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Inside the Courts

A Quarterly Update From Skadden Securities Litigators

Trends and Filings


Spotlights

Working Through the Riddles of Tokenized Securities

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Key Points

- The SEC's Crypto Task Force acknowledges past hostility toward digital assets and aims to create more sensible regulations.
- Tokenized securities face complex regulatory challenges, including compliance with the Investment Company Act and broker-dealer rules.
- Developers must consider regulatory frameworks from the start to avoid undermining the economic and technological benefits of blockchain projects.

In the Ancient Greek tale of Oedipus, great rewards awaited travelers able to solve difficult riddles, but a powerful sphinx posed the riddles and devoured those who failed to solve them. Similarly, in ancient crypto times, circa 2017, blockchain technology stood to revolutionize finance and other fields. But two challenges stood in the way of this technology enjoying its full potential: (i) securities laws that don't easily map onto decentralized systems, and (ii) a securities regulator hostile to digital assets, which often posed grave risks to those who tried to solve the first challenge.

Today, the sphinx has resolved to be more helpful, but the riddles remain. The Securities and Exchange Commission's (SEC's) Crypto Task Force has stated that the agency's previous regime created "an environment hostile to innovation" and has committed to working with industry participants to craft sensible regulations. While promising, significant challenges remain. U.S. securities laws are a mix of statutes passed by Congress and rules adopted by the SEC. The Task Force has signaled the SEC's willingness to make the latter more workable through new rules and exemptions. Statutes, however, present most of the challenges and only Congress, not the SEC, can change them.

Below is a primer on the more common riddles currently facing developers of tokenized securities.

Regulatory Considerations

For tokenized securities, the developer creates on-chain tokens that each represent a share of equity in a company or other security, or another asset that offers the right to cashflows. This tokenization can open up possibilities — such as instantaneous settlement, share fractionalization and daily dividend payments — that make the product more efficient or functionally diverse than its TradFi counterpart.

Even though the SEC may be more receptive to ideas for tokenized securities, it doesn't have the authority to change statutes. Tokenized securities projects, therefore, will still need to solve or avoid the riddles these statutes present.

The Investment Company Act

If a token gives its holder economic exposure to assets that the developer has pooled, that token project could be an investment company covered by the Investment Company Act, which regulates companies, like mutual funds, that invest in securities and let investors get exposure to those investments through shares that they issue.

This riddle existed well before crypto, and most opted to navigate it by avoiding being classified as an investment company in the first place. That's because the requirements imposed by the Investment Company Act don't work well with business models that involve more than the buying and selling of securities. There are substantial restrictions on debt and equity raises, borrowing and even business with affiliates. For those unable to avoid triggering these requirements, there are exemptions that may be available.

Broker-Dealers Under the Securities Exchange Act

Anyone who buys and sells securities for others or stands ready to buy and sell securities for their own account may be a broker or dealer. There is no bright line rule for qualifying as a broker-dealer, but the SEC and courts consider as indicia whether you provide liquidity, charge a fee related to the trade price, actively find investors, or play a role in holding customer funds or securities. While there's no practical way to trade digital assets as a broker-dealer currently, the SEC could use its existing authority to chart a realistic path for doing so. In the best case, that will take time and still come with some compliance obligations.

Exchanges Under the Securities Exchange Act

While it may not look like a traditional securities exchange, a platform using smart contracts to bring together orders for tokenized securities from multiple buyers and multiple sellers for matching and execution could qualify as one, depending on its structure.

Currently, only broker-dealers can trade on exchanges, and exchanges can't hold customer accounts or custody customer securities. Even if the SEC is able to rework these rules, some requirements would no doubt persist.

Security-Based Swaps Under the Securities Exchange Act

If a tokenized security gives its holder exposure to the economic performance of one or more securities, it may have crossed over into the complicated world of security-based swaps. Generally, tokens that provide for the exchange of future payments based on the value of a security (or events relating to that security) without conveying ownership rights are likely to be swaps. Security-based swaps are under the joint jurisdiction of the SEC and the Commodity Futures Trading Commission. The requirements for them are many, with the most notable being rules prohibiting retail investors from purchasing swaps.

AML and KYC

Companies involved in trading or transferring tokenized securities also need to consider the applicability of anti-money laundering and know-your-customer laws. Compliance requirements depend on the role being played in the transactions but can include collecting and verifying the name, birthdate and address of customers.

The Riddles Must Be Worked Through, Not Around

Solving these riddles is not an end in itself. When designing any tokenized securities project, developers make choices based on the economics, the technology and the regulatory framework. These areas are intertwined, as the technology can make the economics possible and decide where a project falls within the regulatory framework. But because these considerations are so interrelated, developers should analyze them holistically from the beginning. Leaving regulatory considerations for the end can turn into a game of Jenga where problematic parts are removed only to topple the benefits of and objectives for the economics and technology. The riddles posed today aren't merely obstacles to the many advantages of blockchain technology, but crucial parts of the answer.

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Ninth Circuit Extends Tracing Requirement to Section 12(a)(2) of the Securities Act of 1933

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Key Points

- The U.S. Supreme Court's 2023 decision in *Slack Technologies v. Pirani* (Slack I) and the Ninth Circuit's follow-up (Slack II) require investors to trace their shares directly to a public offering to have standing for claims under Sections 11 and 12(a)(2) of the Securities Act of 1933.
- Plaintiffs must now establish a clear chain of title showing their shares were issued under the allegedly false or misleading registration statement or prospectus — statistical tracing or inference is not sufficient.
- These rulings make it extremely difficult, if not impossible, for investors who purchase shares in direct listings — where both registered and unregistered shares are sold simultaneously — to bring successful Section 11 or 12(a)(2) claims, as tracing is generally not feasible.
- The decisions significantly reduce litigation risk for companies conducting public offerings.

