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Securities Law Alert

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Simpson Thacher offers "expert securities lawyers" who are "highly capable of handling a large breadth of matters at the same time."

–*Chambers USA* 2018

Supreme Court: Unanimously Upholds State Court Jurisdiction Over Class Actions Alleging Only Claims Under the Securities Act of 1933

On March 20, 2018, the Supreme Court unanimously held that state courts have jurisdiction over class actions alleging only violations of the Securities Act of 1933 ("the '33 Act").[1] *Cyan v. Beaver Cty. Emp. Ret. Fund*, 2018 WL 1384564 (2018) (Kagan, J.). The Court rejected the issuer's argument that the Securities Litigation Uniform Standards Act ("SLUSA") passed in 1998 eliminated the jurisdiction of state courts to hear such class actions. In resolving a split among state and federal courts, the Court likewise rejected a middle-of-the-road position advanced by the Solicitor General that such actions should be removable from state to federal court.

Background

The '33 Act allows persons who acquire a registered security to bring suit against an

1. Simpson Thacher filed a brief in this case on behalf of amici curiae in support of Petitioners.

issuer, underwriter, and numerous others for materially false or misleading statements or omissions made in a registration statement or offering document. As originally passed, the ’33 Act provided for concurrent jurisdiction, meaning that a plaintiff could bring such a claim in either state or federal court.

In 1995, Congress passed the Private Securities Litigation Reform Act (“PSLRA”) to combat the “nuisance filings, targeting of deep-pocket defendants, vexatious discovery requests, and ‘manipulation by class action lawyers of the clients whom they purportedly represent’” that had become a known feature of private securities litigation. *Merrill Lynch, Pierce, Fenner, & Smith v. Dabit*, 547 U.S. 71 (2006). The PSLRA instituted significant changes to class actions brought under federal securities statutes, including the ’33 Act. Because these class action reforms generally applied only to cases brought in federal court, however, the PSLRA had an unintended consequence: plaintiffs bringing securities fraud class actions could avoid the PSLRA’s new restrictions by bringing their claims in state court, asserting claims under state law or under the ’33 Act.

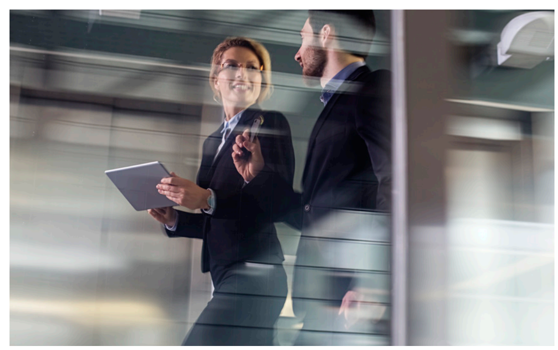
Concerned that the intent of the PSLRA was not being fully effectuated, Congress passed SLUSA in 1998. SLUSA’s “core provision” is § 77p, in which SLUSA divested state courts of the ability to hear class actions bringing state law claims involving “covered securities.” *Merrill Lynch*, 547 U.S. 71. Generally, a security is a “covered security” if it was listed on a national stock exchange at the time the alleged misrepresentation, omission, or deceptive conduct occurred.

§ 77p Does Not Limit State Court Jurisdiction Over Class Actions Alleging Only ’33 Act Claims

The question before the Court was “whether § 77p limits state court jurisdiction over class actions brought under” the ’33 Act.

The Court held that the provision of SLUSA in dispute does not deprive state courts of their concurrent jurisdiction over class actions alleging violations of the ’33 Act. That provision provides that federal district courts “shall have jurisdiction[,] concurrent with State and Territorial courts, *except as provided in section 77p of this title with respect to covered class actions*, of all suits in equity and actions at law brought to enforce any liability or duty created by” the ’33 Act. 15 U.S.C. § 77v(a) (2012) (emphasis added). The Court termed the italicized language of this provision the “except clause,” and the central dispute in the case was whether the clause’s reference to “covered class actions” pointed to the definition of that term in § 77p(f)(2). If it did, Petitioners argued, state courts would not have jurisdiction over such class actions brought under the ’33 Act.

The Court rejected Petitioners’ argument for two reasons. First, if Congress had wanted to refer to § 77p(f)(2)—instead of more broadly to § 77p, as it did in the except clause—it would have done so, “just by adding a letter, a number, and a few parentheticals.” Indeed, elsewhere in SLUSA Congress did use a pinpoint reference to a subsection of § 77p, the Court noted. Second, § 77p(f)(2) provides a *definition* (of “covered class action”) not an *exception* to concurrent jurisdiction, and Congress is well aware of the difference between those two functions.



