023) (Brief for the United States as Amicus Curiae Supporting Respondent Moab Partners, L.P., at (I)).

[5] *In re NVIDIA Corp. Sec. Litig.*, 768 FDA 1046, 1056 (9th Cir. 2014).

[6] *See Oran v. Stafford*, 226 F.3d 275, 288 (3d Cir. 2000) (Item 303 violation "does not automatically give rise to a material omission under Rule 10b-5"); *Carvelli v. Ocwen Fin. Corp.*, 934 F.3d 1307, 1331 (11th Cir. 2019) (Item 303 violation "does not *ipso facto* indicate a violation of the latter").

We also should expect plaintiffs to attempt to maneuver in light of the Supreme Court's decision in *Slack Technologies LLC v. Pirani*.[7]

Decided last term, the court in *Slack* unanimously rejected the Ninth Circuit's holding that under Section 11 of the Securities Act, plaintiffs may recover even when shares owned are not traceable to a defective registration statement.[8] Or as Pirani argued, when the shares "bear some sort of minimal relationship" to a defective registration statement.[9]

Instead, a plaintiff must plead and prove that the securities held are traceable to the particular registration statement alleged to be false or misleading.[10]

Courts will continue to assess short-seller reports underlying securities complaints.

As 2023 confirmed, short-seller reports are increasingly being used by the plaintiffs bar to form the basis of securities complaints.[11] It is estimated that short-seller reports have underpinned at least 75 securities class actions filed against public companies in roughly the last three years.

Given the recent proliferation of these suits, a body of law has developed around the extent to which allegations derived from such reports should be credited on a motion to dismiss.

The better-reasoned opinions discount allegations where they lack independent corroboration or verification citing a short-seller's motivation to drive down the target's stock price. Accordingly, these courts equate short-sellers to confidential witnesses and apply the Private Securities Litigation Reform Act's heightened pleading standard.[12]

In January 2023, in *In re: DraftKings Inc*., for example, the Southern District of New York analyzed the credibility of a short-seller report and concluded that the plaintiffs' reliance on the allegations in the report — which were largely unsourced or anonymously sourced — was "a global deficiency" spanning the complaint that mandated dismissal.[13]

Similarly, in *Hershewe v. Joyy Inc.* last year, the Ninth Circuit discredited a short-seller report because it lacked "indicia of reliability" and "failed to substantiate [plaintiffs] allegations of falsity."[14]

Separately, courts have also held that shareholders cannot rely on short-seller reports as corrective disclosures if they are based on public information because a corrective disclosure "must by definition reveal new information to the market that has not yet been incorporated into the price."[15]

We note that some courts have credited short-seller reports under particular circumstances at the pleading stage.[16] This line of cases often cites older decisions, which rejected the premise that short-sellers are the functional equivalent of confidential witnesses and must be evaluated under the PSLRA's pleading standard for confidential sources.

According to these older decisions, short-seller reports do "not implicate the same skepticism as a 'traditional' anonymous source."[17]

[7] *See* Jean Eaglesham, *SEC Wins With In-House Judges*, *The Wall Street Journal*, May 6, 2015, https://www.wsj.com/articles/sec-wins-with-in-house-judges-1430965803.

[8] *Slack Techs., LLC v. Pirani*, 598 U.S. 759 (2023).

[9] *Id.* at 762.

[10] *Id.* at 768.

[11] *Id.* at 1442.

[12] In addition to their impact on falsity and scienter, short-seller reports may also bear on loss causation if their allegations are drawn from publicly available (*i.e.*, previously disclosed) facts.

[13] *See Leacock v. IonQ, Inc.*, No. 22-1306, at *22 (D. Md. Sep. 28, 2023) (granting motion to dismiss because of plaintiffs' reliance on short-seller report with unsourced allegations) (citing *Tchrs.' Ret. Sys. of La. v. Hunter*, 477 F.3d 162, 174 (4th Cir. 2007) ("Under the PSLRA, '[w]hen the complaint chooses to rely on facts provided by confidential sources, it must describe the sources with sufficient particularity'").).

[14] *In re DraftKings Inc. Sec. Litig.*, 2023 WL 145591, at *18 (S.D.N.Y. Jan. 10, 2023).

[15] *Hershewe v. Joyy, Inc.*, 2023 WL 3316328, at *1 (9th Cir. 2023).

[16] *In re Bolf Holding, Inc. Secs. Litig.*, 977 F.3d 781, 794 (9th Cir. 2020); *see also Macphee v. MiMedx Grp.*, 73 F4th 1220, 1245 (11 Cir. 2023) ("[T]he mere repackaging of already-public information by an analyst or short-seller is simply insufficient to constitute a corrective disclosure" (citing *Meyer v. Greene*, 710 F.3d 1189, 1199 (11th Cir. 2013))). However, in a footnote, the Meyer court left open the possibility that a short-seller opinion could constitute a corrective disclosure if it reveals "to the market something previously hidden or actively." *See id.* n.10; *see also Bishins v. CleanSpark, Inc.*, 2023 WL 112558, at *13 (S.D.N.Y. 2023) (rejecting that third party analysis of already-public financial information cannot contribute new information and holding that plaintiffs can plead a short-seller report containing such analysis as a corrective disclosure); *In re Chi. Bridge & Iron Co. N.V. Sec. Litig.*, 2020 WL 1329354, at *8 (S.D.N.Y. 2020) (holding short-seller report could constitute a corrective disclosure because it provided several new pieces of information to the market although it otherwise consisted of public information).

