Simpson Thacher

Securities Law Alert

*We are pleased to announce that **Michael J. Osnato, Jr.**, former Chief of the Complex Financial Instruments Unit of the SEC's Enforcement Division, has joined Simpson Thacher as a Partner in the Firm's Government and Internal Investigations Practice.*

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Simpson Thacher's "exceptional" securities litigation team is "praised for its practical and commercial approach, which ensures that it is frequently retained by many major banks and private equity firms in high-stakes disputes."

– The Legal 500 2016

First Circuit: Country Club Member Expected to Receive a "Personal Benefit," as Defined in the Supreme Court's Decisions in *Dirks* and *Salman*, for Tipping a Fellow Club Member

On February 24, 2017, the First Circuit affirmed the insider trading conviction of a country club member (the "tippee") who received a tip about an upcoming bank acquisition from a fellow country club member. *United States v. Bray*, 2017 WL 727556 (1st Cir. 2017) (Stahl, J.). The court found evidence of a friendship between the tipper and the tippee, together with the tipper's testimony that he believed the tip would enhance his reputation with the tippee, provided a reasonable basis for the jury to conclude that the tipper expected to receive a "personal benefit" for his tip as required under the Supreme Court's decision *Dirks v. SEC*, 463 U.S. 646 (1983).

Jury Had Sufficient Evidence to Find the Tipper Expected a "Personal Benefit" for the Tip

The First Circuit explained that tippee liability "hinges on whether the tipper breached a duty of trust and confidence by disclosing the inside information, which in turn depends on whether the tipper 'personally will benefit, directly or indirectly, from [the] disclosure.'" *Id.* (quoting *Dirks*, 463 U.S. 646). The First Circuit noted that "a personal benefit can 'often' be inferred where 'a relationship between the [tipper] and the recipient … suggests a *quid pro quo* from the latter, or an intention to benefit the particular recipient.'"

Id. (quoting *Dirks*, 463 U.S. 646). "A personal benefit can likewise be inferred where a tipper makes a gift of 'inside information to a trading relative or friend.'" *Id.* (quoting *Salman v. United States,* 137 S. Ct. 420) (internal quotation marks and citation omitted).[1]

In the case before the First Circuit, the tippee contended that "an informational exchange between casual, as opposed to close, friends does not meet *Dirks*'s personal benefit requirement without some other evidence of a quid pro quo exchange." The First Circuit found that it did not have to "determine … how 'close' a tipper-tippee relationship must be before a jury can infer a gift-based personal benefit." Here, the tipper testified that he and the tippee were "'good friends' who, at the time of the … tip, had known each other for fifteen years." The court also found testimony concerning the tippee's "bond" with the tipper's son "demonstrated that [the tippee] knew [the tipper] well enough to extend favors to [the tipper's] extended family." The First Circuit held "the government [had] presented enough evidence for a reasonable jury to conclude that [the tippee] and [the tipper] had a close relationship, and not one that was 'of a casual or social nature.'" *Id.* (quoting *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014)).[2]

The First Circuit further held the tipper's "testimony … provided a sufficient basis for the jury to conclude that [the tipper] disclosed the tip in expectation of a personal benefit." The tipper testified that he "'figured [the tip] would enhance' his reputation with [the tippee]." Although the tipper represented that he "did not expect anything at the exact time" of the tip, the First Circuit found "a reasonable jury could infer that he expected a benefit 'down the road.'" The First Circuit observed that the tippee's "later offers to bring [the tipper] into [one of the tippee's real estate projects] for free … show[ed] that these expectations were warranted."

Jury Also Had Sufficient Evidence to Find the Tippee Knew the Tipper Expected a "Personal Benefit" for the Tip, and Breached a Duty of Confidentiality in Passing Along the Tip