Companies that raise capital through public offerings of stock, such as in an IPO, have historically faced a heightened risk of being sued in securities class actions when their stock price falls below the offering price. This increased risk is largely due to the Securities Act of 1933, which imposes strict liability for any allegedly false statements made in a prospectus or registration statement filed during the offering.

This strict liability framework allows plaintiffs to bring claims without having to prove that defendants intentionally deceived anyone, that investors relied on the allegedly false statements or even that the statements caused them any damages.

However, this heightened litigation risk has been reduced to an extent by the Supreme Court's 2023 decision in *Slack Techs., LLC v. Pirani*, 598 U.S. 759, 768 (2023)(Slack I) and the Ninth U.S. Circuit Court of Appeals' recent decision on remand: *Pirani v. Slack Techs., Inc.*, 127 F.4th 1183, 1191-92 (9th Cir. 2025) (Slack II).

In Slack I, the Supreme Court held that investors must trace title of their shares to establish that those shares were issued in a public offering, which means they must establish a chain of title back to the share's original owner. If an investor cannot trace their shares to those issued in a public offering, then they lack standing to assert claims under Section 11 of the Securities Act.

In Slack II, the Ninth Circuit expanded that requirement to claims brought under Section 12 of the Securities Act.

Background

Sections 11 and 12(a)(2) of the Securities Act of 1933 impose strict liability, subject to certain defenses, for any "untrue statement of a material fact or [omission of] a material fact" in a "registration statement" or "prospectus," respectively. 15 U.S.C. §§ 77k(a), 77l(a)(2). Plaintiffs frequently invoke these statutes when suing public companies, officers and directors, and underwriters in connection with securities offerings.

On June 20, 2019, Slack Technologies, Inc., went public through a direct listing, which differs from an initial public offering (IPO). In an IPO, a company issues and sells new shares to the public by filing a registration statement, and preexisting unregistered shares are subject to a lockup agreement barring them from being sold for a certain period of time. However, a direct listing enables the direct sale of registered and unregistered shares to the public held by preexisting shareholders.

Through its direct listing, Slack issued 118 million registered shares and also made 165 million unregistered shares available for purchase on the NYSE. That day, plaintiff Fiyyaz Pirani purchased 30,000 Slack shares. Following the direct listing, Pirani brought a putative class action against Slack and asserted claims under Sections 11 and 12(a)(2) predicated on the allegedly misleading registration statement Slack filed in connection with its offering of registered shares.

Slack moved to dismiss the complaint, arguing the plaintiff could not establish that he had purchased registered shares sold under the allegedly misleading registration statement as opposed to the unregistered shares made available in the direct listing.

The plaintiff conceded that he could not trace his shares to the registration statement, but argued that "the concept of 'tracing' a share of stock — *i.e.*, establishing a chain of title for a particular share back to the share's original owner — is a concept that no longer exists in today's market and is not possible." *Pirani*, 127 F.4th at 1188.

The district court denied the motion to dismiss in relevant part, concluding it was sufficient that the plaintiff alleged that the registration statement was false and that the securities he purchased were "of the same nature as [those] issued pursuant to the registration statement." *Pirani v. Slack Techs., Inc.*, 445 F. Supp. 3d 367, 379-85 (N.D. Cal. 2020), aff'd, 13 F.4th 940 (9th Cir. 2021), vacated and remanded, 598 U.S. 759 (2023), and rev'd, 127 F.4th 1183 (9th Cir. 2025).

Accepting the plaintiff's assertion that purchasers in a direct listing cannot "know if they purchased a registered or unregistered share," the Ninth Circuit affirmed. *Pirani v. Slack Techs., Inc.*, 13 F.4th 940, 948-50 (9th Cir. 2021), vacated and remanded, 598 U.S. 759 (2023), and rev'd, 127 F.4th 1183 (9th Cir. 2025).

The Supreme Court vacated the Ninth Circuit's decision. The Court held that "[t]o bring a claim under §11, the securities held by the plaintiff must be traceable to the particular registration statement alleged to be false or misleading." *Slack Techs.*, 598 U.S. at 768.

The Court remanded, leaving for the Ninth Circuit to decide whether the plaintiff's pleadings could satisfy Section 11 as properly construed. *Id.* at 770. The Supreme Court left open whether the tracing requirement is equally applicable to Section 12(a)(2) claims. *See Id.* at 770 n.3.

The Ninth Circuit's Decision on Remand

On remand, the Ninth Circuit held that, like Section 11, Section 12(a)(2) requires tracing a plaintiff's shares to an allegedly false or misleading prospectus. *Pirani*, 127 F.4th at 1191. Section 12(a)(2) of the Securities Act of 1933 provides that "[a]ny person who ... *offers or sells a security* ... by means of a prospectus or oral communication, which includes an untrue statement of material fact or omits to state a material fact ... shall be liable ... to the person purchasing *such security* from him." 15 U.S.C. § 77l(a)(2)(emphasis added).

The Ninth Circuit concluded that the phrase "such security" in Section 12(a)(2) refers back to the "security" that was offered or sold "by means of a prospectus." *Pirani*, 127 F.4th at 1191. A "security can be sold 'by means of a prospectus' only if it is a registered security sold in a public offering, and section 12(a)(2) liability can be based only on the sale of such a security." *Pirani*, 127 F.4th at 1192. Therefore, Section 12(a)(2) liability can arise only from the sale of registered shares, making it necessary for Section 12(a)(2) to "impose[] the same traceability requirement as section 11." *Id.*

The Ninth Circuit also concluded the plaintiff had not alleged tracing. In particular, it rejected the concept of "statistical tracing." The plaintiff argued that he could allege traceability by relying on the "statistical inference" that because 42% of the shares on the exchange were registered, "the likelihood that none of the 30,000 shares [he purchased] was registered is infinitesimally small." *Id*. at 1189-90.