[17] *See, e.g., In re Cassava Scis., Inc. Sec. Litig.*, 2023 WL 3442087, at *8 (W.D. Tex. May 11, 2023); *Handal v. Tenet Fintech Grp. Inc.,* 2023 WL 6214109, at *12 (E.D.N.Y. Sept. 25, 2023) (accepting as true factual allegations contained in the short-seller reports because "the truth or accuracy" of the short-seller reports "are factual disputes not appropriate for resolution at this stage").

Defendants have introduced a roadmap for challenging price impact at class certification.

In 2023, the Second Circuit was called upon — yet again — to adjudicate the plaintiffs' multiyear quest for class certification in *Arkansas Teacher Retirement System v. Goldman Sachs Group Inc*.

This time, the Second Circuit reversed the trial court and denied class certification.[18] In so holding, the court determined that the defendants had rebutted the basic presumption of reliance because there was an "insufficient link between the alleged misrepresentations and corrective disclosures" in the Section 10(b) claim.[19]

While the alleged misstatements were generic — for example, "integrity and honesty are at the heart of our business"[20] — the corrective disclosures were specific, such as an SEC enforcement action against the defendant company for purportedly failing to disclose a conflict of interest.[21]

The Second Circuit determined that the Southern District of New York had failed to apply the Supreme Court's guidance — that when there is a gap in generality between the front- and back-end disclosures, the Vivendi back-end-front-end price inflation inference starts to "break down."[22]

Rather than ask what would have happened if the company had spoken truthfully, at an "equally generic level," the district court allowed the "details and severity … of the corrective disclosure to do the work of proving front-end price impact."[23]

This violated Supreme Court precedent because "utilizing a back-end price drop as a proxy for [a] front end misrepresentation's price impact works only if, at the front end, the misrepresentation is propping up the price."[24] Thus, the proper inquiry is "whether the disclosure as written is specific enough to evoke investor reliance."[25]

We will be watching to see if the business community can replicate elsewhere the defendants' hard-earned victory in *Arkansas Teacher*.[26] At minimum, the plaintiffs cannot demonstrate price impact merely by showing a subject-matter match between a front-end misstatement and back-end corrective statements where, as in *Arkansas Teacher*, there was a ["considerable gap in specificity."][27]

"Materialization of risk" will remain in focus after the Ninth Circuit's decisions in *Facebook* and *Glazer Capital Management*.

We anticipate plaintiffs will continue to press securities fraud claims under a materialization of risk theory — in which plaintiffs allege that defendants have framed a risk in purely hypothetical terms when in fact it has already occurred.

Two recent Ninth Circuit decisions have brought this topic into sharper view. In *In re: Facebook Inc. Securities Litigation*, the Ninth Circuit, in a split decision, revived Exchange Act and Rule 10b-5 claims, holding that because "Facebook was aware of Cambridge Analytica's misconduct [before it filed its 10-K], ... Facebook's statements about risk management 'directly contradict[ed] what the company knew when it filed its [10-K].'"[28]

The Ninth Circuit credited the plaintiffs' allegation that Facebook's 10-K had described a particular risk — specifically, third-party misuse of Facebook users' personal data — as one that could harm the company if it materialized, when in fact the

[18] *See McIntire v. China MediaExpress Holdings.*, 927 F. Supp. 2d 105, 124 (S.D.N.Y. 2013); *accord In re Hebron Tech. Co.*, 2021 WL 4341500, at *13 (S.D.N.Y. 2021); *see also In re Cassava Scis., Inc. Sec. Litig.*, 2023 WL 3442087, at *8 (W.D. Tex. May 11, 2023) ("Other courts have found it permissible to rely on short-seller reports to allege falsity at the motion to dismiss stage" (citing *McIntire*, 927 F. Supp. 2d at 123-24)).

[19] *Ark. Tchr. Ret. Sys. v. Goldman Sachs Grp., Inc.*, 77 F.4th 74 (2d Cir. 2023).

[20] *Id.* at 105.

[21] *Id.* at 94.

[22] *Id.* at 83.

[23] *Id.* at 81 (citing *Goldman Sachs Grp., Inc. v. Ark. Tchr. Ret. Sys.*, 141 S. Ct. 1951 (2021)).

[24] *Id.* at 99.

[25] *Id.* 101.

[26] Jessica Corso, *Goldman's 2nd Circ. Win Opens Path to Class Action Defense, Law360*, Aug. 14, 2023, https://www.law360.com/articles/1710686/goldman-s-2nd-circ-win-opens-path-to-class-action-defense ("[I]t's up for debate whether other corporations can replicate the fact pattern the investment bank used to win its appeal."). The challenged statements at issue in *Arkansas Teacher* were "highly generic" and being able to point to 36 media reports discussing the alleged conflicts of interest before the SEC settlement helped demonstrate the disclosures had no impact on the company's stock price. *See id.*

[27] [*Ark. Tchr. Ret. Sys. v. Goldman Sachs Grp., Inc.*, 77 F.4th 74, 99 (2d Cir. 2023).] In another decision this year, the Second Circuit further clarified its interpretation of *Omnicare. See New Eng. Carpenters Guaranteed Annuity & Pension Funds v. DeCarlo*, 80 F.4th 158 (2d Cir. 2023). There, the court considered whether defendant company's historical financial statements, which reflected discretionary decisions, were actionable under the securities laws. The Second Circuit reversed the district court's ruling and held that a statement of opinion that reflects some subjective judgment can nevertheless be actionable under the securities laws if it misleads investors into thinking that the issuer had historical or factual support for the judgment made. *See id.* at 176. According to the court, because the challenged statements incorrectly presupposed the existence of historical evidence for a chosen accounting treatment and implied an "erroneous fact" that payment of discretionary bonuses was not "probable," plaintiffs could proceed with their claim. *See id.* at 172-76.

