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Trends and Filings That Matter

Spotlight

Macquarie Ruling Raises the Bar for Securities Fraud Claims

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Key Points

- On April 12, 2024, the U.S. Supreme Court unanimously reversed and vacated the Second Circuit's decision in *Macquarie Infrastructure Corp. v. Moab Partners LP*.
- The issue presented was whether the failure to make a disclosure pursuant to Item 303 of the SEC's Regulation S-K can serve as the basis for a securities fraud claim under Section 10(b) of the Exchange Act, "even in the absence of an otherwise-misleading statement."
- The Court held that Rule 10b-5(b) does not proscribe pure omissions; rather, the plain text of the rule prohibits omitting material facts necessary to make the statements made not misleading.
- *Macquarie* is a major setback for the plaintiffs bar, which is now foreclosed from predicating Section 10(b) claims on pure omissions.

On April 12, the U.S. Supreme Court unanimously reversed and vacated the U.S. Court of Appeals for the Second Circuit's decision in *Macquarie Infrastructure Corp. v. Moab Partners LP*.

The issue presented was whether the failure to make a disclosure pursuant to Item 303 of the U.S. Securities and Exchange Commission's Regulation S-K can serve as the basis for a securities fraud claim under Section 10(b) of the Securities Exchange Act, "even in the absence of an otherwise-misleading statement."

Section 10(b) and Rule 10b-5 make it unlawful for an issuer to "omit a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." Item 303 of Regulation S-K requires an issuer to disclose "any known trends or uncertainties that have had or that are reasonably likely to have a material favorable or unfavorable impact" on the issuer's "financial condition or results of operations."

The plaintiffs alleged that Macquarie had made 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 Securities 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 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.

The Second Circuit's decision created a circuit split with the Third, Ninth and Eleventh Circuits, which had held that Item 303 does not create a duty to disclose under Section 10(b), and that therefore, Item 303 disclosure violations do not necessarily or automatically give rise to Section 10(b) liability.

The Supreme Court held that Rule 10b-5(b) does not proscribe pure omissions. Rather, the plain text of the rule prohibits omitting material facts necessary to make the statements made not misleading, which "requires disclosure of information necessary to ensure that statements already made are clear and complete."

In that way, Rule 10b-5 covers half-truths and not pure omissions. Relying both on logic and the plain text of the rule, the court held that the rule "requires identifying affirmative assertions (*i.e.*, 'statements made') before determining if other facts are needed to make those statements 'not misleading.'"

The court emphasized its prior decision in *Matrixx Initiatives Inc. v. Siracusano*, where it stated in 2011 that "[Section] 10(b) and Rule 10b-5(b) do not create an affirmative duty to disclose any and all material information. Disclosure is required under these provisions only when necessary 'to make ... statements made, in the light of the circumstances under which they were made, not misleading.'"

The court also reasoned that statutory context confirms its plain text reading of the rule. The court explained that Congress imposed liability for pure omissions in Section 11(a) of the Securities Act by prohibiting any registration statement that contains an untrue statement of a material fact, or omits to state a material fact required to be stated therein or necessary to make the statements therein not misleading.

Section 11(a) therefore expressly creates liability for failure to speak on a subject at all, whereas there is no similar language in Section 10(b) or Rule 10b-5(b). The court explained that the lack of any similar language shows that neither Congress in Section 10(b) nor the SEC in Rule 10b-5(b) mirrored Section 11(a) to create liability for pure omissions.

The court rejected the argument that without private liability for pure omissions under Rule 10b-5(b), there will be "broad immunity any time an issuer fraudulently omits information Congress and the SEC require it to disclose" because "private parties remain free to bring claims based on Item 303 violations that create misleading half-truths" and "the SEC retains authority to prosecute violations of its own regulations."

In short, the court held that "[p]ure omissions are not actionable under Rule 10b-5(b)." The court explained that its decision "confirms that the failure to disclose information required by Item 303 can support a Rule 10b-5(b) claim only if the omission renders affirmative statements made misleading."

Macquarie is a major setback for the plaintiffs bar, which is now foreclosed from predicating Section 10(b) claims on pure omissions. While the court's opinion specifically addressed Item 303, the ruling should apply to other disclosure obligations under Regulation S-K, including those concerning climate-related information.

Further litigation will focus on the impact of omitted information to previously made statements. In that regard, courts are likely to be skeptical of plaintiffs who attempt to end run the Supreme Court's unanimous ruling by dressing up an omissions case as one alleging a purported half-truth.

Similar to private plaintiffs, the court's opinion also bars the SEC from pursuing enforcement actions under Section 10(b) and Rule 10b-5 based on pure omissions. However, the court specifically acknowledged the SEC's ability to investigate and pursue alleged violations of Item 303 and other disclosure-related rules.

Cryptocurrency

Second Circuit Reverses SDNY Decision, Allowing Securities Class Action To Proceed Against Cryptocurrency Exchange

Williams v. Binance (2d Cir. Mar. 8, 2024)

What to know: The Second Circuit reversed a district court's decision dismissing a putative securities class action, allowing claims to proceed against a cryptocurrency exchange alleging Securities Act violations and state "Blue Sky" laws, as well as for rescission of the plaintiffs' contracts with the cryptocurrency exchange under the Exchange Act.

The Second Circuit unanimously reversed a district court's order dismissing a putative securities class action against cryptocurrency exchange Binance. The plaintiffs allege they were purchasers of crypto assets (tokens) on Binance. The putative class complaint alleged that Binance violated Section 12(a)(1) of the Securities Act of 1933 (Securities Act) — and the Blue Sky securities laws of various states — by unlawfully promoting, offering and selling billions of dollars of tokens, which were not registered as securities. The plaintiffs also sought rescission of the contracts they entered into with Binance under Section 29(b) of the Securities Exchange Act of 1934 (Exchange Act), arguing that Binance contracted to sell securities without registering as a securities exchange or broker-dealer.