The Ninth Circuit rejected the theory, concluding: (i) the plaintiff had not alleged anything to support that he purchased shares in 30,000 separate, statistically independent transactions, instead of one single transaction with a single seller of unregistered shares, *Id.* at 1190; and (ii) statistical tracing is contrary to precedent in *In re Century Aluminum Co. Securities Litigation*, 729 F.3d 1104 (9th Cir. 2013). *Id*.

In *Century Aluminum*, the court held that the plaintiffs seeking to bring Section 11 claims based on a new registration statement could establish traceability only "in one of two ways" — they (i) "could prove that they purchased their shares directly in the secondary offering itself" or (ii) "trace the chain of title for their shares [purchased in the aftermarket] back to the secondary offering." *Century Aluminum*, 729 F.3d at 1106. By so holding, *Century Aluminum* had "implicitly rejected" statistical tracing. *Pirani*, 127 F.4th at 1190.

Following *Pirani*, it remains an open question of how, if at all, purchasers of shares following a direct listing can allege traceability sufficient to state Section 11 and Section 12(a)(2) claims. Federal courts are already finding that *Pirani* "likely forecloses Section 11 liability in direct listings," and such an issue is "best resolved through statutory or regulatory changes." *Cupat v. Palantir Techs., Inc.*, No. 1:22-CV-02384-CNS-SKC (D. Colo. 2025).

Ultimately, the strict "tracing requirement is the condition Congress has imposed for granting access to the 'relaxed liability requirements'" that Sections 11 and 12(a)(2) afford. *Century Aluminum*, 729 F.3d at 1107. Though the Ninth Circuit's decision arguably limits the class of plaintiffs who can allege Section 11 and Section 12(a)(2) claims to those who buy directly in an offering, the holding appears to be consistent with the statutory scheme of strict liability.

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Blockchain and Digital Assets

SDNY Denies Cryptocurrency Firm's Motion for Judgment on Pleadings, Orders Parties To Develop Discovery Schedule

Underwood v. Coinbase Glob., Inc. (S.D.N.Y. Feb. 7, 2025)

What to know: The Southern District of New York denied the defendants' motion for judgment on the pleadings, but ordered the parties to develop a bifurcated discovery schedule to resolve the specific issue of whether the defendants were statutory sellers under Section 12(a)(1) of the Securities Act.

Judge Paul A. Engelmayer of the U.S. District Court for the Southern District of New York denied Coinbase, Inc.'s motion for judgment on the pleadings, allowing discovery to proceed on whether Coinbase qualifies as a "statutory seller" under Section 12(a)(1) of the Securities Act of 1933 (Securities Act), while maintaining the plaintiffs' control person and state law claims.

Coinbase, Inc., operates an online trading platform that facilitates the exchange of digital assets between users. A putative class of persons that transacted on Coinbase, Inc.'s trading platforms alleged that "[b]ecause Coinbase brings together buy and sell orders," Coinbase "stands between the buyer and seller in each trade on its platform, meaning that [it] is the actual seller of the unregistered securities that transact each day on its platform."

Defendants Coinbase Global Inc., Coinbase, Inc. and CEO Brian Armstrong moved for judgment on the pleadings, arguing that the amended complaint did not plausibly allege that either Coinbase entity qualifies as a "statutory seller" under Section 12(a)(1) of the Securities Act. The court denied the motion, but ordered the parties to develop a discovery schedule to "front-load resolution of the statutory seller issue, given the potential for the resolution of that issue to resolve the outstanding claims."

The court explained that a defendant is a "statutory seller" in either of two scenarios: (i) "where the defendant 'passed title, or other interest in the security, to the buyer for value,' the buyer may recover from her 'immediate seller' (but not from her 'seller's seller')"; and (ii) "a defendant can be held liable where it 'successfully solicit[ed] the purchase [of a security], motivated at least in part by a desire to serve [its] own financial interests or those of the securities owner.'" On the first prong, the court held that, at this stage, it was bound by the Second Circuit's order in the case, holding that the amended complaint pled sufficient facts to raise a plausible inference that Coinbase was a statutory seller.

The court held, *sua sponte*, that "discovery pertinent to whether Coinbase qualifies as a 'statutory seller' amenable to suit under Section 12(a)(l) of the Securities Act (and as relevant, under state law) is a discrete issue that is segregable from the merits of plaintiffs' claims" and, as a result, "instruct[ed] the parties to develop a case management plan entailing bifurcated discovery that is aimed at front-loading resolution of that issue via early summary judgment motion(s)." Indeed, the court noted that "the factual record developed in discovery, including the parties' written agreements, will ultimately control."

The court also held that the plaintiffs' corollary control person and state law claims survived and the defendants' argument as to improper group pleading failed because the amended complaint sufficiently alleged at this stage that other defendant Coinbase entities worked in concert with and lacked corporate separateness from Coinbase, Inc.

Energy

Court of Chancery Dismisses Bylaws Challenge on Ripeness Grounds Due to Lack of Proxy Contest

Siegel v. Morse (Del. Ch. Apr. 14, 2025)

What to know: The Court of Chancery dismissed a stockholder's equitable challenge to board-adopted advanced notice bylaws as unripe because the stockholder himself was not contemplating nominating a director for a board seat and did not know anyone else who was.