The Court reasoned that, by its terms, § 77p only prevents certain class actions based on state law from being heard in state courts (the statute requires that they be removed to federal court and dismissed), and that nothing in the text prevents a state court from hearing class actions based exclusively on federal law.

Turning from the statutory language, the Court concluded that even if arguments about SLUSA’s legislative purpose and history could overcome a plain reading of the statutory text, Cyan failed to account for other ways in which SLUSA furthers Congress’s objectives. SLUSA’s preamble sets out the statute’s goal of “limit[ing] the conduct of securities class actions under State law.” In barring class actions brought under state law, SLUSA guarantees that the substantive protections of the federal Reform Act will apply to class actions, regardless of whether they proceed in state or federal court. This objective does not depend on stripping state courts of jurisdiction over '33 Act class actions.

Moreover, the Court wrote, SLUSA's revisions to the Securities Exchange Act of 1934 ("the '34 Act") served Congress's goal of moving the majority of securities class actions to federal court. As with the '33 Act, SLUSA also amended the '34 Act to bar class actions based on state law, forcing plaintiffs to bring claims under the '34 Act. Because federal courts are vested with exclusive jurisdiction over '34 Act claims, those plaintiffs end up in federal, not state, court. And far more suits are brought under the '34 Act, which regulates all trading of securities, than the '33 Act, which regulates only securities offerings.

Finally, the Court rejected the Solicitor General's "halfway-house position," holding that SLUSA does not permit the removal of class actions alleging only '33 Act claims from state to federal court. Under that interpretation, another provision of § 77p in subsection (c) would permit the removal of '33 Act class actions to federal court if they allege false statements or deceptive devices in connection with the purchase of a covered security, as listed in § 77p(b). But § 77p(b) refers to *state-law* class actions, which are removable to federal court (after which they are to be dismissed), not *federal-law* class actions asserting '33 Act claims. The Court explained that the government's construction distorted SLUSA's text, and statutory language cannot be ignored "based on an intuition that Congress must have intended something broader."

Supreme Court: Dodd-Frank's Anti-Retaliation Provisions Apply Only to Employees Who Report Allegedly Wrongful Activity to the SEC

On February 21, 2018, the Supreme Court unanimously held that the anti-retaliation protections created by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") do not apply to an employee who internally reports allegedly wrongful activity but fails to report the activity to the SEC. *Digital Realty Trust v. Somers*, 138 S. Ct. 767 (2018) (Ginsburg, J.) (*Digital Realty Trust II*). The Court's decision resolves a split between the Second, Fifth and Ninth Circuits.

Section 78u-6 of the Dodd-Frank Act defines a "whistleblower" as "any individual who provides . . . information relating to a violation of the securities laws *to the Commission*, in a manner established, by rule or regulation, by the Commission." 15 U.S.C. § 78u-6(a)(6) (emphasis added). The same section creates anti-retaliation provisions for "whistleblowers," prohibiting employers from firing employees who "mak[e] disclosures that are required or protected under the Sarbanes-Oxley Act of 2002," among other things. 15 U.S.C. § 78u-6(h)(1)(A)(iii). In 2011, the SEC promulgated a rule that, for the purposes of the anti-retaliation protections, interpreted "whistleblower" to include employees who make only internal disclosures of potentially wrongful activity. 17 C.F.R. § 240.21F-2(a)(1).

In *Somers v. Digital Realty Trust*, 850 F.3d 1045 (9th Cir. 2017) (*Digital Realty Trust I*),[2] the Ninth Circuit adopted the Second Circuit's 2015 conclusion in *Berman v. Neo@Ogilvy*, 801 F.3d 145 (2d Cir. 2015)[3] that the "tension" between the definition of whistleblower and the anti-retaliation provisions is "as a whole sufficiently ambiguous to oblige us to give *Chevron* deference to the reasonable interpretation of the agency charged with administering the statute [i.e. the SEC]." By contrast, in *Asadi v. G.E. Energy (USA)*, 720 F.3d 620 (5th Cir. 2013), the Fifth

2. Please click here to read our discussion of the Ninth Circuit's decision in *Digital Realty Trust I*.

3. Please click here to read our discussion of the Second Circuit's decision in *Berman*.

Circuit held that the Dodd-Frank Act's definition of whistleblower "expressly and unambiguously requires that an individual provide information to the SEC to qualify as a 'whistleblower' for purposes of [the anti-retaliation protections]."[4] In rejecting the Fifth Circuit's approach, the Ninth Circuit noted that the SEC regulation is "consistent with Congress's overall purpose to protect those who report violations internally as well as those who report to the government." *Digital Realty Trust I*, 850 F.3d 1045.