The U.S. District Court for the Southern District of New York dismissed the complaint, concluding that (i) the plaintiffs' claims constituted an impermissible extraterritorial application of the U.S. securities laws because Binance is not a U.S.-based exchange platform, (ii) the plaintiffs' federal claims were untimely under the applicable one-year statute of limitations and (iii) the district court prematurely dismissed claims brought under Blue Sky laws of states where none of the named class members resided.

First, the Second Circuit held that the plaintiffs had adequately alleged that their claims involved domestic transactions subject to U.S. securities laws. The court explained that, to allege the existence of a domestic transaction subject to U.S. securities laws, a plaintiff must allege facts indicating that "irrevocable liability was incurred or that title was transferred within the United States." Irrevocable liability, the court explained, attaches when parties "become bound to effectuate the transaction or enter into a binding contract to purchase or sell securities."

Additionally, the court recognized that irrevocable liability may attach "in more than one location ... and at more than one time" because "there is always more than one side to any given transaction." In light of those principles, the court held that the plaintiffs alleged irrevocable liability when (i) the transactions at issue were matched on servers in the U.S. and (ii) again when the plaintiffs transacted on Binance from the United States. The court noted that it may not always be appropriate to determine where irrevocable liability attached based solely on the location of servers utilized for a transaction, but it was appropriate to do so in this case because Binance alleged that it is a decentralized platform that does not have a single physical location in any one country. The court also noted that Binance's decentralized nature resulted in decreased comity concerns because there was no risk that the U.S. securities regime would be incompatible with the applicable laws of another country.

Second, the court held that the plaintiffs' claims were timely because they did not accrue — and, therefore, the one-year statute of limitations did not begin to run — until the plaintiffs actually made their purchases, regardless of when they signed up with Binance or otherwise agreed to Binance's terms of use. The court explained that a prospective buyer has no recourse against a person who touts securities to them and, therefore, a claim for a securities violation cannot accrue until a purchase is actually made.

Finally, the court held that the district court erred in dismissing claims under Blue Sky laws of states where no named plaintiff resided because "as long as the named plaintiffs have standing to sue the named defendants, any concern about whether it is proper for a class to include out-of-state, nonparty class members with claims subject to different state laws" is a question to be decided after the motion to dismiss stage.

Financial Institutions

SDNY Largely Denies Motion To Dismiss Exchange Act Claims Against Financial Institution and Executives

In re Barclays PLC Sec. Litig. (S.D.N.Y. Feb. 23, 2024)

What to know: The Southern District of New York largely denied a motion to dismiss Exchange Act claims against a financial institution and certain of its executives, alleging the defendants' disclosures were materially false and misleading.

Judge Katherine Polk Failla of the U.S. District Court for the Southern District of New York granted, in part, and denied, in part, a motion to dismiss putative class claims brought under the Exchange Act against Barclays PLC and Barclays Bank PLC (together, Barclays). The plaintiff alleged that Barclays offered and sold $17.7 billion worth of unregistered securities (the Over-Issuances) because Barclays failed to track the number of securities it was issuing pursuant to its active shelf registration statements, which capped the total number of securities that Barclays could issue over any particular period of time. Barclays discovered the error, commenced an investigation and issued a series of disclosures that gradually revealed the error. The plaintiff claimed that Barclays' disclosures were materially false and misleading.

Barclays initially disclosed statements such as "[g]roup-wide frameworks, policies[,] and standards enable Barclays to meet regulators' expectations relating to internal control and assurance" and "[Barclays] has operated a sound system of internal control that provides reasonable assurance of financial and operational controls and compliance with laws and regulations," but later disclosed that Barclays had not implemented a system for tracking or monitoring the issuance of securities from the shelves. The court held that the dueling assertions that (i) Barclays "operated a sound system of internal control" and (ii) Barclays had no system of internal control cannot at the same time be true. Therefore, the court held that Barclays' alleged statements regarding controls, prior to disclosing that no internal system of controls existed, were misleading. The court also found that such statements were made with scienter because the defendants acted in disregard of their failure to implement a control system.

The court held that once Barclays revealed the Over-Issuances, it effectively disclosed what its previous disclosures had wrongfully omitted. Thus, the remainder of the alleged misstatements identified by the plaintiff were not actionable.

The court also dismissed the plaintiff's Section 20(a) liability claims because the plaintiff did not adequately allege that the defendants controlled the primary violator and were, in some meaningful sense, culpable participants.

Life Sciences and Health Care

Court of Chancery Dismisses Oversight Claim, Reaffirms 'Narrow Confines' of *Caremark* Doctrine

Clem v. Skinner (Del. Ch. Feb. 19, 2024)

What to know: The Court of Chancery dismissed plaintiff stockholders' derivative action for failure to plead demand futility. The plaintiffs failed to show substantial likelihood of liability of the board for oversight claims arising from an alleged legal violation because they alleged that the board learned of the violation via a board-level reporting system and acted to correct it.

The Delaware Court of Chancery dismissed plaintiff stockholders' derivative action against Walgreens' board of directors, alleging the board breached its oversight duties. According to the plaintiffs, Walgreens' pharmacy software was programmed to dispense a minimum number of insulin pens even if fewer were prescribed. When government health care programs subsequently rejected Walgreens' reimbursement requests because the quantity of pens exceeded prescription limits for the patients, Walgreens' pharmacists would edit the prescription data and resubmit the requests, causing unnecessary refill reminders and overbilling. Whistleblowers filed a *qui tam* action challenging the practice under the False Claims Act, the Department of Justice issued a civil investigative demand and Walgreens ultimately settled the claims for $209 million.