The Delaware Court of Chancery dismissed a plaintiff's challenge to U.S.-based utility and power generation company The AES Corporation's advanced notice bylaws on ripeness grounds, finding that the absence of an actual or potential proxy contest meant the plaintiff's claims of inequitable chilling of stockholder franchise were not ripe for adjudication.

After receiving a presentation from counsel, AES' board of directors adopted changes to its advanced notice bylaws that included concepts — such as "wolf pack" and "daisy chain" language — that had been the subject of scrutiny in other cases. The plaintiff originally brought suit alleging that the bylaws were facially invalid under Delaware law and that the AES directors breached their fiduciary duties in adopting invalid bylaws. The plaintiff subsequently dropped his facial validity challenge and revised his breach of fiduciary duty claim to allege that the directors had adopted bylaws that "inequitably chill the fair exercise of the AES stockholders' franchise" and were "unenforceable." The plaintiff subsequently conceded that he was not trying to nominate a director for the AES board or knew anyone who was. The defendants moved to dismiss the case as unripe and for failure to state a claim.

The court granted the defendants' motion on ripeness grounds. Because the plaintiff's claim involved only an equitable challenge to the bylaw's enforceability, the court held that a ripe dispute required "a proxy contest, or even a stockholder saying he or she is chilled from making a nomination." The plaintiff had neither.

The court rejected the plaintiff's argument that the impact of the bylaws on chilling proxy contests was analogous to the effects of stockholder right plans and dead-hand proxy puts, which the court did consider as ripe even without an actual or potential proxy contest. Unlike in those circumstances, under the bylaws, "the stockholder does not suffer devastating equity dilution, nor does the company confront a potentially ruinous debt acceleration." The extreme and immediate harm in those instances warranted a different ripeness evaluation. By contrast, nominating stockholders may suffer, at most, the rejection of their slates.

Financial Services

Northern District of Illinois Dismisses Securities Case Alleging Misstatements About Compliance Programs

KBC Asset Mgmt. NV v. Discover Fin. Serv. (N.D. Ill. Mar. 31, 2025)

What to know: The Northern District of Illinois dismissed a securities fraud putative class action against a financial services company and several of its current and former officers and directors, holding that dozens of general statements about the company's compliance practices, risk management and corporate values — especially when accompanied by cautionary language — were inactionable under the federal securities laws.

Judge Martha M. Pacold of the U.S. District Court for the Northern District of Illinois dismissed a putative securities fraud class action complaint against Discover Financial Services Inc. and several current and former officers and directors alleging that the defendants made materially false and misleading statements regarding the company's compliance program and risk management practices.

The plaintiffs alleged that the defendants' public statements gave an inaccurate and overly optimistic picture of the company's compliance efforts which, in reality, were deficient. The plaintiffs further claimed that the misrepresentations artificially inflated Discover's stock price and that they and other investors suffered losses when the truth about Discover's compliance failures emerged.

The plaintiffs alleged that dozens of statements about the company's compliance program and position were false and misleading in light of several regulatory issues that Discover faced, including a Federal Deposit Insurance Corporation investigation into Discover's banking practices and actions taken by the Consumer Financial Protection Bureau related to Discover's student loan servicing practices. When Discover announced that it would suspend its share repurchase program because of an internal investigation related to student loan servicing practices and related compliance matters, Discover's stock price dropped 9%. Discover then exited the student loan servicing business. Shortly thereafter, Discover disclosed longstanding compliance issues in its credit card business, leading to a $365 million liability and resulting in a further 16% drop in its stock price.

The court, applying the heightened pleading standards for securities fraud, granted the defendants' motion to dismiss. The court found that most of Discover's statements about compliance and risk management were general, aspirational or descriptive of goals and processes — not concrete assurances of actual compliance. The court also determined that many of the challenged statements were protected under the Private Securities Litigation Reform Act's (PSLRA's) safe harbor because they were forward-looking statements accompanied by meaningful cautionary language. In addition, the court held that none of the challenged statements, when read in context, would mislead a reasonable investor into believing that Discover had achieved perfect compliance or that its compliance program was free of deficiencies.

Life Sciences and Health Care

District of Minnesota Dismisses Class Action Against Medical Device Company Over Alleged Misstatements on Changes to Insurance Approval Process

City of Hollywood Firefighters' Pension Fund v. Inspire Med. Sys., Inc. (D. Minn. Mar. 24, 2025)

What to know: The District of Minnesota dismissed a putative securities fraud class action alleging a medical device company and its CEO and CFO falsely assured investors about the success of a new insurance approval process.

Judge Nancy E. Brasel of the U.S. District Court for the District of Minnesota dismissed with prejudice a putative securities fraud class action against medical device company Inspire and its CEO and CFO alleging the defendants falsely assured investors that the company's Prior Authorization Approval Process (PAAP) for a sleep apnea medical device was growing more effective and fueling Inspire's growth.

The plaintiffs alleged that Inspire's PAAP historically allowed obstructive sleep apnea patients to receive purchase approval from their medical insurance quickly, which in turn drove revenue for the company. Beginning in January 2023, however, Inspire made changes to its PAAP program that allegedly resulted in a decrease in approvals and a $7-10 million revenue shortfall in the third quarter of 2023. The plaintiffs claimed that between May 3, 2023, and November 7, 2023, the defendants made false or misleading statements regarding PAAP's success, when they in fact knew that the recent changes had resulted in a decrease in the number of implant procedures and resulting financial consequences.

The court dismissed the plaintiffs' claims in full, finding that they failed to adequately plead both falsity and scienter. The court first held that the plaintiffs did not adequately plead that many of the defendants' statements regarding "signs of improvement" in the new PAAP and its positive reception by patients were materially false or misleading when made. The court also noted that many of the alleged misstatements were mere puffery or so vague that no reasonable investor would rely on them. Other statements were taken out of context by the plaintiffs and were unrelated to the changes made to the PAAP. The court further found that the defendants' statements about the company's "continued growth across all [] centers" were in fact true, based on the company records for the second half of 2023.