[28] *In re Facebook, Inc. Sec. Litig.*, 84 F.4th 844, 867 (9th Cir. 2023), *opinion amended and superseded on denial of reh'g*, 2023 WL 8365362 (9th Cir. Dec. 4, 2023).

alleged misuse had already transpired. Accordingly, the Ninth Circuit concluded that the district court had "overlook[ed] the reality of what Facebook knew."[29]

Earlier in 2023, the Ninth Circuit addressed a similar issue in *Glazer Capital Management LP v. Forescout Technologies*.[30] In *Glazer*, the plaintiffs alleged that Forescout had made materially false or misleading statements relating to the likelihood of its merger closing, in violation of the Exchange Act and Rule 10b-5.[31]

In particular, they claimed that Forescout was in possession of information that its counterparty was considering not closing the merger, yet stated it "look[ed] forward to completing our pending transaction."[32]

Although Forescout provided risk disclosures about the transaction, "including that the timing of the closing was uncertain and closing conditions might impact the deal's course," the Ninth Circuit reversed the district court's dismissal, holding that a company "cannot rely on boilerplate language describing hypothetical risks to avoid liability for the failure to disclose ... [when] the company already had information suggesting the merger might not ensue."[33]

This holding may conflict with other circuits, which hold that the disclosure of facts is necessary under the securities laws only when the risk has materialized or where there is a "near certainty" of its occurrence.[34] That said, after *Glazer*, we expect the plaintiffs in the Ninth Circuit to pursue materialization of risk cases even where the risk has not yet occurred.

As 2024 continues, all signs indicate that plaintiffs will continue bringing securities class actions at elevated levels consistent with what we have seen in the past several years. What the filing data suggests is that the securities plaintiffs bar has proven adept at shifting theories and areas of focus when circumstances warrant.

We saw this in 2020 and 2021, when plaintiffs brought an onslaught of COVID-focused suits in response to the coronavirus pandemic; or more recently, in 2021 and 2022, when plaintiffs reacted to the rise in SPACs by filing scores of SPAC-focused securities suits.

Now, as we begin a new year, we expect plaintiffs will continue following the headlines — whether they be based on legal decisions, legislative amendments, macroeconomic developments or world events. And although the theories might change, the end result will be the same: numerous newly filed securities class actions targeting public companies.

[29] *Id.* at 858. The SEC is likewise focused on similar issues. It has promulgated and proposed risk disclosure obligations in cybersecurity and climate change, respectively. And it recently brought an enforcement action against a company and its CISO, alleging that they defrauded investors by, among other issues, understating or failing to disclose known risks.

[30] *Glazer Cap. Mgmt. L.P. v. Forescout Techs., Inc.*, 63 F.4th 747 (9th Cir. 2023).

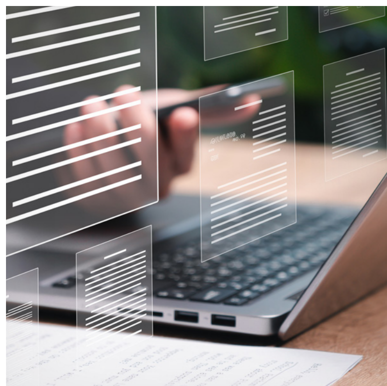
[31] *Id.* at 781.

[32] *Id.* at 780.

[33] Id. at 779 (emphasis added). That said, the decision also stated that "Forescout was aware of a significant likelihood that the risk would materialize." *Id.* at 781.

[34] *See, e.g., Mia. Firefighters & Police Officers' Ret. Tr. v. CBS Health Corp.*, 46 F.4th 22, 35 (1st Cir. 2022) (speaker only has a duty to disclose facts affecting the likelihood of that risk when the alleged risk had a "near certainty" of occurring or when the warned-of-risk had begun to materialize); *Ind. Pub. Ret. Sys. v. Pluralsight, Inc.*, 45 F.4th 1236, 1254-57 (10th Cir. 2022) (materially misleading risk factors exist where "the risk had materialized or was virtually certain to occur").

Consumer and Retail



Second Circuit Upholds Dismissal of Class Action Alleging Tobacco Company and Officers Made False, Misleading Statements About Smoke-Free Products

In re Philip Morris Int'l Inc. Sec. Litig. (2d Cir. Dec. 26, 2023)

What to know: The Second Circuit affirmed the dismissal of a putative class action securities complaint against a tobacco company and certain of its officers for failure to plead an actionable misstatement or omission and scienter.

The Second Circuit affirmed the dismissal of a putative class action against a tobacco company and certain of its officers under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 (Exchange Act), and Rule 10b-5 promulgated thereunder. The plaintiffs had alleged that the company made false and misleading statements about its smoke-free tobacco products, including statements pertaining to studies the company conducted to support its FDA application to market its smoke-free tobacco products as a "reduced-risk" product. The district court had previously granted the company's motion to dismiss, finding that the plaintiffs failed to adequately plead falsity or scienter.

On appeal, the Second Circuit concluded that statements characterizing the studies as, for example, "extensive" and "rigorous" were mere puffery. Likewise, the court held that representations that the studies were "conducted according to Good Clinical Practice ('GCP')" were inactionable opinions.

The Second Circuit also rejected the plaintiff's arguments that the company's representations were at odds with an FDA-convened advisory committee's conclusion that the company's evidence was insufficient to substantiate the reduced-risk claims. The court was not persuaded since, under its precedent, a disagreement over the interpretation of data does not alone amount to liability so long as the defendant's competing analysis is reasonable.