The plaintiffs alleged that Walgreens' board breached its oversight duties by implementing an ineffective system of internal controls and failing to respond to red flags indicating regulatory and legal violations.

The court held that the plaintiffs' prong one claim failed because the plaintiffs alleged that the audit committee was tasked with legal and regulatory oversight, and regularly received and discussed reports on the subject. The plaintiffs' claim that Walgreens' internal controls were "ineffective" was insufficient because "how directors choose to craft a monitoring system in the context of their company and industry is a discretionary matter." Moreover, "the reporting system *worked*" as the board learned of the alleged violation through the reporting system.

The plaintiffs' prong two claims failed for two reasons. First, the plaintiffs failed to allege red flags. The court held that neither reports of compliance and legal issues unrelated to the specific corporate trauma at issue nor "[t]he receipt of a lone subpoena or launch of a regulatory investigation" constituted red flags.

Second, even if the plaintiffs had pled red flags, the plaintiffs failed to plead bad faith. On the facts alleged, the board stayed up to date on Walgreens' response to the demand and the *qui tam* action, and Walgreens fixed the problem after the audit committee learned of it and before the settlement.

The court closed its opinion by warning that *Caremark* claims "reflexively filed" in response to every government investigation, class action lawsuit victory or large settlement do "more harm than good" by "drain[ing] resources from the very corporations that derivative plaintiffs purport to represent."

Ninth Circuit Affirms Dismissal of Securities Fraud Claims Against Biopharmaceutical Company for Failure To Plead Falsity or Loss Causation

In re Sorrento Therapeutics, Inc. Sec. Litig. (9th Cir. Mar. 25, 2024)

What to know: The Ninth Circuit affirmed the dismissal of a putative securities fraud class action brought by investors against a biopharmaceutical company and certain of its officers. The court held that, in context, the defendants' claims that they had discovered a COVID-19 "cure" were not misleading to investors, and that the company's need to raise funds and purportedly overleveraged position were not sufficient to warrant an inference of scienter.

The Ninth Circuit affirmed the dismissal of a putative securities fraud class action brought by investors against clinical-stage biopharmaceutical company Sorrento Therapeutics and certain of its officers, alleging Sorrento misled investors about its COVID-19 "cure."

In May 2020, Sorrento Therapeutics announced in a press release that it had identified an antibody that demonstrated "100% inhibition" against COVID-19. The press release also disclosed that the antibody was still in preclinical stages and had not received FDA approval. Following the release, the individual defendants claimed in media interviews the new antibody could "100% completely prevent infection" and, if approved, could end the need to socially distance. The company's stock price rose 243%. Days later, however, the stock price plummeted as media outlets published stories questioning the importance of Sorrento's development.

The plaintiffs, a group of purported Sorrento shareholders, alleged that the defendants falsely claimed to have developed a cure for COVID-19 and purposefully misled investors so that Sorrento could raise the capital it needed to sustain operations. The district court granted Sorrento's motion to dismiss, finding the plaintiff failed to plausibly allege falsity because (i) Sorrento contemporaneously disclosed that its antibody was in the early stages of development and (ii) the enthusiastic statements about the antibody amounted to nonactionable "corporate puffery." It also determined that "Sorrento's need to raise funds to retire its high-interest debt did not give rise to a strong inference of scienter."

The Ninth Circuit affirmed. Regarding falsity, the court concluded that, although the defendants' statements about the new antibody "might have been overblown," taken within the context of the company's surrounding disclosures, "their statements were not materially misleading."

With respect to scienter, the court held that although the plaintiffs had alleged the company "was clearly helped by the market's response to the announcement" about its antibody, they failed to identify "any particular improper or inflated sales." Without pleading some kind of plausible motive for fraud, like improper stock sales taking advantage of an allegedly "inflated" stock price, the court concluded that the plaintiffs failed to plead facts creating a strong inference that Sorrento sought to improperly manipulate its stock price through false statements.

District of Minnesota Grants Motion To Dismiss Securities Fraud Claims Against Medical Device Company, Finding Alleged Misrepresentations Were Not Actionable

Trs. of Welfare & Pension Funds of Local 464A v. Medtronic PLC (D. Minn. Mar. 28, 2024)

What to know: The District of Minnesota dismissed securities fraud claims against a medical device company and its officers relating to FDA approval and undisclosed customer complaints.

Judge Katherine Menendez of the U.S. District Court for the District of Minnesota dismissed securities fraud claims against medical device company Medtronic PLD and its officers. The plaintiffs alleged that Medtronic and its executives misled investors about the progress of FDA approval and concealed significant product quality issues relating to its insulin pumps in violation of Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder.

The plaintiffs alleged that Medtronic had obtained a large share of the insulin pump market through the development of a particular series of insulin pumps. However, the product began to experience increased competition and product quality issues, which led to a recall and FDA investigation. The plaintiffs claimed that Medtronic failed to disclose customer complaints and product quality issues, which led the company to overstate its financial health and growth prospects. The plaintiffs also alleged that Medtronic failed to disclose that the FDA had identified issues with the product during an inspection, which the plaintiffs argued was a material omission that misled investors.

The court found that the plaintiffs had not identified any false statements of material fact. The court stated that, though material omissions can serve as the basis of a Rule 10b-5(b) violation, companies do not have an affirmative duty to disclose all information that could potentially affect the stock price unless silence renders an affirmative statement misleading. The court found that the company was not obligated to disclose customer complaints or other product concerns about its new line of insulin pumps when attributing the growth in its diabetes business to those pumps. The court also rejected the plaintiffs' argument that these revenue statements were misleading because they implied that the product's sales would continue to experience the same growth. The court found that the company did not attribute growth to the insulin pump when no such growth was occurring and that the revenue was not attributable to a hidden unsustainable source like illegal sales practices.