The court also held that the plaintiffs failed to plead a strong inference of scienter, finding that there were no factual allegations to support that the defendants knew or should have known of the extent of the issues with the changed PAAP at the time the statements were made. The court held that even if it accepted the general assertions of the plaintiffs' confidential witnesses as true — which the court noted it was not required to do — it could infer only that certain low-level employees multiple levels below the defendants had knowledge of the issues resulting from the changed PAAP, which could not support the defendants' scienter.

The court also rejected the plaintiffs' argument that the court could infer scienter under the core operations doctrine because the PAAP was an alleged core matter of central importance to the company. The court held that even if it adopted a broad interpretation of the doctrine, the plausible alternative inference that the defendants were unaware of the extent of the changes to the PAAP until the third quarter of 2023, months after the allegedly misleading statements were made, was more compelling.

M&A

Court of Chancery Dismisses Control Claims Against Alternative Investment Management Firm, Orders Discovery on Key Disclosure Issue in Sale Process

Anchorage Police & Fire Ret. Sys. v. Adolf (Del. Ch. Apr. 3, 2025)

What to know: The Court of Chancery found that a 20.6% stockholder of a target company, which designated 25% of the company's board seats and held additional contract rights as a "permitted holder" under the company's credit agreement, was not a controlling stockholder, and dismissed controller-based claims. The court refused to dismiss remaining claims, but rather than allowing full discovery, it granted limited discovery on one dispositive point.

The Delaware Court of Chancery dismissed claims against alternative investment management firm Stone Point Capital LLC, finding insufficient evidence of its control over target company Focus Financial Partners Inc., but converted the motion to dismiss into a motion for summary judgment to allow discovery on a key disclosure issue regarding the exclusion of Wealth Enhancement Group (WEG) from the sale process.

Focus, a Delaware corporation, was a party to a credit agreement that would accelerate repayment if Focus experienced a change of control unless one of the "permitted holders" under that agreement retained the ability to appoint a majority of the board after the relevant transaction. Stone Point, owning 20.6% of Focus' stock and holding two of its eight board seats, was identified as a "permitted holder" under this agreement. In June 2022, Clayton, Dubilier & Rice LLC (CD&R) expressed interest in acquiring Focus, prompting Focus' board to approve engagement with CD&R.

Subsequently, WEG expressed acquisition interest to Rudy Adolf — Focus' founder, CEO and director — though Mr. Adolf allegedly delayed communicating this interest to the board, a claim disputed by the defendants. Ultimately, Focus merged with CD&R, Stone Point's alleged preferred bidder, despite WEG's higher offer. Stone Point retained half of its equity and secured an investor agreement allowing it to appoint a majority of the board post-close, thus preventing payment acceleration under the credit agreement for CD&R's offer.

The plaintiffs sued, alleging that Stone Point controlled Focus either individually or as part of a control group, and breached fiduciary duties owed as Focus' controlling stockholder. The plaintiff also alleged, among other claims, breach of fiduciary duty claims against Focus' directors and officers for approving the transaction with CD&R and approving a purportedly misleading proxy statement in connection with the transaction. The defendants moved to dismiss.

The court dismissed the plaintiffs' arguments that Stone Point controlled Focus because the plaintiffs had failed to adequately plead that Stone Point exercised general or transaction-specific control over Focus. The court also dismissed the plaintiffs' arguments of a control "group" involving Stone Point because the plaintiffs failed to adequately plead anything more than general "aligned interests" among certain stockholders.

The court then analyzed whether the business judgment rule should apply to the remaining fiduciary duty claims against Focus' directors and officers because there was a fully informed vote from stockholders approving the transaction. The court held that it could not dismiss the remaining claims because of one alleged disclosure issue: The plaintiffs alleged that the defendants failed to properly disclose that they "iced WEG out of the sale process" and failed to timely raise WEG's interest with Focus' board.

The defendants claim the allegations are not true, and in support of this claim, the defendants point to certain statements that were alleged in the complaint and statements made in a letter between counsel. The court found that the defendants' motion to dismiss had effectively narrowed the dispute down to this one disclosure issue. Instead of denying the motion to dismiss and allowing broad discovery, the court noted that the defendants had introduced "countervailing facts" in their motion. As a result, the court converted the motion to dismiss into a motion for summary judgment and permitted the plaintiffs to take discovery limited to the disclosure issue involving interactions with WEG.

SDNY Dismisses Class Action Against Software Company, Citing Lack of Misleading Statements and Scienter

In re Adobe, Inc. Sec. Litig. (S.D.N.Y. Mar. 27, 2025)

What to know: The Southern District of New York dismissed securities fraud claims against a software company and its executives surrounding statements made prior to its acquisition of a competitor.

Judge John G. Koeltl of the U.S. District Court for the Southern District of New York dismissed putative class action claims brought under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 (Exchange Act) against a software company and certain of its officers. In April 2022, the defendants began merger negotiations with a competitor. The complaint alleged that the defendants fraudulently concealed the threat the competitor posed to the company, publicly promoted the company's product line while privately deprioritizing it in response to competitive pressure from the competitor and downplayed the potential that the company would pursue acquisitions.

The court, in dismissing the complaint, agreed with the defendants that the challenged statements were truthful or nonactionable as statements of opinion, puffery and corporate optimism. The court found that the statements that minimized competitive risks were not actionable, as there had not yet been "tangible and concrete harm" caused to the defendants' business by the competitor. The court noted that the plaintiffs also failed to meet the "high bar to show that the defendants contemporaneously disbelieved their statements of opinion" regarding competitive pressure and the future prospects of its product line. Contrary to the plaintiffs' allegations regarding potential acquisitions, the court found that the defendants' statements "explicitly acknowledged the possibility that the company would pursue acquisitions."