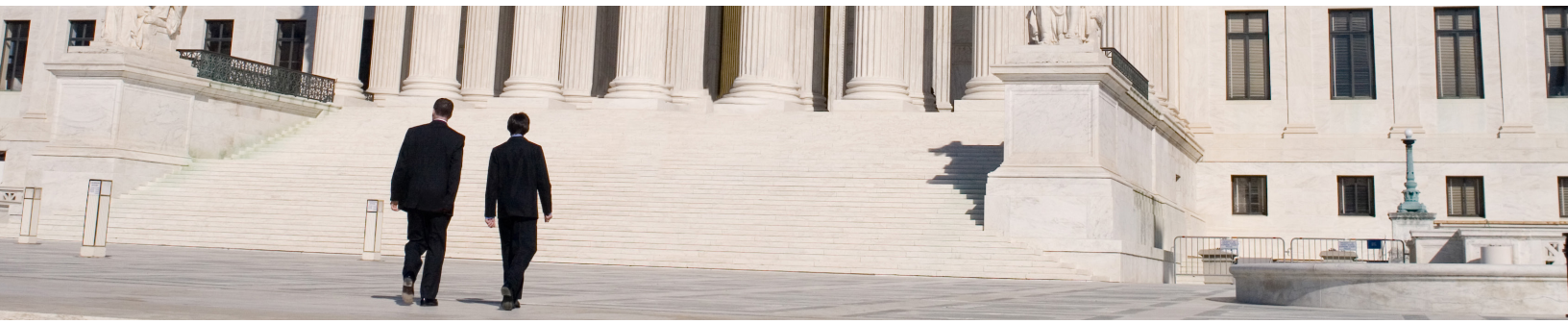
The First Circuit determined that there was "sufficient evidence in the record to support a finding that [the tippee] knew [the tipper had] tipped him in expectation of a personal benefit" even though the tippee "may not have known the exact benefit [the tipper] sought in exchange for the tip." The court found it significant that shortly after receiving the tip, the tippee offered the tipper an opportunity to invest in a real estate project—something he had never done prior to receiving the tip.

The First Circuit further held that "[a] reasonable jury could also infer that [the tippee] knew [the tipper] had breached a duty of confidentiality by giving him the … tip." The tipper provided the tip "in a surreptitious manner" (scribbled on a cocktail napkin), "after which [the tippee] neither made any comments nor asked any questions." The tippee then proceeded to acquire tens of thousands of shares of the company the tipper mentioned, and these shares ultimately accounted for more than half of the tippee's portfolio.

The First Circuit concluded that "all of the evidence regarding the tip and its aftermath show that there was a sufficient basis from which a jury could reasonably conclude beyond a reasonable doubt that [the tippee] knew [the tipper] had anticipated a benefit and breached a fiduciary duty to his employer."

1. Please click here to read our prior discussion of the Supreme Court's decision in *Salman*.

2. Please click here to read our prior discussion of the Second Circuit's decision in *Newman*.



Ninth Circuit: Dodd Frank Act's Anti-Retaliation Provision Protects Whistleblowers Who Report Potential Misconduct Internally as Well as Whistleblowers Who Report to the SEC

On March 8, 2017, the Ninth Circuit held that the Dodd-Frank Act's anti-retaliation provision "should be read to provide protections to [whistleblowers] who report internally as well as to those who report to the SEC." *Somers v. Digital Realty Trust*, 2017 WL 908245 (9th Cir. 2017) (Schroeder, J.). The Ninth Circuit found that to the extent there is any "uncertainty" on this issue, the SEC's implementing regulation defining the term "whistleblower" to include "those who make internal disclosures" "has resolved any ambiguity and … is entitled to deference." *Id.* (citing 17 C.F.R. § 240.21F-2).

In so holding, the Ninth Circuit deepened a circuit split on the question of whether the Dodd-Frank Act's anti-retaliation provision reaches whistleblowers who do not report to the SEC. The Second Circuit has ruled that the Dodd-Frank Act protects whistleblowers who report potential misconduct internally, while the Fifth Circuit has held that the anti-retaliation protections only apply to whistleblowers who report to the SEC. *Compare Berman v. Neo@Ogilvy*, 801 F.3d 145 (2d Cir. 2015)[3] *with Asadi v. G.E. Energy (USA)*, 720 F.3d 620 (5th Cir. 2013).[4]

Ninth Circuit Finds the Statutory Definition of the Term "Whistleblower" Does Not Limit the Reach of the Dodd-Frank Act's Anti-Retaliation Provision

The Dodd-Frank Act defines a "whistleblower" as "any individual who provides … information relating to a violation of the securities laws to the Commission." 15 U.S.C. § 78u-6(a)(6). The Ninth Circuit acknowledged that "[t]his definition … describes only those who report information to the SEC." *Somers*, 2017 WL 908245.