The court also rejected the plaintiffs' claim that the defendants' statements regarding the prospects of FDA approval for a new line of insulin pumps were actionable misrepresentations. The court found that the plaintiffs had not alleged facts showing that the defendants had ever assured, guaranteed or promised that the FDA would approve the new insulin pumps. The court also found that, on several occasions, the defendants had made it clear that a specific timeline for approval could not be predicted. Additionally, the court found that even if there were actionable misrepresentations under securities laws, the plaintiffs had not adequately alleged facts supporting a strong inference of scienter. For these reasons, the court dismissed the plaintiffs' claims.

M&A

Seventh Circuit Outlines Framework for Courts To Evaluate Individual Mootness Fees in Merger Challenge Lawsuits

Alcarez v. Akorn, Inc. (7th Cir. Apr. 15, 2024)

What to know: The Seventh Circuit mapped out one means by which a court may evaluate mootness fees paid to individual shareholders after the voluntary dismissal of an action challenging a public company merger. The decision could be persuasive to other courts and reduce the filing of merger challenge cases.

The Seventh Circuit recently mapped out one means by which a court may evaluate mootness fees paid to individual shareholders after the voluntary dismissal of an action challenging a public company merger. The decision indicates that Rule 11 of the Federal Rules of Civil Procedure provides the proper framework to evaluate the propriety of the underlying disclosure case, and it could be persuasive to other courts and reduce the filing of merger challenge cases.

After former pharmaceutical manufacturer Akorn, Inc. asked its investors to approve a merger with Fresenius Kabi AG, six suits were filed against Akorn under federal securities law alleging that its proxy statements should have contained additional details. Within weeks, Akorn amended its proxy statements to add additional disclosures. All six plaintiffs then moved to dismiss their suits, asserting that the disclosures mooted their complaints, and district judges entered the orders of dismissal. Akorn agreed to pay the plaintiffs' counsel a $322,500 "mootness fee." Theodore Frank, one of Akorn's shareholders, filed a motion to intervene and asked the court to require counsel to disgorge the mootness fee and to enjoin the lawyers from filing "strike suits," aimed at extracting money for counsel with little or no benefit to investors.

Though the district court denied Mr. Frank's motion to intervene, the district judge reopened the suits, concluded the complaints were frivolous and ordered counsel to return the fees. The lawyers and Mr. Frank appealed.

The Seventh Circuit panel held that the district court did not have the inherent authority to re-open the merger challenge and review the mootness fee following the action's voluntary dismissal. It held the court could only re-open the case following a formal motion under Rule 60(b) of the Federal Rules of Civil Procedure, which had not occurred. But it noted that Mr. Frank had moved to intervene in the case and, had the court granted his motion, he could have filed such a motion to re-open.

The Seventh Circuit held that the district court erred because it addressed only Mr. Frank's proposal to intervene as of right and not his proposal to intervene permissively under Federal Rule of Civil Procedure 24(b). Reasoning that "class counsel and Akorn [we]re looking out for their own interests rather than those of the class," the Seventh Circuit held that "intervention [wa]s appropriate" and that Mr. Frank, a member of the proposed class and an investor in Akorn, was "entitled to participate as a party."

The Seventh Circuit further held that, although Rule 23(e) does not require judicial approval to settle or dismiss cases brought as putative class actions, the PSLRA supplies a mechanism for reviewing a supplemental disclosure case and mootness fees on the merits. That mechanism obligates a district court to make specific findings regarding compliance with Rule 11(b) of the Federal Rules of Civil Procedure upon final adjudication of any action brought under the Exchange Act.

The Seventh Circuit thus determined that while the district court's reference to its "inherent authority" was misplaced, the court's reasoning held. Mr. Frank alleged — and the district court had already found — that plaintiffs' counsel violated Rule 11 by bringing suits whose very purpose was to "needlessly increase the cost of litigation" to "induce Akorn to pay the lawyers to go away." Still, the Seventh Circuit acknowledged that given the denial of the motion to intervene, the district court had not yet conducted the proper proceeding under the PSLRA and Rule 11, including by providing notice and an opportunity to be heard, thus necessitating a remand.

Ninth Circuit Affirms Dismissal of Securities Fraud Claims Against Information Services Company for Failure To Plead Scienter and Loss Causation

Espy v. J2 Glob., Inc. (9th Cir. Apr. 19, 2024)

What to know: The Ninth Circuit affirmed the dismissal of a putative securities fraud class action against an information services company, holding that the plaintiff shareholder failed to plead scienter based on confidential witness reports, or loss causation based on short seller reports that relied on publicly available information.

The Ninth Circuit affirmed the dismissal of a putative securities fraud class action against J2, an international information services company that regularly acquires digital media businesses. The plaintiff, a purported J2 shareholder, alleged that J2 hid adverse details about the financial impact of two prior acquisitions by using consolidated accounting that supposedly created a misleading impression about how the acquisitions had performed. The district court dismissed the plaintiff's complaint for failure to plead scienter.

The Ninth Circuit affirmed, holding that the complaint failed to plead either scienter or loss causation. Regarding scienter, the court held that while most of the plaintiff's allegations were based on criticisms from anonymous witnesses, he failed to plead facts showing that the witnesses had reliable, firsthand knowledge. Rather, the witnesses' accounts amounted to generalized criticisms of management instead of facts showing that management intended to defraud the market.