Separately, the court also found that the plaintiffs failed to sufficiently plead scienter. The plaintiffs' allegations that the defendants sought to artificially increase its share price were overly generalized. Further, none of the defendant executives' stock trading was so unusual as to support an inference of scienter. The court also determined that the plaintiffs' allegation that an executive at the company would pursue the acquisition to the detriment of his stock holdings in the company merely to increase his stature at his former employer "defies economic reason."

Reasoning that the plaintiffs failed to plausibly allege scienter or a materially misleading statement, the court dismissed the complaint without addressing loss causation, but gave the plaintiffs leave to amend.

Private Equity

Ninth Circuit Finds Venture Capital Firm Could Not Adequately Represent Shareholders in Derivative Action Due to History of Prior Litigation With Company

Bigfoot Ventures Ltd. v. Knighton (9th Cir. Mar. 8, 2025)

What to know: The Ninth Circuit affirmed a district court's dismissal of a shareholder derivative action brought by a venture capital firm against certain parties on the basis that the firm was an inadequate plaintiff to represent the shareholders of the technology company in the litigation.

The Ninth Circuit upheld the dismissal of a shareholder derivative action brought by venture capital firm Bigfoot Ventures against NextEngine, citing Bigfoot's inability to adequately represent NextEngine's shareholders due to its ongoing litigation and personal interests in acquiring NextEngine's intellectual property (IP).

Mark Knighton — the founder, CEO and chairman of NextEngine — incorporated ShapeTools, LLC in 2017. Bigfoot made several loans to NextEngine between 2002-05, secured by NextEngine's patent IP. In 2008, the parties agreed to restructure the loan pursuant to a new promissory note and several agreements. In the agreements, Bigfoot retained its first place security interest in NextEngine's IP and the parties crated a new entity, NextPat, to hold the IP.

Bigfoot ultimately sued NextEngine in state court to collect on the 2008 note. The state court found NextEngine and Mr. Knighton liable on the note. Since then, there have been several lawsuits in state and federal court between NextEngine and Bigfoot involving the 2008 note, NextEngine's IP and the agreements between the two. After Mr. Knighton incorporated ShapeTools, the state court amended its judgment to add ShapeTools as a judgment debtor. Bigfoot continued to aggressively pursue NextEnginge's IP.

In September 2019, Bigfoot brought a shareholder derivative action on behalf of NextEngine against the defendants. The defendants filed a motion to dismiss, arguing that Bigfoot could not fairly or adequately represent the interest of NextEngine's shareholders. In support of the motion to dismiss, several NextEngine shareholders submitted declarations describing their objections to Bigfoot's action due to its "chronic litigation" against NextEngine. The district court granted the motion to dismiss.

The Ninth Circuit affirmed. The court applied the eight-factor test from *Larson v. Dumke*, 900 F.2d 1363 (9th Cir. 1990) to evaluate whether a plaintiff is an adequate representative. As an initial matter, the Ninth Circuit clarified that courts need not evaluate adequacy under all eight factors of the *Larson* test, and that the eight factors are not exhaustive. The appeals court reasoned that Bigfoot's outside entanglements with NextEngine due to the ongoing litigation between the two entities precluded Bigfoot from being an adequate representative plaintiff. In particular, the ongoing litigation made it "likely that the interests of the other stockholders [would] be disregarded in the management of the suit."

In dismissing Bigfoot's action, the Ninth Circuit also found (i) the derivative action was another attempt by Bigfoot to collect on its judgment and take ownership of NextEngine's IP, (ii) Bigfoot's personal interest in gaining NextEngine's IP was greater than its interest in asserting rights on behalf of NextEngine in the shareholder derivative action, (iii) there was no evidence NextEngine shareholders supported the derivative action and (iv) Bigfoot's "personal vindictiveness" towards NextEngine weighed against finding that Bigfoot could adequately represent the shareholders.

Retail

SDNY Allows Exchange Act Claims Against Beauty Company To Proceed Over Alleged Concealment of *Daigou* Market Risks

In re The Estée Lauder Co., Inc. Sec. Litig. (S.D.N.Y. Mar. 31, 2025)

What to know: The Southern District of New York allowed claims under Section 10(b) and 20(a) of the Exchange Act concerning statements about a global beauty company's sales in Chinese gray markets (*daigou*) to proceed based on allegations supported by confidential witnesses and the availability of detailed sales data to executives.

Judge Arun Subramanian of the U.S. District Court for the Southern District of New York denied global beauty company The Estée Lauder Co., Inc. and certain of its officers' motion to dismiss a purported class action asserting claims under Sections 10(b) and 20(a) of the Exchange Act, alleging the defendants defrauded investors by covering up the company's vulnerability to Chinese gray markets, known as *daigou*. *Daigou* involves resellers purchasing luxury goods at duty-free prices and selling them at a markup, though still below retail.

The complaint alleges that during the COVID-19 pandemic, the defendants capitalized on the expanding *daigou* market, concealed its reliance on these sales and minimized its risk exposure in public statements. A government crackdown on *daigou* in 2021 and 2022 led to a significant decline in the defendants' sales. On November 1, 2023, the defendants acknowledged that "changes in government and retailer policies related to unstructured market activity" were a primary cause of the revenue decline.