Court of Chancery Clarifies Standard of Conduct for Controller Acting in Capacity as Stockholder

In re Sears Hometown & Outlet Stores, Inc. S'holder Litig. (Del. Ch. Jan. 24, 2024)

What to know: In a post-trial opinion, the Court of Chancery clarified the standard of conduct for controllers exercising stockholder-level voting rights: A controller "owes a duty of good faith that demands the controller not harm the corporation or its minority stockholders intentionally" and "owes a duty of care that demands the controller not harm the corporation or its minority stockholders through grossly negligent action."

In a post-trial opinion, the Delaware Court of Chancery clarified the standard of conduct for controllers exercising stockholder-level voting rights after minority stockholders alleged a controller breached his fiduciary duties.

The defendant, Edward Lampert (the Controller), controlled shares comprising more than 50% of the voting power of Sears Hometown and Outlet Stores (the Company). The Controller did not sit on the Company's board of directors, was not an officer and, before the events giving rise to this case, had been a hands-off controller and largely passive investor.

An independent committee of the Company's board of directors endorsed a plan to liquidate one of the Company's business segments. The Controller believed that the liquidation plan would destroy value and tried to convince the committee not to implement it.

When the committee refused to back down, the Controller used his voting power as a stockholder to (i) adopt a bylaw amendment that prevented the board from implementing the liquidation plan without two separate super-majority board approvals, 30 business days apart; and (ii) remove two (of three) committee members who he believed were the most insistent on the liquidation plan (the Controller Intervention). Afterward, the sole remaining special committee member did not believe the status quo for the Company was viable and negotiated an end-stage squeeze-out transaction with the Controller that eliminated the minority stockholders' interest in the Company (the Transaction).

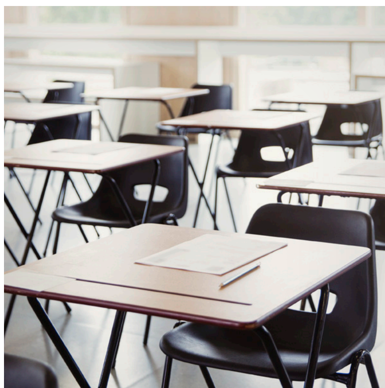
Minority stockholders sued, contending that the Controller breached his fiduciary duties by using his stockholder voting power to effectively block the liquidation plan and force the Company to enter into the Transaction. Delving into Delaware precedent, the court concluded that when a controller exercises stockholder-level voting power, it "owes a duty of good faith that demands the controller not harm the corporation or its minority stockholders intentionally" and "owes a duty of care that demands the controller not harm the corporation or its minority stockholders through grossly negligent action."

The court also noted that Delaware law did not presently state clearly "what standard of review (if any) applies to a controller's exercise of stockholder voting power." The court concluded that enhanced scrutiny applied to the Controller Intervention because the Controller "t[ook] action to impair the rights of the directors or a stockholder minority." In order to prevail, the Controller needed to prove that he acted in good faith for a legitimate objective, had a reasonable basis for believing that action was necessary and that he selected a reasonable means for achieving his legitimate objective.

Taking these precepts and weighing the Controller's testimony, the court found that the Controller did not intend to harm the Company and believed in good faith that the liquidation plan was unlikely to prove successful. The court further found that the Controller did not act in a grossly negligent manner having engaged in discussions with the committee, understood their plan and had sufficient information. Thus, the court held, when the Controller exercised his stockholder-level voting power to carry out the Controller Intervention, he acted consistently with his fiduciary duties.

However, the subsequent squeeze-out Transaction was an inherently conflicted deal subject to entire fairness review. The court found that the defendants failed to prove that the Transaction was entirely fair, and awarded per-share damages equal to the difference between the consideration paid and the fair value of the Company. The court also found that while the Controller Intervention was not itself a breach of fiduciary duty, it helped yield an unfair process because it "boxed in the Committee and eliminated the Company's principal alternative." The court found that the Controller "believed sincerely that the [T]ransaction was fair," but fiduciary liability in a "conflict transaction" does not turn on the "fiduciary's mental state." The court noted that this was the "risk that a fiduciary takes in a self-dealing transaction."

Education



SDNY Dismisses Securities Act Claims Alleging For-Profit School Operator Misled Investors in IPO Registration Statement

Dagan Invs., LLC v. First High-Sch. Educ. Grp. Co. Ltd. (S.D.N.Y. Dec. 6, 2023)

What to know: The Southern District of New York dismissed claims brought against a for-profit company operating private schools in China for failure to plead a material misstatement or omission and for being time-barred.

Judge John G. Koeltl of the U.S. District Court for the Southern District of New York dismissed claims brought under Sections 11, 12(a)(2) and 15 of the Securities Act against a for-profit company operating private schools in China. The complaint alleged that the company's registration statement in connection with its upcoming IPO was misleading because it failed to disclose that the Chinese government was publicly considering regulatory reforms aimed at reigning in China's for-profit education industry. The court disagreed and dismissed the case.

Specifically, the court found no plausible allegations of an omission, reasoning that the company had no duty to disclose the regulations because they had yet to be announced. The court also found no plausible allegations of a misstatement, explaining that while the registration statement did cite "favorable government policies" as a growth driver, the company had "adequately circumscribed" that with cautionary language on the "possibility of future adverse regulations."

Finally, the court held that the one-year statute of limitations barred the claims under Sections 11 and 12(a)(2) of the Securities Act.

Energy

EDNY Dismisses Claims Alleging Battery Company Violated Exchange and Securities Acts in Merger Announcement With SPAC

Lanigan Grp., Inc. v. Li-Cycle Holdings Corp. (E.D.N.Y Oct. 6, 2023)

What to know: The Eastern District of New York dismissed claims against a lithium-ion battery recovery and recycling firm for failure to plead false or misleading statements.