Regarding loss causation, the court held that the plaintiff could not rely on a pair of short seller reports as corrective disclosures because the reports were based entirely on publicly available information, and neither report revealed new or hidden details about the two acquisitions in question, meaning that the reports did not "correct" any supposed misimpression the market may have had based on J2's allegedly false statements about those acquisitions.

Delaware Supreme Court Confirms Scope of Application and Independence Requirements Under *MFW*

In re Match Grp., Inc. Derivative Litig. (Del. Apr. 4, 2024)

What to know: The Delaware Supreme Court held that, even outside the freeze-out merger context, when a controlling stockholder stands on both sides of a transaction or receives a nonratable benefit, to secure the benefits of business judgment review, all of *MFW*'s requirements must be implemented. The court also held that all members of a special committee in such a transaction, not just a majority, must be independent in order for the committee itself to be independent under the *MFW* test.

The Delaware Supreme Court affirmed in part, and reversed in part, a Court of Chancery decision dismissing a stockholder suit challenging the fairness of holding company IAC's separation from online dating service company Match Group, Inc., its controlled subsidiary.

At the trial court level, all parties agreed that the "multi-step reverse spinoff" was an interested transaction in which a controller obtained a nonratable benefit at the expense of the minority and, accordingly, was presumptively subject to entire fairness review. Therefore, the primary question for the Court of Chancery was whether the reverse spinoff complied with *MFW* and, accordingly, was subject to business judgment review. The Court of Chancery concluded that "the process as pled satisfied *MFW*," even though the plaintiffs had adequately pled that one member of the three-member special committee was not independent. "Thus, [the reverse spinoff was] subject to review under the business judgment standard, and this matter must be dismissed."

The plaintiffs appealed, claiming that the Court of Chancery erred in applying *MFW* because, among other things, one special committee member lacked independence. In response, certain defendants raised the argument that *MFW* need not be satisfied to secure business judgment review of a controlling stockholder transaction not involving a freeze-out merger.

The Delaware Supreme Court held that, even outside the freeze-out context, for controlling stockholder transactions where the controller receives a nonratable benefit, "[t]he presumptive standard of review is entire fairness, unless the defendants can satisfy all of *MFW*'s requirements to change the standard of review to business judgment."

In evaluating whether the *MFW* factors were satisfied, the Delaware Supreme Court agreed with the Court of Chancery that the plaintiffs had adequately pled that one committee member lacked independence. However, the Delaware Supreme Court held that all members of the special committee must be independent under the *MFW* test. While the Delaware Supreme Court recognized that a "majority" independence standard is generally used under Delaware law, the requirement under *MFW* that the controller "disable" itself from being able to dictate the outcome of the negotiations requires that all members of the committee be independent from the controller. Accordingly, the Delaware Supreme Court reversed the Court of Chancery's dismissal of the plaintiffs' direct claims and remanded for further proceedings.

SDNY Dismisses Exchange Act Claims Against Surviving Entity and Directors, Officers in De-SPAC Transaction

In re Lottery.com, Inc. Sec. Litig. (S.D.N.Y. Feb. 6, 2024)

What to know: The Southern District of New York dismissed claims brought under Sections 10(b), 14(a) and 20(a) of the Exchange Act against the surviving entity and several of its officers and directors in a de-SPAC transaction that erroneously recognized $30 million in sales.

Judge Jennifer L. Rochon of the U.S. District Court for the Southern District of New York dismissed claims brought under Sections 10(b), 14(a) and 20(a) of the Exchange Act against Lottery.com, Inc. (Lottery), the surviving corporation of a de-SPAC transaction with SPAC Trident, and several of its officers and directors. In advance of the de-SPAC, Trident's SEC filings touted Lottery's close collaboration with gambling regulators and rosy financial projections, but warned about lax internal accounting controls. Following the de-SPAC, Lottery reported sales driven by "LotteryLink Credits" for prepaid promotions and advertising. Later, Lottery disclosed that it had overstated those sales by $30 million, which represented nearly half of Lottery's revenue for the fiscal year.

The complaint alleged that Lottery and its leadership made material false or misleading statements regarding Lottery's regulatory compliance, financial projections and financial statements to inflate the stock price and enrich themselves via executive compensation tied to stock value. The court, accepting the plaintiffs' allegations as true, dismissed each of these claims.

First, the court found that Lottery's statements regarding collaboration with gambling regulators were "non-actionable puffery" and thus not material. The court reasoned that optimistic statements like "[Lottery] has been a pioneer in the lottery industry, working closely with state regulators to advance the industry into the digital age" were too general for a reasonable investor to rely on.

Second, the court held that Lottery's published financial projections could not support the plaintiffs' securities fraud claims under the "bespeaks-caution doctrine" because they were accompanied by sufficient cautionary language. The court reasoned that because Lottery warned that its internal accounting controls were lacking, Lottery "addressed the very risk that plaintiffs allege it failed to disclose."

Third, the court found that Lottery's financial statements, which included the erroneous $30 million in sales, were materially false, but that the plaintiffs had not established scienter. The court found that the "magnitude of a restatement and the centrality of a revenue category to a company's core operations" could not establish scienter, even when combined with Lottery's high-level corporate resignations and the departure of Lottery's independent auditor. While the court recognized the divergent incentives of SPAC investors and SPAC sponsors, it rejected the plaintiffs' invitation to "hold that SPACs are an exception to the general principle that the prospect of a public offering" is insufficient to establish scienter.

Media and Entertainment

Ninth Circuit Partially Revives Securities Fraud Claims Against Children's Media Company for Allegedly Inflating Share Price Following Delisting Notice

In re Genius Brands Int'l, Inc. Sec. Litig. (9th Cir. Apr. 5, 2024)

What to know: The Ninth Circuit partially revived a putative class action against a children's media and entertainment company, holding that plaintiff shareholders adequately alleged falsity and loss causation with respect to most of their false statement claims.