In an opinion authored by Justice Ginsburg, the Supreme Court unanimously reversed the Ninth Circuit's judgment. The Court began by noting that the "definition section of the statute supplies an unequivocal answer" to the issue of the meaning and reach of the term "whistleblower" in the Dodd-Frank Act's anti-retaliation provisions. The Court emphasized that the definition requires reporting "*to the Commission*," and that the statutory text instructs "that the 'definition shall apply' 'in this section,' that is, throughout § 78u-6." *Digital Realty Trust II*, 138 S. Ct. 767 (quoting 15 U.S.C. § 78u-6(a)(6)).

The Court further noted that "'when Congress includes particular language in one section of a statute but omits it in another, . . . this Court presumes that Congress intended a difference in meaning.'" *Id.* (quoting *Loughrin v. United States*, 134 S. Ct. 2384 (2014)). Title 10 of the Dodd-Frank Act, which created the Consumer Financial Protection Bureau, features "another whistleblower-protection provision [that] imposes no requirement that information be conveyed to a government agency." *Id.* Specifically, it prohibits discrimination against a "covered employee" who provides "information to [an] employer, the Bureau, or any other State, local, or Federal, government authority." 12 U.S.C. § 5567(a)(1). Because Congress placed a government-reporting requirement in § 78u-6 but not elsewhere in the Dodd-Frank Act, the Court concluded that Congress intended that the definition of "whistleblower" cover only individuals who report potentially wrongful activity to the SEC.

The Court explained that the "purpose and design" of the Dodd-Frank Act "corroborate[s] [its] comprehension of § 78u-6(h)'s reporting requirement." The Court cited a Senate Report stating that the core objective of the Act's whistleblower protection scheme is "to motivate people who know of securities law violations to *tell the SEC*." *Id.* (quoting S. Rep. No. 111-176, p. 38) (emphasis added by the Court). The Court found that by creating § 78u-6, Congress "undertook to improve SEC enforcement." In a concurring opinion joined by Justices Alito and Gorsuch, Justice Thomas took issue with the Court's reliance on the Senate Report as evidence of Congressional intent. Justice Sotomayor, joined by Justice Breyer, rebutted Justice Thomas's opinion in her own concurrence defending the Court's use of this kind of legislative history as a method for ascertaining the Act's purpose.

The Court rejected the respondent's contention, supported by the United States, that Congress intended the term "whistleblower" to retain its "ordinary sense" rather than the statutory definition. While conceding that "the plain-text reading of the statute undoubtedly shields fewer individuals from retaliation than the alternative proffered by [the respondent] and the Solicitor General," the Court was not persuaded that applying the § 78u-6 definition would "create obvious incongruities," "produce anomalous results," and "vitiate much of the statute's protection[s]" such that a departure from the statutory definition would be warranted. *Id.* Finally, finding that Congress's primary aim in creating this section of the Dodd-Frank Act was to incentivize "prompt reporting to the SEC," the Court rejected as unpersuasive arguments that its holding would diminish the deterrent effects of the Act.

Fourth Circuit: Once a Company Decides to Speak on a Topic, the Company Has a Duty to Disclose All Material Information Concerning That Topic

On February 22, 2018, the Fourth Circuit revived a dismissed securities fraud action alleging that a medical device company failed to disclose its fraudulent insurance coding scheme. *Singer v. Reali*, 883 F.3d 425 (4th Cir. 2018) (King, J.). Because the company chose "to speak about its reimbursement

4. Please click here to read our discussion of the Fifth Circuit's decision in *Asadi*.

practices," the court found plaintiffs adequately alleged that the company had "a duty to disclose its alleged illegal conduct" in connection with those practices. The court further held that plaintiffs sufficiently pled scienter by alleging that the individual defendants were personally involved in executing the alleged scheme. Finally, the court found plaintiffs adequately alleged loss causation based on partial disclosures concerning a government subpoena into the company's reimbursement practices.