Judge Hector Gonzalez of the U.S. District Court for the Eastern District of New York dismissed a putative securities class action alleging that a lithium-ion battery recovery and recycling company violated Section 14(a) of the Exchange Act and Sections 11 and 15 of the Securities Act in connection with its announcement to go public through a merger with a special purpose acquisition company. Specifically, the plaintiff alleged that the company's proxy statement, prospectus and registration statement contained false and misleading information concerning the company's accounting practices, which when later disclosed by a short seller caused its stock value to decline.

In dismissing the Section 14(a) claim, the court found that the company *had* disclosed details concerning its accounting practices, and that while the company had revealed certain accounting control weaknesses months after the registration statement and proxy were disseminated, the plaintiff had not adequately alleged that the company knew of those material weakness at the time of the IPO. The court also rejected the plaintiff's theory of loss causation based on a stock price decline following the issuance of a short seller's report.

Having already found under the Section 14(a) analysis that the plaintiff had not sufficiently alleged any false or misleading statement, the court then dismissed the plaintiff's Section 11 claim. And, finding no underlying violation of the Securities Act, the court also dismissed the Section 15 control person liability claim.

Financial Services

Ninth Circuit Holds Board Approval Exemption Applies in Section 16(b) of Exchange Act

Roth v. Foris Ventures, LLC (9th Cir. Nov. 13, 2023)

What to know: The Ninth Circuit reversed in part the district court's order denying the defendants' motion to dismiss a shareholder derivative action, holding that the board approval exemption in Rule 16b-3 applies to claims under § 16(b) of the Exchange Act regardless of whether the board approves the challenged stock purchase or sale for the specific purpose of exempting it from liability.

The Ninth Circuit reversed in part a district court's order denying venture capital firm Foris Ventures, LLC's motion to dismiss a shareholder derivative action involving § 16(b) of the Exchange Act. Section 16(b) is designed to prohibit short-term trading by officers, directors and beneficial owners, thus barring those individuals from purchasing securities from the issuer and then subsequently selling those securities within six months. It likewise prohibits those individuals from selling securities and then subsequently repurchasing them within six months.

Rule 16b-3 provides an exception to that prohibition. Under Rule 16b-3, a beneficial owner, director or officer may engage in otherwise-prohibited short-term trading if the issuer's board of directors approves the purchase or sale.

Foris was a beneficial owner of Amyris stock. Foris, in turn, was indirectly owned by Amyris director John Doerr. Foris and Amyris entered into several stock purchases and sales involving Amyris securities between April 2019 and January 2020. The Amyris board of directors approved each transaction.

An Amyris shareholder filed suit on behalf of Amyris, alleging that the Foris transactions violated § 16(b) by engaging in short-term stock transactions. The district court denied the defendants' motion to dismiss, holding that the Rule 16b-3 exemption did not apply because even though the Amyris board approved the purchases and sales, the board did not approve those transactions for the specific purpose of exempting them from liability.

The Ninth Circuit accepted interlocutory review and reversed, holding that Rule 16b-3 contained no "purpose-specific approval requirement." The court reasoned that the lack of any such requirement was supported by the text of the rule, which contained "no suggestion that [a purpose-specific requirement] exists" and "mentions nothing about the subjective motivations of the approving body."

The Ninth Circuit remanded the case back to the district court to determine whether Foris falls within the class of individuals who can invoke the Rule 16b-3 exemption, which applies only to directors and officers, not beneficial owners. A beneficial owner qualifies for the exemption only if it can show it is a "virtual director" by deputizing a natural person to perform the beneficial owner's duties on the board of the securities issuer. Therefore, the court remanded the case back to the district court to determine whether Foris — a beneficial owner of Amyris — qualified as a virtual director.

Northern District of Illinois Grants Motion To Dismiss Securities Fraud Claim Brought by Plaintiff-Investors Over Lack of Scienter

Magnuson v. Window Rock Residential Recovery Fund, L.P. (N.D. Ill. Nov. 21, 2023)

What to know: The Northern District of Illinois granted in part an investment management firm, its officers and its investment platform partner's motion to dismiss plaintiff-investors' Securities Act violation claims against them, though a state law claim survived.

Judge Manish S. Shah of the U.S. District Court for the Northern District of Illinois granted in part investment management firm Window Rock, its officers and its investment platform partner's motion to dismiss plaintiff-investors' Securities Act violation claims against them. Plaintiff-investors in a particular new fund of Window Rock's (the Fund) sued the defendants, alleging that they made false and misleading statements in the promotional statements for the Fund and in the quarterly updates about the Fund's performance in violation of Section 10(b) of the Exchange Act, Securities and Exchange Commission Rule 10b-5 and state law.

Before they invested in the Fund, the plaintiffs received promotional materials about the Fund in a PowerPoint presentation bearing Window Rock's logo. The presentation showed how the Fund was expected to perform based on the performances of other funds and asset pools, showcasing a positive rate of return on six of the seven of those funds. After becoming investors in the Fund, the plaintiffs alleged they received information about the Fund's performance through Window Rock's quarterly updates and its annual asset reviews. The plaintiffs alleged that these materials showed that the Fund was performing positively and meeting expectations.

The Fund ultimately closed in February 2020. The plaintiffs lost approximately $1.3 million and subsequently filed this lawsuit. In the complaint, the plaintiffs pointed to statements from Window Rock's promotional PowerPoint presentation and the quarterly updates created by Window Rock as the basis for their fraud claims.