The Ninth Circuit partially revived a putative class action against children's media and entertainment company Genius Brands, alleging the company made false statements after it received a delisting notice once its share price fell below the NASDAQ minimum trading requirement. The plaintiffs, a group of purported Genius Brands shareholders, claimed that Genius Brands' allegedly false statements concerned (i) whether the company had hired a stock promoter, (ii) whether Arnold Schwarzenegger had invested in the company, (iii) how frequently its Rainbow Rangers children's television show would air per week, (iv) whether Disney or Netflix would acquire the company and (v) its rights to the collected works of deceased comic book author Stan Lee. The district court dismissed the shareholders' suit for failure to plead falsity and loss causation.

Reversing in part, the Ninth Circuit held that the plaintiffs sufficiently pled that Genius Brands made a false statement when it told investors it had not hired anyone to solicit the purchase of its securities because Genius Brands had purportedly hired a stock promoter to publish favorable articles about the company.

The court next held that the plaintiffs sufficiently pled loss causation for their Rainbow Rangers claim by alleging that the Genius Brands' stock price declined after the market supposedly learned that the Rainbow Rangers show would air roughly half as often as Genius Brands had represented.

The court then held that the plaintiffs sufficiently pled loss causation for their claim that Genius Brands falsely implied Disney or Netflix would acquire the company by retweeting an article speculating about such an acquisition, because the plaintiffs plausibly alleged that the retweet stopped Genius Brands' stock price from declining as rapidly as it would have otherwise.

The court further held that the plaintiffs sufficiently pled loss causation for their claim that Genius Brands falsely represented that it owned the intellectual property rights to Stan Lee's works because the plaintiffs plausibly alleged that the purported misrepresentation maintained Genius Brands' stock price.

The panel also affirmed the dismissal, in part, holding that the district court correctly dismissed the claim that Genius Brands had misrepresented its relationship with Gov. Schwarzenegger on the grounds that the plaintiffs failed to identify a "corrective disclosure" showing Gov. Schwarzenegger had not, in fact, invested in Genius Brands' securities.

EDNY Dismisses Securities Act Claims Against Mobile Games Company, Finding Plaintiff Failed To Plead Viable Claim Under Omissions Theory

Bar-Asher v. Playtika Holding Corp. (E.D.N.Y. Mar. 18, 2024)

What to know: The Eastern District of New York dismissed a plaintiff's claims that the defendant, a mobile games company, had violated Sections 11 and 15 of the Securities Act. The court held that the plaintiff failed to plead a viable claim under an omissions theory where the defendant had disclosed the general risks in its registration statement.

Judge Rachel P. Kovner of the U.S. District Court for the Eastern District of New York granted Playtika's motion to dismiss Securities Act Section 11 claims. Playtika is a mobile games company whose revenue comes primarily from in-app purchases in two games: Slotomania and Bingo Blitz. Playtika filed a Form S-1 and went public on January 15, 2021. Ten months later, Playtika released Q3 2021 results, disclosing that revenue had fallen 3.6%, revising financial guidance down and attributing the shortfall, in part, to "product and platform investment[s]" in Slotomania and Bingo Blitz.

Relying on the confidential informants, the plaintiff alleged that undisclosed, complicated overhauls of the technical infrastructure underlying Slotomania and Bingo Blitz had slow product development, resulting in decreased user engagement and revenue. The plaintiff brought claims under an omissions theory, alleging that Playtika's failure to disclose the specific infrastructure risks for Slotomania and Bingo Blitz rendered 20 different statements in the S-1 materially misleading.

In dismissing the Section 11 claim, the court found that general risk disclosures in the S-1 concerning changing technology, evolving industry standards, systems integration or migration work, and the ability to introduce improvements and enhancements to games on a timely basis sufficiently covered the infrastructure overhauls of Slotomania and Bingo Blitz and "[n]o section 11 liability lies where a registration statement 'adequately warned the reasonable investor of the allegedly omitted risks.'" The court noted that while the risk disclosures did not mention Slotomania or Bingo Blitz specifically, "Playtika's disclosure was 'broad enough to cover' the risk associated with those specific upgrades, [and] 'the disclosure is not misleading simply because it fails to discuss the specific risk.'" The court also rejected the plaintiff's argument that the disclosures were misleading because the "risks had already materialized," finding that the plaintiff failed to sufficiently plead a timeline in support of that allegation.

The court similarly found that the general disclosures were sufficient to put shareholders on notice of technological risks and rejected the plaintiff's Item 105 claim. And, finding no underlying violation of the Securities Act, the court dismissed the Section 15 control person liability claim.

Real Estate

SDNY Dismisses Exchange Act Claims for Failing To Plead Scienter, But Allows Securities Act Claims To Proceed

Saskatchewan Healthcare Emps.' Pension Plan v. KE Holdings Inc. (S.D.N.Y. Feb. 26, 2024)

What to know: The Southern District of New York dismissed claims against a holding company alleging Exchange Act violations due to the plaintiff's lack of scienter, but allowed Securities Act claims to proceed alleging the holding company's secondary offering documents contained misleading statements.

Judge Gregory H. Woods of the U.S. District Court for the Southern District of New York dismissed the plaintiff's claims alleging violations of Sections 10(b) and 20(a) of the Exchange Act because the plaintiff did not adequately plead scienter. However, the court declined to dismiss the plaintiff's claims under Sections 11, 12(a)(2) and 15 of the Securities Act because the plaintiff adequately pled that the company's secondary offering documents contained misleading statements.