Duty to Disclose the "Whole Material Truth" Attaches Once a Company Chooses to Speak on an Issue

The Fourth Circuit emphasized that Section 10(b) and Rule 10b-5 "'do not create an affirmative duty to disclose any and all material information.'" *Id.* (quoting *Matrixx Initiatives v. Siracusano*, 563 U.S. 27 (2011)). Rather, "'companies can control what they have to disclose . . . by controlling what they say to the market.'" *Id.* (quoting *Matrixx*, 563 U.S. 27). Here, the Fourth Circuit found that once the company decided to inform the market that it was training surgeons on how to obtain reimbursements for its medical devices, the company allegedly "possessed—and breached—a duty to disclose the fraudulent reimbursement scheme."

The Fourth Circuit rejected defendants' argument that there were no allegations that any court or government agency had deemed the reimbursement scheme illegal. The court explained that "the duty to disclose may extend to uncharged and unadjudicated illegal conduct."

The Fourth Circuit also found meritless defendants' contention that the company had never "specifically asserted it was complying with a particular law." The court noted that plaintiffs did not rely on "mere generic assertions of legal compliance." Rather, plaintiffs based their claim on "the [c]ompany's choice to speak about its reimbursement practices . . . without telling the whole, material truth."

Finally, the Fourth Circuit held that "general warnings about the risks of regulatory scrutiny and litigation" were insufficient to satisfy the company's duty to disclose. The court emphasized that "'[a] generic warning of a risk will not suffice when undisclosed facts on the ground would substantially affect a reasonable investor's calculations of probability.'" *Id.* (quoting *Meyer v. Jinkosolar Holdings Co.*, 761 F.3d 245 (2d Cir. 2014)).

Allegations That the Individual Defendants Executed the Fraudulent Scheme Were Sufficient to Plead Scienter

The Fourth Circuit determined that plaintiffs adequately alleged scienter because the complaint was "premised on the proposition that the [individual defendants] directed the fraudulent reimbursement scheme, not that lower-level agents or employees independently conjured up and carried out the scheme without the [individual defendants'] knowledge."

The court found plaintiffs' allegation that "the fraudulent reimbursement scheme was known to the" individual defendants supported "a strong inference that [defendants] intended to deceive the market, or at the very least acted recklessly," by failing to disclose the scheme.

Partial Disclosures Concerning a Government Subpoena, Taken Together, Sufficed to Plead Loss Causation

Plaintiffs relied on the company's disclosure in its Form 8-K that the company had received a subpoena from the Department of Health and Human Services, as well as an analyst report addressing the subpoena, to allege loss causation. The Fourth Circuit found the "Form 8-K and the analyst report revealed enough facts for the market to finally recognize . . . the existence of the [c]ompany's fraudulent reimbursement scheme."

The court emphasized that "neither a single complete disclosure nor a fact-for-fact disclosure of the relevant truth to the market is a necessary prerequisite to establishing loss causation." The court further stated that these "partial disclosures need not precisely identify the misrepresentation or omission" but "must at least relate back to the misrepresentation or omission and not to some other negative information about the company."

In a Dissenting Opinion, Judge Agee Expressed His View That Plaintiffs Failed to Plead Material Misrepresentations, Scienter or Loss Causation

Judge George S. Agee dissented from the majority's opinion on several grounds. Among other reasons, he opined that "the majority's analysis errs in its central assumption that the [c]ompany, if speaking about its reimbursement practices at all, not only had to characterize those practices fairly, but also had to further describe them as fraudulent or illegal." Judge Agee stated that "the majority's holding creates an inflexible rule that requires a publicly traded corporation engaged in ambiguous activity to represent its behavior as illegal or else risk being the subject of a securities fraud lawsuit." In his view, "neither [S]ection 10(b) nor the [Private Securities Litigation Reform Act] requires that result."

Judge Agee further opined that the majority "incorrectly assume[d] that, because the [c]ompany's reimbursement framework was allegedly illegal, the [c]ompany axiomatically intended to defraud its investors." He stated that "[e]ven if it were fair to infer that the [c]ompany's officers were aware that the [c]ompany's reimbursement scheme was illegal, it is unfair to carry that inference one step further and conclude that *because* the [c]ompany acted illegally it therefore *also* intended to deceive its investors." Judge Agee expressed his view that "[j]ust because a plaintiff alleges an illegal act does not mean he has also pled fraud."

Finally, Judge Agee stated that plaintiffs failed to plead any "revelation of the truth" as required to allege loss causation. He noted that "the Form 8-K suggested, and the analyst's report speculated, only that the [c]ompany was involved in a government investigation." Judge Agee observed that "[t]he possibility that some unspecified negative information may eventually come to light as a result of the investigation is not the same thing as the possibility that information about fraud will also be reflected" because "fraud is but one of a panoply of reasons that a given company could be under investigation."