However, the Ninth Circuit explained that subdivision (iii) of the Dodd-Frank Act's anti-retaliation provision "gives whistleblower protection to all those who make any required or protected disclosure under [the] Sarbanes-Oxley [Act] and all other relevant laws." *Id.* (citing 15 U.S.C. § 78u-6(h)(1)(A)). The court noted that the "Sarbanes-Oxley [Act] expressly protects those who lawfully provide information to … 'a person with supervisory authority over the employee.'" *Id.* (citing 18 U.S.C. § 1514A(a)). The Ninth Circuit determined that "[b]y broadly incorporating, through subdivision (iii), Sarbanes-Oxley's disclosure requirements and protections, [the Dodd-Frank Act] necessarily bars retaliation against an employee of a public company who reports violations to the boss."

The Ninth Circuit found the Dodd-Frank Act's definition of the term "whistleblower" "should not be dispositive of the scope of" the anti-retaliation provision. The court reasoned that "[t]erms can have different operative consequences in different contexts." In this case, the court determined that "[r]eading the use of the word 'whistleblower' in the anti-retaliation provision to incorporate the earlier, narrow definition would make little practical sense and [would also] undercut congressional intent." The Ninth Circuit agreed with the Second Circuit's finding in *Berman* that such an interpretation would "narrow[ ]" subdivision (iii) of the Dodd-Frank Act's anti-retaliation provision "to the point of absurdity" because "the only class of employees protected [under subdivision (iii)] would be those who had reported possible securities violations both internally and to

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

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

the SEC" but who were "fire[d] … solely on the basis of the employee's internal report." The Ninth Circuit found this reading of the statute "illogical."

Ninth Circuit Disagrees with the Fifth Circuit's Decision in *Asadi*

The Ninth Circuit expressly disagreed with the Fifth Circuit's decision in *Asadi*. There, the Fifth Circuit found the statutory definition of "whistleblower" applied to the Dodd-Frank Act's anti-retaliation provision. The Fifth Circuit "reasoned that if [the Dodd-Frank Act] protected the same conduct that [the] Sarbanes-Oxley [Act] did, then the Sarbanes-Oxley enforcement scheme would be rendered moot or superfluous, on the theory that no one would use it" in light of the Dodd-Frank Act's more favorable provisions. *Somers*, 2017 WL 908245.

The Ninth Circuit found the two "statutes provide alternative enforcement mechanisms" that offer different advantages to different types of plaintiffs. The court noted that the "Sarbanes-Oxley [Act] may be more attractive to the whistleblowing employee" because of its option for adjudication through administrative review, as well as its compensation for special damages, such as emotional injury.

Ninth Circuit Defers to the SEC's Implementing Regulation Defining the Term "Whistleblower"

The Ninth Circuit agreed with the Second Circuit's determination that "even if the use of the word 'whistleblower' in the anti-retaliation provision [of the Dodd-Frank Act] creates uncertainty because of the earlier narrow definition of the term," the SEC "has resolved any ambiguity and its regulation is entitled to deference." The Ninth Circuit found the SEC's implementing regulation "accurately reflects congressional intent that [the Dodd-Frank Act] protect employees whether they blow the whistle internally, as in many instances, or they report directly to the SEC."

Central District of California: (1) Plaintiffs Cannot Plead Failure to Disclose a Material Risk Through Allegations of Fraud by Hindsight, and (2) "Absurd to Suggest" Exception to Core Operations Theory Requires More Than "Vague Quantifiers"

On March 15, 2017, the Central District of California dismissed a putative securities fraud class action against a solar energy company (the "Company"). *Knox v. Yingli Green Energy Holding Co.*, 2017 WL 1013293 (C.D. Cal. 2017) (Wright, II, J.).[5] The court held plaintiffs could not plead failure to disclose a material risk simply by contrasting the Company's optimistic statements concerning a Chinese government subsidy program with subsequent adverse developments impacting the profitability of that program. The court further held plaintiffs could not rely on the "absurd to suggest" exception to the "core operations doctrine" to plead scienter by offering only "vague quantifiers." The court explained that this exception usually requires allegations of "concrete numbers" concerning the alleged fraud.

5. Simpson Thacher represents Yingli Green Energy Holding Co. in this matter.

Background

The Company manufactured and sold solar panels to companies around the world and had a growing presence in the China market, where the government was encouraging the adoption of solar technology through a subsidy program called "Golden Sun." The case before the court concerned statements the Company had made concerning the Golden Sun program. Plaintiffs claimed the Company's statements were misleading because they failed to disclose that a significant percentage of Golden Sun subsidies were "procured through 'outright fraud,'" including by allegedly "overstating project costs in subsidy applications" and deliberately delaying construction of approved Golden Sun projects until the cost of materials dropped, thus putting the entire Golden Sun program at risk of cancellation.