The plaintiff alleged that China-based holding company KE Holdings Inc. and several of its executives and underwriters misrepresented the value of its real estate transactions and the number of stores and agents using its online platform. The plaintiff relied upon a report by a short seller, Muddy Waters Capital LLC, that the court found sufficiently reliable.

As to the Exchange Act claims, although the court found that certain statements were actionable misstatements, it found that the plaintiff had not established scienter. Specifically, the court held that the plaintiff did not establish scienter against the individual defendants merely by noting that the individuals had important roles in the organization and were involved in day-to-day operations.

Likewise, the court held that the plaintiff had not established the scienter of the company because the plaintiff's argument that the defendants sought to maintain the company's stock price and remain profitable was common to all corporate officers and could not suffice to establish motive.

As to the Securities Act claims, the court held that the plaintiff plausibly alleged based on the Muddy Waters report that certain KE Holdings' statements in the secondary offering documents regarding its reported number of agents and stores were false and misleading.

Southern District of Ohio Dismisses Claims Against Shopping Mall Operator and Owner, Finding Forward-Looking Statements Fall Under PSLRA Safe Harbor

In re Wash. Prime Grp., Inc. Sec. Litig. (S.D. Ohio. Mar. 27, 2024)

What to know: The Southern District of Ohio granted a REIT's motion to dismiss plaintiff-investors' Exchange Act violation claims against it. The claims alleged the defendants made false and misleading statements in securities filings and earnings calls.

Judge James L. Graham of the U.S. District Court for the Southern District of Ohio granted the motion to dismiss a federal securities complaint filed against Washington Prime Group, Inc., a real estate investment trust (REIT) that owns shopping malls. Plaintiff-investors in the REIT alleged the defendants made false and misleading statements in securities filings and earnings calls in violation of Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder.

The plaintiffs based their allegations on two statements made by the defendants: (i) that the defendants expected the REIT to obtain a 9-10% yield from general redevelopment efforts and expected significant yield on specific projects, and (ii) that the REIT would secure relief from debt covenants and be able to survive the COVID-19 pandemic.

Beginning in 2018, the defendants had communicated to investors that, as online shopping overtook onsite retail sales, the REIT would need to focus on redeveloping its portfolio. The plaintiffs alleged executives on earnings calls inflated the expected yield from these redevelopment efforts, and the REIT filed 8-Ks that reflected falsely inflated yields. The plaintiffs also alleged that the company's internal numbers had been manually adjusted upward to arrive at 9-10%. The plaintiffs further alleged that the company had been overstating income and understating costs associated with redevelopment projects.

Additionally, in 2020, the REIT disclosed in a Form 10-Q that it was engaged in discussions with unsecured creditors to remain compliant with its debt covenants and also announced it had entered into credit facility modifications. The REIT ultimately filed for bankruptcy in 2021. The plaintiffs alleged that statements made by executives about the REIT receiving modifications to credit facilities that would get the REIT "through to the other side of the pandemic" were false and misleading. In response, the defendants argued that these statements were vague, nonactionable expressions of corporate optimism.

As to the first category of statements, the court found the alleged misrepresentations were forward-looking statements that fell within the PSLRA's safe harbor, and that the company properly identified them as such in its filings. The court noted that items such as "Earnings Expectations" were properly distinguished from metrics relating to past performance. While the plaintiffs alleged that they had only received a boilerplate Safe Harbor warning, the court found that investors had received additional and more specific warnings, which cautioned investors that estimates were subject to changes "inherent in the development process."

As to the second category of statements, the court agreed with the defendants, finding that the executives' comments were loosely optimistic statements that no reasonable investor would find material. This finding was based on the fact that executives made no promises and offered no concrete numbers or financial details as to how the REIT would survive the pandemic.

For these reasons, the court dismissed the plaintiffs' claims under 10(b) and Rule 10(b)-5 thereunder. Because it found no underlying violation of securities law, the court dismissed the plaintiffs' claim for control person liability under Section 20(a).

Retail

SDNY Dismisses Claims, in Part, Alleging Securities Act and S-K Violations Against PaaS Provider

Lian v. Tuya Inc. (S.D.N.Y. Mar. 5, 2024)

What to know: The Southern District of New York dismissed claims, in part, alleging violations of Sections 11 and 15 of the Securities Act, and Items 105 and 303 of SEC regulation S-K against a PaaS provider.

Judge John P. Cronan of the U.S. District Court for the Southern District of New York dismissed claims, in part, alleging violations of Sections 11 and 15 of the Securities Act, and Items 105 and 303 of SEC regulation S-K against platform-as-a-service (PaaS) provider Tuya.

Tuya sells connectivity services to companies that sell products running on the Internet of Things. Approximately 30% of Tuya's customers are China-based, cross-border e-commerce merchants. Tuya went public in the U.S. via an IPO in March 2021. In mid-2021, the publication of a cybersecurity report that revealed widespread use of fake reviews on the product pages of China-based e-commerce merchants resulted in Amazon banning 600 Chinese brands, making the products of many of Tuya's customers unavailable. Thereafter, Tuya repeatedly disclosed financial losses and attributed Tuya's difficulty to "Amazon's strict execution of seller policy" and "Amazon store closures."

The plaintiff alleged Tuya violated its Item 105 obligation by failing to disclose the risk of fake reviews, and that Tuya violated its Item 303 obligation by failing to disclose a known trend that could impact sales. In rejecting the Item 303 claim, the court held that the plaintiff could not rely on general newspaper reports of endemic fake reviews where the plaintiff failed to specifically tie those newspaper stories to Tuya's customers ("[i]n other words, public reports about broader trends in the e-commerce industry fail to raise the inference of actual knowledge of Tuya's 'customers' systematic violations of Amazon's policies'"). And, because the plaintiff had not alleged that Tuya held actual knowledge of the risk of fake reviews, the court rejected the Item 105 claim.