Ninth Circuit: (1) Generalized Allegations of an IPO-Related Motive to Boost Profitability Are Insufficient to Plead Scienter, and (2) Core Operations Theory Is Inapplicable to an Accounting Error Affecting a Small Division of the Company

On March 8, 2018, the Ninth Circuit affirmed dismissal of a securities fraud action against a solar energy company arising out of an accounting error. *Webb v. SolarCity Corp.*, 2018 WL 1189422 (9th Cir. 2018) (Smith, Jr., J.). The Ninth Circuit held that generalized allegations of a motive to boost a company's financial performance in the months before and after an IPO are insufficient to meet the high bar for pleading scienter. The court further held that plaintiffs could not rely on the core operations theory to allege scienter because the accounting error at issue involved only a small division of the company.

The Ninth Circuit began its analysis by emphasizing that the scienter pleading standard set by the Supreme Court in *Tellabs v. Makor Issues & Rights*, 551 U.S. 308 (2007) "is not easy to satisfy." The court explained that plaintiffs must "plead an inference of scienter that is 'cogent and at least as compelling as any opposing inference one could draw from the facts alleged.'" *Id.* (quoting *Tellabs*, 551 U.S. 308).

The Ninth Circuit found plaintiffs' IPO-related motive allegations "unhelpful" towards pleading scienter. The court noted that plaintiffs' allegations were neither "specific" nor "particularized," but instead spoke to the type of "routine corporate objectives" that it has rejected in the past. The court explained that "[s]urely every company that goes public wants to maximize its apparent profitability prior to its IPO and to maintain a high share price afterward in order to finance acquisitions and expand."

The Ninth Circuit also rejected plaintiffs' effort to rely on the core operations doctrine to plead defendants' knowledge of the accounting error. While plaintiffs alleged that defendants "had a hands-on style and general accounting acumen," there were no allegations that defendants "were involved in accounting decisions as minute as the calculation" at issue. The court further found plaintiffs alleged no facts supporting an inference that it would have been "absurd" for defendants to have missed the impact of the accounting error. The court noted that the division affected by the accounting error accounted for "a relatively minor portion of the company's overall business." Moreover, the court observed that the error "was so subtle that it appears that even the company's specialized accounting division and professional auditors missed it." Finally, the court found it significant that the accounting error "only misstated the degree of the company's *un*profitability." The court determined that these factors, taken together, precluded it "from holding that the falsity of the erroneous financials was necessarily 'immediately obvious'" to defendants.

Based on a holistic consideration of plaintiffs' scienter allegations, the Ninth Circuit concluded that plaintiffs' "narrative of fraud is simply not as plausible as a nonfraudulent alternative."[5] The court found that at most, plaintiffs "paint[ed] a picture of a mismanaged organization in need of closer financial oversight that made a minute error at a critical stage in its development."

M.D. Tenn.: (1) Plaintiffs Cannot Rely on a Prior Dissimilar Event to Allege That Defendants Should Have Foreseen the Financial Impact of a Later Event, and (2) Allegations of Access to Data, Standing Alone, Are Insufficient to Plead Scienter

On March 8, 2018, the Middle District of Tennessee dismissed in its entirety a securities fraud action alleging that a low-cost retailer misrepresented the business impact of the expiration of government benefits received by certain of its customers. *Iron Worker Local Union No. 405 v. Dollar General Corp.*, Nos. 3:17 CV 63, 3:17 CV 275, and 3:17 CV 276 (M.D. Tenn. 2018) (Zouhary, J.).[6] The court rejected plaintiffs' contention that defendants should have known that the benefits expiration "would have the same, foreseeable impact" as a "very different" benefits reduction several years prior. The court further held that plaintiffs could not plead scienter based on defendants' access to data that allegedly would have shown the financial impact of the benefits expiration, absent allegations that the data had been analyzed and reported to senior management.

Plaintiffs Failed to Allege That Defendants Should Have Predicted and Disclosed the Negative Impact of the Benefits Expiration

Plaintiffs claimed that a number of statements made by the company's CEO in March and May 2016 were misleading in light of an

5. The Ninth Circuit rejected plaintiffs' contention that the district court had erred by considering each scienter allegation individually before conducting a holistic analysis. While the Ninth Circuit noted that it has recognized the "potential pitfalls" of such an approach, the court stated that "such an analytical process is permitted under [its] precedents."