First, the plaintiffs alleged the actual performances of the funds shown in the promotional PowerPoint were materially worse than the information contained in the presentation led them to believe. As a result, the plaintiffs claimed they were fraudulently induced to invest in the new Fund. In addition, the plaintiffs alleged that, while they received quarterly updates about the Fund's performance, they did not receive other financial information about the Fund, which showed that the Fund was losing money.

Window Rock argued that the quarterly updates were not misleading because the financial information the plaintiffs alleged was withheld contained different categories of data than what the quarterly updates contained and could not be fairly compared. The defendants also argued that the complaint impermissibly lumped them together without differentiating each defendant's role. Finally, the defendants argued that the complaint failed to allege that Window Rock intended to make a false statement because the company provided all available unaudited financial information to the investors.

The court found in favor of the defendants and dismissed the plaintiffs' Section 10(b) claims. First, the court found that the PowerPoint presentation was a forward-looking projection of how the Fund might perform based on the past performances of other funds. As such, the court held it was an aspirational, nonactionable statement.

While the court did find that the plaintiffs plausibly alleged that Window Rock's quarterly reports contradicted information contained in other financial reports that were withheld from the plaintiffs, it found that the plaintiffs failed to plead Window Rock's complicity in the omission and the scienter necessary for a fraud claim.

In addition, to survive dismissal, the plaintiffs needed to state with particularity which defendant made each fraudulent statement and how their actions amounted to fraud. The court found the plaintiffs failed to do so and dismissed the plaintiffs' federal securities claims in their entirety.

EDNY Dismisses Claims Against Electronic Payments Company and Officers, Finding Plaintiffs Failed To Plead Actionable Misstatements and Scienter

In re Qiwi PLC Sec. Litig. (E.D.N.Y. Nov. 3, 2023)

What to know: The Eastern District of New York dismissed claims against a Cyprus-based financial services company and its officers for failure to plead actionable misstatements and scienter.

Judge Rachel P. Kovner of the U.S. District Court for the Eastern District of New York granted a motion to dismiss a

proposed putative securities class action alleging that a Cyprus-based electronic payments company and certain of its officers violated Section 10(b) and Section 20(a) of the Exchange Act. Specifically, the plaintiffs alleged that the company made false and misleading statements regarding its compliance with Russian regulations that prohibited the facilitation of payments to certain online gambling sites.

The court dismissed the complaint for failure to plead actionable misstatements and scienter. It concluded that the plaintiff's allegations that the company's internal bookkeeping and audit controls violated Russian regulations were too vague to be actionable where the plaintiff failed to identify "any specific legal violations, the substance of those violations, or the underlying conduct that led to the violations." The court also held that the plaintiff failed to show that the company had omitted to disclose material information concerning revenue from illegitimate transactions because the plaintiff failed to allege that such transactions were "a material source" of the company's success.

Moreover, the court rejected the plaintiff's attempt to establish scienter, which was largely based on the individual defendants' positions as senior officers, as well as the alleged imputation of corporate scienter.

Life Sciences and Health Care

Second Circuit Affirms Dismissal of Class Action Alleging Insurance, Health Care Platform Released Materially Misleading Registration Statement

Qi Mi v. Waterdrop Inc. (2d Cir. Jan. 15, 2024)

What to know: The Second Circuit affirmed the dismissal of a putative class action securities complaint for failure to state a claim, finding the plaintiff failed to plead sufficient facts showing that the registration statement was materially misleading.

The Second Circuit affirmed the dismissal of a putative securities class action against China-based insurance and health care platform Waterdrop Inc.; certain of its officers, directors and representatives; and the underwriters of its IPO, alleging claims under Sections 11 and 15 of the Securities Act. The plaintiff had alleged that the company's registration statement was materially misleading because it disclosed the cessation of the company's mutual aid platform, but did not disclose the reason for the cessation; disclosed interim financials from the first quarter of 2021, but omitted increases in aggregate expenses during that same quarter; and contained misleading forward-looking statements. The Second Circuit disagreed with the plaintiff on all grounds, finding that Waterdrop's registration statement was not materially misleading.

As to the alleged failure to disclose regulatory pressure, the Second Circuit agreed with the district court that publicly available information provided reasonable investors with the opportunity to learn about the regulatory scrutiny of mutual aid platforms during the time period of the company's IPO. As to the alleged failure to disclose the rate of increase in aggregate expenses in the first quarter of 2021, the Second Circuit explained that the registration statement repeatedly specified that operating costs and expenses had increased and were expected to continue to increase.

Finally, as to the forward-looking statements, the Second Circuit held that the "bespeaks-caution doctrine" applied, which holds that "alleged misrepresentations in a stock offering are immaterial as a matter of law if it cannot be said that any reasonable investor could consider them important in light of adequate cautionary language set out in the same offering." The court explained that the company's "registration statement cautioned investors by painting an overall picture of a risky and speculative investment in a company that might never be profitable," and therefore any forward-looking statements were not materially misleading.

Court of Chancery Upholds Board Rejection of Nomination Notice, But Strikes Certain Advance Notice Bylaws

Kellner v. AIM ImmunoTech Inc. (Del. Ch. Dec. 28, 2023)

What to know: The Court of Chancery upheld an immuno-pharma company's rejection of an advance notice of nomination, finding the board acted reasonably in rejecting the notice because it obscured obvious arrangements pertaining to the nomination. Applying enhanced scrutiny review, the court also determined that four provisions of the company's advance notice bylaws were invalid and not a proportionate response to activist activity.

The Delaware Court of Chancery found the board of immuno-pharma company AIM ImmunoTech, Inc. acted reasonably in rejecting an advance notice of nomination. In 2022, as part of a group's scheme to run a proxy contest against AIM, a stockholder submitted a dissident director nomination. The stockholder's notice neglected to disclose, among other things, certain members of the group participating in the nomination — as required by AIM's advance notice bylaws governing stockholder proposals and nominations for director elections — and was therefore rejected by the AIM board. The stockholder sought a preliminary injunction, which the Delaware Court of Chancery denied on a disputed factual record.