In rejecting the defendants' motion, the court found that the defendants omitted material information by not acknowledging its *daigou* sales and associated risks. The court noted that the defendants "should have expected that at some point, the Chinese authorities would catch up — the question wasn't if but when." The court credited allegations from three mid-level former employees in sales and marketing, despite the fact that only one was alleged to have worked in the Asia-Pacific market. The court rejected the defendants' argument that these employees were "low-level rank-and-file" employees who could not support the allegations, and found that through their positions, these former employees were exposed to relevant information.

The court also found that the plaintiffs plausibly alleged scienter via recklessness. The court noted that the defendants had access to detailed sales reporting and a sales analytics team focused on *daigou*. That information, combined with the defendants' public statements about tracking travel-retail data, "create[d] a compelling inference that" the defendants "made a conscious decision not to disclose" the *daigou* sales vulnerability. The court rejected the defendants' claim that they could not have predicted the severity of the 2022 crackdown and held that they recklessly "kept quiet out of fear of spooking investors."

SDNY Clears Cloud Platform Manufacturer of Misleading Claims in Registration Statement Amid Fake Review Allegations

Lian v. Tuya, Inc. (S.D.N.Y. Mar. 7, 2025)

What to know: The Southern District of New York dismissed securities claims against a cloud platform manufacturer and its officers, finding that the company's registration statement did not contain any false or misleading statements related to a "Fake Review Scheme" involving its customers.

Judge John P. Cronan of the U.S. District Court for the Southern District of New York granted the defendants' motion for judgment on the pleadings in a securities fraud case, finding that the plaintiffs failed to allege any false or misleading statements by a cloud platform manufacturer and certain of its officers regarding the impact of a purported fake reviews involving the company's customers.

The defendants' registration statement contained statements regarding its relationships with its customers, business prospects and marketing efforts. After the defendants issued their registration statement, a cybersecurity organization published a report alleging that many of the defendants' customers procured fake reviews of their products to boost sales (the Fake Review Scheme). An online shopping company thereafter banned many of the defendants' customers. The defendants' sales took a hit, its share price dropped and the plaintiffs filed a lawsuit alleging that the defendants' registration statement contained misleading statements related to the Fake Review Scheme.

The court held that the plaintiffs failed to identify "any language in [the Defendants] Registration Statement that could plausibly have suggested to a reasonable investor that the Fake Review Scheme ... did **not** exist" because there were "subject matter and specificity mismatches" with the Fake Review Scheme. The court explained that the statements were not reasonably connected to nor suggested facts inconsistent with the Fake Review Scheme. Many of the statements were "directed at [Defendants'] plans for marketing **its** brand," "not at its **customers**' independent strategies for generating demand for their products," and "came nowhere close to placing at issue the subject of its customers' compliance with [an online shopping company's] seller policies." For example, the defendants' warning that its "success depends, in part, on our ability to generate positive customer feedback and minimize negative feedback on social media channels" related to the defendants' capabilities to generate positive feedback, not its customers' capabilities. And broad statements such as the defendants' success depended on generating positive feedback were "relatively abstract in comparison to the Fake Review Scheme."

The court further found it "relevant" that "the alleged misconduct underlying [the] Plaintiffs' claims was committed solely by third parties and without any alleged involvement by the [Defendants'] itself." The court also noted that the defendants could not have reasonably uncovered the Fake Review Scheme and that finding the challenged statements actionable would "encourage less transparency by issuers, not more," because "[i]f there is no realistic way to avoid liability for speaking on a topic, issuers might simply choose not to speak on that topic at all."

SEC

Ninth Circuit Upholds Bar Orders To Protect Receivership Assets in Ponzi Scheme Case

SEC v. Peterson (9th Cir. Feb. 20, 2025)

What to know: The Ninth Circuit affirmed district court orders barring investors in a Ponzi scheme from suing third parties involved in the fraud due to a global settlement between those third parties and the receiver of the company that operated the scheme.

The Ninth Circuit upheld bar orders against Chicago Title Company and Nossaman LLP, preventing further litigation related to Gina Champion-Cain's Ponzi scheme, after determining that the orders were necessary to protect the assets of ANI Development, LLC's receivership and were fair and equitable.

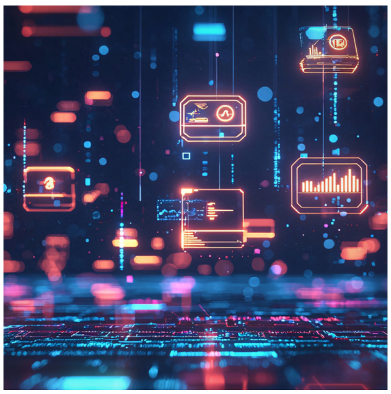
Ms. Cain purportedly operated a Ponzi scheme through her company, ANI Development. Ms. Cain allegedly falsely represented to investors that they could make short-term loans at high interest rates to liquor license applicants, who are required by state law to place the amount of the purchase price of the license in escrow pending the application's approval. Ms. Cain allegedly defrauded investors into believing their loans would sit protected in escrow, when in reality she deposited all investments into a holding account at Chicago Title Company for her personal use. Ms. Cain was allegedly aided by Kim Peterson, an early investor who in turn recruited additional investors and Nossaman LLP, the law firm retained by Mr. Peterson.

In 2019, the SEC uncovered Ms. Cain's Ponzi scheme, successfully brought a civil enforcement action against Ms. Cain and ANI for violations of securities laws, and placed ANI in receivership. The court ordered all of ANI's assets frozen so that they could be distributed to defrauded investors and temporarily stayed all litigation against ANI. Because the investors were not able to seek recovery from ANI, they initiated litigation against third parties, including Chicago Title and Mr. Peterson. The district court permitted the receiver to sue Chicago Title on ANI's behalf to recover the amounts ANI would be liable to the investors due to Chicago Title's complicity in the fraud. The receiver and Chicago Title ultimately reached a global settlement, one of the conditions of which was to permanently bar any further litigation against Chicago Title or Nossaman stemming from the scheme.