6. Simpson Thacher represents the defendants in this action.

expiration of benefits for certain recipients of the federal government's Supplemental Nutritional Assistance Program (SNAP) earlier that year (the "2016 Expiration"). Plaintiffs contended that the CEO should have addressed the actual and expected financial impact of the 2016 Expiration because an across-the-board reduction in SNAP benefits in 2013 (the "2013 Reduction") had an adverse effect on the company's sales.

The court held that even though the 2016 Expiration may have ultimately resulted in reduced sales, plaintiffs did not adequately allege that the company "could or should have predicted that result" based on the 2013 Reduction. The court pointed out that plaintiffs themselves "acknowledge[d] that the 2013 Reduction was very different from the 2016 Expiration." The court found plaintiffs alleged "no facts supporting an inference that [the company] should have forecasted the same result in 2016 as in 2013."

Plaintiffs Could Not Plead Scienter Based Solely on Defendants' Access to Real-Time Financial Data

During an analyst call on May 26, 2016, the CEO indicated that the company's "core consumer" was "probably about the same" as she was "coming out of Q4." Plaintiffs contended that this statement was materially misleading because the 2016 Expiration had already begun to impact sales by that point. Plaintiffs alleged that the CEO knew or should have known of the sales decline because the company employed "Moneyball"-style data analytics, which allegedly provided the CEO with "access to critical sales information at all times."

Plaintiffs attempted to bolster this claim by pointing to the CEO's August 2016 statement that "you could see it immediately in the numbers." The CEO made this statement on the same day that the company issued a press release reporting lower-than-expected second quarter sales that the company attributed in part to "a reduction in both SNAP participation rates and benefit levels."

The court found plaintiffs' allegations insufficient to plead scienter. Although plaintiffs claimed that the CEO had access to real-time financial data, plaintiffs did "not allege that anyone in the [c]ompany actually analyzed or reported the impact of the 2016 Expiration to senior management before [the May 2016] call." The court also held that plaintiffs could not rely on the CEO's August 2016 statement to support an inference of scienter. The court explained that "a statement made with the benefit of hindsight does not plausibly suggest either [the CEO or the company] was actually aware of the negative trend at the time of the May 26 conference call."

CEO's Statements Were Not Misleading When Considered in Context

Plaintiffs challenged as misleading a number of the CEO's statements concerning the company's "core customer." The court found plaintiffs' claims rested on the "unwarranted factual inference[ ]" that the company's "core customers" were those who lost benefits in the 2016 Expiration. The court explained that "those individuals made up only a small portion (about 2%) of all SNAP participants, [and] a correspondingly smaller percentage of [the company's] 'core customers.'"

The court found that the other alleged misstatements were either inactionable corporate optimism, or "inherently forward looking." The court emphasized that when considering whether a statement is misleading, "[c]ontext matters." The court explained that "[i]t is [p]laintiffs' responsibility to connect the dots," which the court found plaintiffs here failed to do.

S.D.N.Y.: (1) Plaintiffs Cannot State a Securities Fraud Claim If Cautionary Language Addressed the Risks That Were Allegedly Realized, and (2) Representation of Alignment with International Standards Is Inactionable

On March 8, 2018, the Southern District of New York dismissed without leave to amend a securities fraud action alleging that a group of Brazilian entities failed to disclose that the value of certain notes could fall if the market discovered that defendants were allegedly involved in an illegal bid-rigging scheme. *Banco Safra S.A.—Cayman Islands Branch v. Andrade Gutierrez Int'l*, 2018 WL 1276847 (S.D.N.Y. 2018) (Furman, J.).[7] The court found "no reasonable investor could have been misled about the nature of the risk" because the Offering Memorandum included cautionary language that "addressed the relevant risks directly." The court further held that a representation concerning the alignment of business practices with international standards was too aspirational and generalized to support a securities fraud claim.

Defendants Disclosed the Specific Risks That Allegedly Materialized

The court explained that "[w]here, as here, the alleged deceptive act is a failure to disclose uncharged criminal conduct, the critical consideration is whether the alleged omissions are sufficiently connected to defendants' existing disclosures to make those public statements misleading." Courts in the Second Circuit "have found a sufficient connection in three circumstances: (1) when a corporation puts the reasons for its success at issue, but fails to disclose that a material source of its success is the use of improper or illegal business practices; (2) when a defendant makes a statement that can be understood, by a reasonable investor, to deny that the illegal conduct is occurring; and (3) when a defendant states an opinion that, absent disclosure, misleads investors about material facts underlying that belief."