In 2023, in response to the activist activity, AIM's board amended the company's bylaws, focusing on the advance notice procedures. A few months later, a different stockholder supported by largely the same group behind the failed prior nomination made a renewed attempt with another notice. The board met repeatedly to consider the nomination and ultimately rejected it.

The nominating stockholder sued, seeking declaratory judgments that six amended bylaws were invalid, the application of the challenged bylaws to his notice was unlawful and inequitable, and the board breached its fiduciary duties in adopting the bylaws and rejecting the notice.

Expedited litigation ensued. The court stated that advance notice bylaws are "often construed and frequently upheld as valid by Delaware courts." However, the court held that it was required to apply enhanced scrutiny to the AIM bylaw amendments because they were not adopted on a "clear day." The court struck four of the challenged bylaws, but nevertheless held that the plaintiff's nomination notice contravened AIM's valid bylaws and upheld the board's rejection of the notice because it "obscure[d] obvious arrangements or understandings pertaining to the nomination."

Regarding the bylaws' adoption, the court determined that the board made a "reasonable assessment" that its "information-gathering objective" was threatened because the 2022 nomination failed to disclose known participants in the nomination. However, the court found that four of the bylaws contained "vague" and "far-flung" requirements calling for subjective interpretation that "unduly restrict[ed] the stockholder franchise." Included in the struck bylaws was a definition for "Stockholder Associated Person" that the court referred to as a "tripwire" and a 1,099-word "indecipherable" bylaw regarding the disclosure of ownership in AIM and its competitors. The court noted that the board failed to present evidence to suggest that the problematic features were proportionate to its information-gathering goal.

Delaware Supreme Court Reverses Court of Chancery Dismissal of *Caremark* Claim

Lebanon Cnty. Emps.' Ret. Fund v. Collis (Del. Dec. 18, 2023)

What to know: The Delaware Supreme Court reversed the Court of Chancery's dismissal of stockholder plaintiffs' *Caremark* claims, holding that the Court of Chancery erred by adopting the factual findings of another court in dismissing the complaint where the factual findings at issue were reasonably in dispute.

The Delaware Supreme Court reversed the Court of Chancery's dismissal of stockholder plaintiffs' *Caremark* claims against opioid distributor AmerisourceBergen Corp. (ABC). ABC faced multiple lawsuits related to its distribution and monitoring practices. After, among other things, ABC paid $6 billion to settle multidistrict litigation, stockholder plaintiffs brought *Caremark* claims against certain of ABC's directors and officers.

The plaintiffs alleged that the directors and officers breached their fiduciary duties by "failing to respond to 'a tidal wave of red flags' that the Company was not complying with its obligations under" federal regulations (a Red Flags Claim) and by "knowingly causing [ABC] to seek profit by violating the law" (a *Massey* Claim). The Court of Chancery concluded that the lack of response to "the avalanche of investigations and lawsuits … would support a well-pled Red-Flags Claim" and that the plaintiffs had adequately pled a *Massey* Claim.

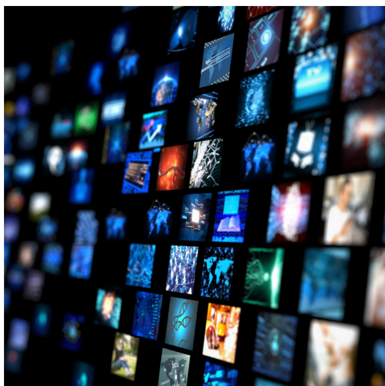
However, despite these conclusions, the Court of Chancery dismissed the complaint because the U.S. District Court for the Southern District of West Virginia (the West Virginia Court) — conducting a "bellwether" trial against opioid distributors, including ABC — issued a decision after the Delaware litigation was filed that ruled in favor of the defendants and found that ABC's anti-diversion efforts complied with federal regulations. Taking judicial notice of the West Virginia Court's findings, the Court of Chancery stated that they "knock[ed] the stuffing" out of the plaintiffs' claims.

On appeal, the Delaware Supreme Court reversed, holding that "the way the Court of Chancery considered, and the weight that it accorded, the West Virginia Court's factual findings is [not] consistent with our rules of evidence and Court of Chancery Rule 23.1."

The Delaware Supreme Court concluded that the Delaware Rules of Evidence did not permit the Court of Chancery to take judicial notice of factual findings by the West Virginia Court because the factual determination about whether wrongdoing had occurred "was, and is, reasonably disputed," and the plaintiffs had adequately pled their claims.

The Delaware Supreme Court also explained that by relying on the West Virginia Court's decision, the Court of Chancery "changed the date" for purposes of considering whether the stockholder plaintiffs had standing to bring a derivative claim because making a demand on ABC's board of directors to investigate the plaintiffs' allegations would have been futile. Typically, the Court of Chancery examines the question of demand futility at the time the complaint is filed. The Delaware Supreme Court held that the lower court erred by examining the plaintiffs' demand futility allegations while considering facts that were not available at the time the Delaware complaint was filed.

Media and Entertainment



Northern District of California Finds Shareholder Allegations Regarding Streaming Account Sharing Insufficient To State Section 10(b) Claim

Pirani v. Netflix, Inc. (N.D. Cal. Jan. 5, 2024)

What to know: The Northern District of California granted a major video-on-demand streaming service's motion to dismiss a Section 10(b) claim arising out of its representations concerning the impact of account sharing on its business.