On interlocutory appeals, two investors — Mr. Peterson and Ovation Fund Management II — challenged the Chicago Title and Nossaman bar orders. First, the Ninth Circuit affirmed the bar order against Chicago Title. The appeals court reasoned that the district court properly exercised its equitable discretion barring Mr. Peterson's claims against Chicago Title because (i) Mr. Peterson's claims substantially overlapped with the receiver's claims against Chicago Title because both parties sought to recover for the same losses from the Ponzi scheme, (ii) the bar order was necessary to protect the ANI receivership's assets by ensuring the global settlement and thereby relieving the receiver from paying litigation costs or potentially having to indemnify Chicago Title for a judgment against it, and (iii) the bar order was fair and equitable.

Second, the Ninth Circuit affirmed the bar order against Nossaman for similar reasons that it affirmed the Chicago Title bar order: (i) Ovation's claims would have substantially overlapped with the receiver's claims against Nossaman; and (ii) barring Ovation's claims was necessary to protect the ANI receivership's assets because if Ovation succeeded in winning a judgment against Nossaman, Nossaman could have sought indemnification from the receiver and depleted the receiver's assets. Finally, the Ninth Circuit held that neither bar orders violate the Anti-Injunction Act.

Technology



Fourth Circuit Holds Putative Shareholder Class Failed To Plead Loss Causation Based on Short-Seller Report

Defeo v. IonQ, Inc. (4th Cir. Apr. 8, 2025)

What to know: A three-judge panel of the Fourth Circuit unanimously affirmed the dismissal of a shareholder securities class action against a quantum computer developer, holding that a short-seller report did not establish loss causation and that the company's press release was not a corrective disclosure. This decision marks the first time the Fourth Circuit has addressed whether a short-seller report can be used to plead loss causation in securities fraud litigation.

A three-judge panel of the Fourth Circuit unanimously affirmed the district court's dismissal with prejudice of a shareholder securities class action lawsuit against IonQ, Inc., holding that a short-seller report on which the lawsuit was primarily based did not support an allegation of loss causation and that the company's press release issued after the report's publication was not a corrective disclosure.

Defendant IonQ, Inc. develops quantum computers. On May 3, 2022, an activist short-selling firm published a report making various accusations against IonQ. On May 4, IonQ issued a press release disputing the report. By May 12, IonQ's stock value had significantly decreased. The plaintiffs filed a class action lawsuit that raised various securities fraud claims and argued that they suffered financial losses after the report was issued. The plaintiffs further asserted that IonQ's May 4 press release, when viewed with the report, was a corrective disclosure that revealed IonQ's alleged fraud.

The district court dismissed the shareholders' first amended complaint with prejudice for failure to state a claim. The shareholders simultaneously moved for reconsideration and leave to file a second amended complaint. Their proposed second amended complaint attempted to bolster their allegations that the report caused the drop in the stock price by citing four news articles published after the report. The district court denied both motions after finding that the proposed second amended complaint failed to plead loss causation. The shareholders appealed the dismissal and denial of post-judgment relief to the Fourth Circuit.

The Fourth Circuit affirmed the ruling of the district court, marking the first time it had considered whether a short-seller report could be used to plead loss causation. The court held that the report could not support an allegation of loss causation because it "relie[d] on anonymous sources for its nonpublic information and disclaim[ed] its accuracy." The court added that the news articles cited in the proposed second amended complaint did not credit the report as revealing any alleged fraud. Finally, the court held that IonQ's press release was not a corrective disclosure because it did not support the allegations made in the report but derided the report for its inaccuracies and mischaracterization of IonQ's business.

District of Colorado Dismisses Class Action Against Cable Network Over Alleged Misleading Statements on Network Development, Customer Relations

Lingam v. Dish Network Corp. (D. Colo. Mar. 20, 2025)

What to know: A Colorado federal court dismissed a securities class action against a cable network and its officers, finding that the plaintiffs failed to adequately allege that the defendants made false or misleading statements.

Judge Gordon P. Gallagher of the U.S. District Court for the District of Colorado dismissed a class action complaint that brought claims under Sections 10(b) and 20(a) of the Exchange Act against a cable network corporation and certain of its officers based on the primary violations alleged in Count I of the complaint. The plaintiffs alleged that the defendants made materially false and misleading statements and omissions regarding (i) the capabilities and progress of the defendants' network development and deployment, (ii) the defendants' purported relationships with enterprise customers, (iii) the rate at which the company expected to achieve enterprise revenues and (iv) the purported demand in the enterprise segment.

The plaintiffs alleged 19 materially misleading statements. The court categorized these statements into two groups: (i) those concerning network integration and launch, and (ii) those concerning the defendants' construction of network infrastructure for enterprise customers. The court focused its analysis on one statement from each category.

The court concluded that the statements concerning network integration and launch were overly optimistic forward-looking statements. The plaintiffs failed to provide evidence supporting a strong inference that the defendants possessed the requisite scienter. In essence, the plaintiffs could not demonstrate that the defendants knew the network integration and launch would be unsuccessful.

The court also concluded that the statements concerning the defendants' construction of network infrastructure for enterprise customers did not support a conclusion that the statements were false when made or that the defendants acted with scienter.

The court further concluded that the plaintiffs could not meet the stringent pleading requirements of the PSLRA. The plaintiffs acknowledged that the cable network's plan was overly ambitious regarding its deadlines and relied on unproven technologies. Without more, the optimistic statements about the plan's successes were insufficient to state a claim for securities fraud or to support derivative claims.

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