7. Simpson Thacher represents Andrade Gutierrez International and Andrade Gutierrez Engenharia in this matter.

Here, plaintiffs alleged that defendants failed to disclose "that an investigation into [d]efendants' business might reveal that they rigged bids for public projects in Brazil, causing the market value of the [notes at issue] to fall precipitously." The court held that plaintiffs' "claims fail as a matter of law" because "[d]efendants adequately disclosed the ongoing investigations into their bid-rigging scheme." The court noted that the Offering Memorandum stated as follows:

> [W]e are currently subject to claims alleging irregularities in certain bidding processes and public contracts for which we were awarded construction works. . . . In case decisions are issued against us, we could suffer a material adverse effect.

The court found "[t]his cautionary language addressed the very risks that [p]laintiffs claim were later realized."

The court also rejected plaintiffs' contention that "[d]efendants' disclosure was deceptively broad." The court explained that "where there is disclosure that is broad enough to cover a specific risk, . . . the disclosure is not misleading simply because it fails to discuss the specific risk." The court found similarly meritless plaintiffs' claim that "[d]efendants were required in the Offering Memorandum to estimate potential fines and penalties to which [the entity offering the notes] could be subjected." The court observed that plaintiffs "cite[d] no authority for the proposition that such a specific (and usually unknowable) disclosure is required."

Statements Concerning Alignment with International Standards Were Too Aspirational to Support a Securities Fraud Claim

Plaintiffs also challenged as misleading a statement in the Offering Memorandum that one of the defendants "aligns its corporate practices to standards issued by international entities, such as the International Finance Corporation" and other lenders that provide funding for the company's projects. The court noted that plaintiffs did not cite to the specific standards themselves, nor did plaintiffs allege that many of the lenders had even "established relevant standards." The court concluded that a representation concerning alignment with such standards was "both too general and too aspirational to support a securities-fraud claim."

N.D. Cal.: *Affiliated Ute* Presumption Does Not Apply If the Only Omission Is the Truth That an Affirmative Misstatement Fails to Disclose

On March 2, 2018, the Northern District of California held that the presumption of reliance for omission-based Section 10(b) claims established in *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128 (1972) does not apply if the alleged "omission is of the truth that certain affirmative statements allegedly misrepresent." [*In re Volkswagen "Clean Diesel" Mktg., Sales Practices, and Prod. Liab. Litig.*, 2018 WL 1142884 (N.D. Cal. 2018) (Breyer, J.)]. In so holding, the court expressly followed the Second Circuit's recent decision in *Waggoner v. Barclays*, 875 F.3d 79 (2d Cir. 2017).[8]

The Northern District of California had previously determined that the *Affliated Ute* presumption applied because plaintiffs' "case can be characterized as one that primarily alleges omissions." *In re Volkswagen "Clean Diesel" Mktg., Sales Practices and Prod. Liab. Litig.*, 2017 WL 3058563 (N.D. Cal. 2017). Defendants moved for reconsideration based on the Second Circuit's intervening decision in *Waggoner*. The Second Circuit held that plaintiffs cannot rely on the *Affiliated Ute* presumption if their claims "are primarily based on misstatements." *Waggoner*, 875 F.3d 79. The Second Circuit underscored that "[t]he *Affiliated Ute* presumption does not apply to earlier misrepresentations made more misleading by subsequent omissions, or to what has been described as 'half-truths,' nor does it apply to misstatements whose only omission is the truth that the statement misrepresents."

The Northern District of California found the Second Circuit's reasoning "persuasive." The court noted that "[t]he Ninth Circuit has also recognized a need to 'maintain[ ] the well-established distinction, for purposes of the *Affiliated Ute* presumption, between omission claims, on the one hand, and misrepresentation and manipulation claims, on the other.'" *Id.* (quoting *Desai v. Deutsche Bank Sec.*, 573 F.3d 931 (9th Cir. 2009)). The Northern District of California "conclude[d] that whether the *Affiliated Ute* presumption of reliance is applicable is a decision that should be based on whether the presumption's purpose—of avoiding the need to prove a speculative negative—is implicated."

On reconsideration, the court held that plaintiffs could not rely on the *Affiliated Ute* presumption because their claims were "predicated on affirmative statements" concerning research and development ("R&D") and regulatory risk, which plaintiffs challenged as misleading because defendants did not disclose alleged emissions fraud. The court explained that plaintiffs either "relied on the R&D and regulatory-risk statements . . . or they did not." The court held that if plaintiffs "did not, they should not be able to overcome this shortfall by characterizing their claims as primarily alleging omissions."