Judge Jon S. Tigar of the U.S. District Court for the Northern District of California granted Netflix, Inc.'s motion to dismiss a Section 10(b) claim concerning the impact of account sharing on its business. Account sharing occurs when a paying Netflix member shares his or her account information with a nonpaying user who does not reside in the paying member's household.

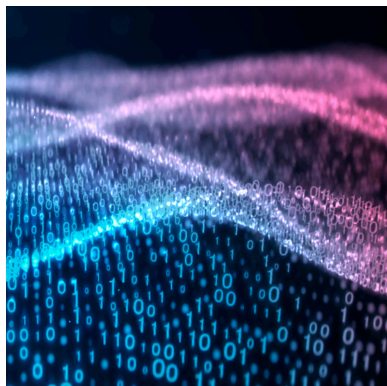
Netflix issues quarterly guidance regarding expected increases in paying memberships to help it track revenue from membership subscriptions. At the start of the class period in Q1 2021, Netflix forecasted a lower increase in paying memberships than in Q1 2020. Netflix attributed the discrepancy to higher-than-normal paying membership increases during the COVID-19 pandemic lockdown. Though Netflix exceeded its targets for increases in paying memberships in the second and third quarters of 2021, it ultimately missed metric targets for Q4 2021, Q1 2022 and Q2 2022.

After Netflix announced lower-than-expected financial results in April 2022 and that it did not meet its targets for paying membership increases for Q1 2022, several shareholders filed suit. The shareholders alleged Netflix knew that user account sharing would hinder its ability to acquire new subscribers, but inadequately disclosed that information to the market. The plaintiffs challenged four categories of statements as misleading for omitting the extent of the account sharing problem:

- Statements concerning Netflix's market penetration.
- Statements concerning Netflix's metrics and long-term growth.
- Statements concerning the impact of COVID-19 on Netflix's growth.
- Account sharing-specific statements.

The district court dismissed the complaint, concluding that the plaintiffs failed to allege with particularity that the statements were false when made. The court reasoned that the plaintiffs did not allege *what level* of account sharing monitoring Netflix was doing *when*, or *what was known* regarding the extent of account sharing and *when*. The court explained that the complaint's allegation that Netflix was aware it had "always had" account sharing did not establish what level Netflix monitored account sharing during the class period or that the defendants were even aware of the impact on its business. Nor did the allegations concerning internal discussions regarding account sharing specify when the company discussed account sharing.

Web3 and Digital Assets



Northern District of California Dismisses Claims Alleging Crypto Company Colluded With Foreign Token Issuer To Boost Digital Asset Price

Patterson v. Jump Trading LLC (N.D. Cal. Jan. 4, 2024)

What to know: The Northern District of California granted a digital asset trader's motion to dismiss a putative class action alleging violations of Section 10(b) of the Exchange Act in connection with a foreign token issuer's efforts to boost the value of a digital asset.

Judge P. Casey Pitts of the U.S. District Court for the Northern District of California granted Terraform Labs' (TFL's) motion to dismiss a putative class action alleging the company violated Section 10(b) of the Exchange Act by colluding with Jump Trading to boost the price of a digital asset.

TFL is a Singapore-based company that sells digital assets, including its UST and LUNA coins. UST is a "stablecoin," meaning its value is tied or "pegged" to the U.S. dollar. One UST stablecoin may be exchanged for one dollar's worth of LUNA coin. TFL did not register its digital assets as a class of securities pursuant to federal securities law.

In November 2019, TFL attempted to improve its liquidity by loaning LUNA to U.S.-based token issuer Jump Trading. Jump Trading began selling LUNA on a secondary market in July 2020. TFL loaned additional LUNA to Jump Trading in September 2020. In May 2021, UST began to "de-peg" from the U.S. dollar. Jump Trading's president agreed to purchase large quantities of UST to restore its value. In return, TFL loaned additional LUNA to Jump Trading for an amount substantially under market value.

In May 2022, the price of UST and LUNA dropped by 91% and 99.7% percent, respectively, "after it was revealed that TFL's [digital assets] were [allegedly] unstable and unsustainable."

The plaintiffs, purchasers of TFL's tokens, brought suit against Jump Trading for failing to disclose that TFL's algorithm was insufficient to support the peg without human intervention. The plaintiffs alleged that Jump Trading did not publicly disclose (i) the cause of the re-peg, (ii) the loans of LUNA and (iii) Jump Trading's role in increasing the price of TFL's tokens to investors. As a result, investors were allegedly caused to believe that the algorithm had "self-healed" to restore the peg without any human involvement.

As a threshold issue, the court determined that the plaintiffs adequately pled that LUNA and UST were securities because they were "investment contracts" under the Supreme Court's *Howey* test. However, the court dismissed the alleged securities law violations because the plaintiffs failed to satisfy the heightened pleading standards regarding Jump Trading's material misrepresentations. The plaintiffs alleged that Jump Trading's president and TFL's CEO worked together to restore UST's peg using human intervention, rather than allow the algorithm to mint and burn UST and LUNA to control supply and maintain the peg.

The plaintiffs further alleged that Jump Trading failed to disclose this intervention in blog posts and tweets. Aside from this repeated allegation, the plaintiffs did not specify why the failure to disclose this alleged intervention rendered the challenged statements misleading.

In addition, the court held that the plaintiffs failed to allege Jump Trading committed a manipulative or deceptive act in violation of Rules 10b-5(a) and (c) by colluding to restore the peg through bypassing the algorithm. The complaint's allegations did not plead that Jump Trading, as opposed to other parties originally named in the complaint and subsequently dismissed, engaged in the manipulative conduct or that Jump Trading had a responsibility to disclose its role in the re-peg.

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