Under Section 11, the plaintiff also alleged that Tuya's failure to disclose the fake review scheme rendered five categories of statements in its registration statement false and misleading. In denying the motion to dismiss, the court held that unlike Items 105 and 303, the strict liability standard of "Section 11 does not have a requirement that the omitted facts be known, or should have been known, by issuers," and "[r]ather, what is required is that the omitted fact be knowable." Analyzing the Section 11 claims, the court rejected the defendant's position that the scheme was not knowable at the time of the IPO — as at least some public investigation preceded the IPO — and rejected the defendants' position that it had generally disclosed the risk in its registration statement ("general disclosures about customer loss and [] specific disclosures about the potential impact of negative publicity' "did not 'put a reasonable investor on notice of the risk' of the Fake Review Schemes").

The court dismissed Section 11 claims as to statements concerning Tuya's Net Promoter Score, finding the plaintiff waived the claim by failing to respond to the defendant's motion. The court also dismissed the Section 15 claim as to one defendant — the former General Electric chairman and CEO — holding "the mere fact that [he] became a director does not alone establish control."

SEC

Eleventh Circuit Holds Information Provided to Court-Appointed Receiver Does Not Qualify for Whistleblower Award

Meisel v. SEC (11th Cir. Mar. 27, 2024)

What to know: The Eleventh Circuit affirmed the SEC's denial of a whistleblower award under the Dodd-Frank Act, holding that the tipster failed to satisfy a number of statutory prerequisites for such an award.

The Eleventh Circuit affirmed the SEC's denial of a whistleblower award stemming from petitioner John Meisel's suspicions that his former tenant was part of an alleged Ponzi scheme. Under the Dodd-Frank Act, the SEC will pay whistleblowers an award for providing original information that leads to "the successful enforcement of the covered judicial or administrative action, or related action." Under SEC Rule 21F-4, that information must have "significantly contributed to the success of the action." Additionally, whistleblower information must be provided directly "to the Commission, in a manner established, by rule or regulation, by the Commission."

On May 29, 2014, the SEC filed a civil action relating to an alleged Ponzi scheme against several defendants in the U.S. District Court for the Northern District of Ohio. Mr. Meisel read about the action in the newspaper and suspected that his former tenant was part of the scheme. Mr. Meisel called the commission's trial attorneys and informed them of his suspicions. He also corresponded with a court-appointed receiver and provided information that assisted the receiver in recovering funds related to the scheme. After judgment was entered against the defendants in the commission's action, Mr. Meisel applied for a whistleblower award. The commission denied his application, and Mr. Meisel filed a petition for review with the Eleventh Circuit.

The court affirmed the SEC's denial of a whistleblower award, holding that (i) Mr. Meisel's tip did not significantly contribute to the success of the SEC's civil enforcement action because the SEC provided evidence that it already knew Mr. Meisel's information before he shared it; (ii) Mr. Meisel was not eligible for an award based on any information he provided to the court-appointed receiver because he did not share that information directly with the SEC; and (iii) Mr. Meisel could not recover a whistleblower award based on the government's subsequent prosecution of the former tenant for making false statements to the SEC because Meisel was not entitled to an award for helping the SEC's civil enforcement action, and therefore did not meet Dodd-Frank's prerequisites for obtaining an award based on information that helped the government prevail in a "related" criminal action.

DC District Court Holds Proxy Advisory Firms Do Not 'Solicit' Proxies Under Section 14(a) of Exchange Act

Institutional S'holder Servs. Inc. v. SEC (D.D.C. Feb. 23, 2024)

What to know: The D.C. District Court granted summary judgment in favor of a proxy advisory firm that challenged the SEC's extension of the definition of "solicit" in Section 14(a) of the Exchange Act to prohibit the furnishing of proxy voting advice for a fee, finding the extension was contrary to law and exceeded the SEC's statutory authority.

Judge Amit P. Mehta of the U.S. District Court for the District of Columbia granted summary judgment in favor of plaintiff Institutional Shareholder Services (ISS), a proxy advisory firm, which challenged the SEC's extension of the definition of "solicit" in Section 14(a) of the Exchange Act.

Section 14(a) makes it unlawful to "solicit" proxies in violation of SEC rules and regulations. In September 2020, the SEC issued a final rule providing that proxy voting advice constitutes "solicitation" for purposes of Section 14(a) and its implementing regulations. The final rule amended the proxy rules' definition of "solicit" and "solicitation" to expressly include the furnishing of "proxy voting advice" for a fee, subjecting proxy firms to SEC regulation.

ISS challenged the SEC's extension of the proxy rules to proxy voting advice, arguing in part that proxy advisory firms do not "solicit" proxies because they do not seek proxy authority or ask shareholders to vote a certain way to achieve a particular outcome. The SEC and intervenor-defendant National Association of Manufacturers (NAM) countered in part that proxy advisers "solicit" proxies in the sense that advisers move shareholders to vote or, alternatively, aim to obtain votes consistent with their advice. All parties filed cross-motions for summary judgment.

After noting that no court had ever been confronted with the question presented here, the court granted summary judgment in favor of ISS and denied the SEC and NAM's cross-motions for summary judgment. The court found that many dictionaries in 1934 when the Exchange Act was passed defined "solicit" to mean some variant of seeking to secure an action or object from another by actively pleading or asking. According to the court, "importune" invariably appeared among the term's definitions. The court held that proxy advisers do not "vigorously importune" clients to vote in a certain way to benefit themselves. Additionally, the court found no compelling evidence that Congress was "abundantly aware" that the SEC treated proxy voting advice as "solicitation" and acquiesced to such interpretation.

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