Delaware Supreme Court: Board Was Required to Disclose the Chairman's Reasons for Abstaining From a Board Vote on the Sale of the Company

On February 20, 2018, the Delaware Supreme Court reversed dismissal of a shareholder action that alleged that the board of directors failed to disclose the reasons why the chairman of the board, who was also the company's founder, had abstained from a board vote on the sale of the company. [*Appel v. Berkman*, 2018 WL 947893 (Del. 2018) (Strine, C. J.)].[9] The court rejected defendants' contention that "the reasons for a dissenting or abstaining board member's vote can never be material." The court explained that "when, as here, a board expresses its reasons for voting in favor of a transaction, the contrary view of an individual board member may be material to a stockholder

8. Please click here to read our discussion of the Second Circuit's decision in *Waggoner*.

9. The company was sold pursuant to a two-step merger under Section 251(h) of the Delaware General Code. Because the Chancery Court found that the shareholders' acceptance of the first-step tender offer was fully-informed, the court determined that the business judgment rule governed the transaction. *Appel v. Berkman*, 2017 WL 6016571 (Del. Ch. Jul. 13, 2017) (citing *Corwin v. KKR Financial Holdings*, 125 A.3d 304 (Del. 2015) (fully informed shareholder vote cleanses a transaction); *In re Volcano Corp. S'holder Litig.*, 143 A.3d 727 (Del. Ch. 2016) (*Corwin* rule applies where fully-informed stockholders tender their shares in a two-step merger under 8 *Del. C.* § 251(h))).

wrestling with whether to accept the board's recommendation."

In the case before it, the chairman had expressed his view that it was not the right time to sell the company. Defendants argued that the chairman's belief "was just his opinion," rather than a "material fact that requires disclosure." The Delaware Supreme Court found this "distinction between opinion and fact" to be "of little relevance, because proxy statements seeking approval of major transactions are filled with statements of fact about opinions, in the sense that they recount why fiduciaries and their advisors took certain actions and why they believed the transaction was in the company's best interest." The court stated that stockholders are "entitled to give weight to their fiduciaries' opinions about important business matters."

The Delaware Supreme Court emphasized that its "decision in no way implies that the reason for a particular director's dissent or absention will always be material." Rather, the court reaffirmed the "contextual approach" for determining whether disclosure "would materially affect the mix of information, or whether the disclosure is required to make sure that other disclosures do not present a materially misleading picture."

Here, the court found that it is "no common thing" "[f]or a [c]hairman to abstain from voting on the sale of the business he founded." The court noted that the disclosures included so many reasons why the other directors voted in favor of the transaction that the chairman's reasons for abstaining from the vote would "catch a reasonable stockholder's attention." The court found "the founder and [c]hairman's views regarding the wisdom of selling the company were ones that reasonable stockholders would have found material in deciding whether to vote for the merger or seek appraisal, and the failure to disclose them rendered the facts that were disclosed misleadingly incomplete."

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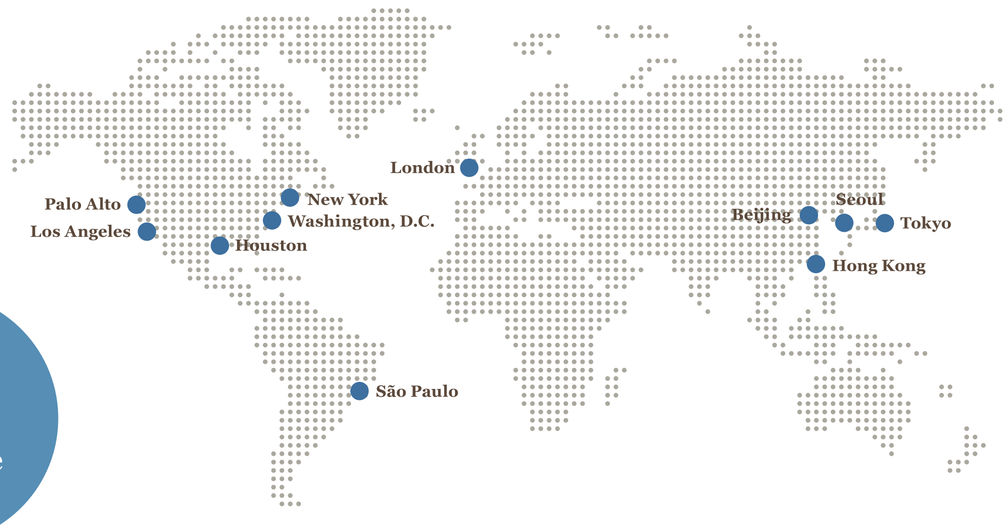

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