In March 2013, reports emerged predicting that the Chinese government would end the Golden Sun subsidy program. These reports allegedly caused a 22% drop in the Company's share price. The following month, the Chinese government issued clawback notices to certain subsidy recipients that had not completed their solar projects within certain deadlines.

Plaintiffs Failed to Allege the Company Had an Obligation to Disclose the Risk of Clawbacks

The court deemed meritless plaintiffs' claim that the Company's "optimistic statements about the Golden Sun Program were misleading because [the Company] failed to disclose the risk that the Chinese government … could clawback subsidies for projects that were not finished on time."

The court recognized that Section 10(b) "require[s] that a company disclose the *risk* that a future event might occur if that risk is material." However, the court emphasized that "Section 10(b) does not require that companies predict the future." The court explained that "[a] plaintiff may not plead fraud by hindsight" by "simply contrast[ing] a defendant's past optimism with less favorable actual results in support of a claim of securities fraud." *Id.* (internal quotation marks and citation omitted).

Here, the court found that plaintiffs had "not presented particular facts in existence at the time of [the Company's] optimistic statements showing *any* likelihood that its customers would not meet their project deadlines." The court determined there was "nothing [in the complaint] to show that potential clawbacks presented a material risk to [the Company's] involvement in Golden Sun at [the] time" the statements at issue were made, and the Company therefore "need not have disclosed that risk."

Plaintiffs Failed to Allege Scienter as to the Possibility That the Chinese Government Could Discontinue the Golden Sun Program

The court found plaintiffs failed to allege scienter with respect to their claims that the Company did not "disclose the risk that the Chinese government … would [allegedly] likely discontinue the program due to [alleged] widespread fraud in procuring subsidies."

Plaintiffs attempted to "rely on the 'absurd to suggest' exception to the core operations theory—i.e., that Golden Sun was so important to [the Company], and [the Company] was so involved in the fraud, that it would be absurd to suggest that [the Company] did not know of it." The court explained that "[t]he core operations theory posits that facts critical to a business's core operations or an important transaction generally are so apparent that their knowledge may be attributed to the company and its key officers." *Id.* (internal quotation marks and citation omitted). While plaintiffs in the Ninth Circuit "cannot rely[ ] exclusively on the core operations inference to plead scienter under the" Private Securities Litigation Reform Act, the court noted that the "only exception is the rare instance where the nature of the relevant fact is of such prominence that it would be absurd to suggest that management was without knowledge of the matter." *Id.* (internal quotation marks and citation omitted).

In the case before it, the court found plaintiffs' generalized "allegations … insufficient to show that [the Company's] upper management knew of even [the Company's] *own* alleged fraud, let alone industry-wide fraud." For example, plaintiffs alleged that the Company engaged in a "widespread" practice of substituting cheaper solar panels for more

expensive ones. The court stated that it could not "draw any meaningful inferences about what [the Company's] executives knew" based on such "vague quantifiers." The court emphasized that "[t]he Ninth Circuit cases relying on the 'absurd to suggest' doctrine are usually based on concrete numbers, not majestic generalities" of the type plaintiffs alleged.

The court also found plaintiffs failed to plead scienter as to claims alleging the Company improperly delayed the recognition of accounts for which collectability was not reasonably assured. The court dismissed plaintiffs' complaint in its entirety, with leave to amend only certain of plaintiffs' claims.

Delaware Supreme Court: Business Judgment Rule Applies to Two-Step Section 251(h) Mergers If the Target Corporation's Fully-Informed, Uncoerced Stockholders Tender a Majority of the Company's Shares in a First-Step Tender Offer

Pursuant to Section 251(h) of the Delaware General Corporation Law, companies may complete two-step mergers without a target company stockholder vote if the acquiring corporation consummates a first-step tender offer.

On February 9, 2017, the Delaware Supreme Court adopted the Chancery Court's reasoning in affirming a June 2016 Chancery Court decision holding that the business judgment rule applies to two-step Section 251(h) mergers if the target corporation's fully-informed, uncoerced stockholders tender a majority of the company's shares in a first-step tender offer. *In re Volcano Corp. Stockholder Litig.*, 2017 WL 563187 (Del. 2017) (Strine, C.J.). The Chancery Court found that "the acceptance of a first-step tender offer by fully informed, disinterested, uncoerced stockholders representing a majority of a corporation's outstanding shares in a two-step merger under Section 251(h) has the same cleansing effect under" the Delaware Supreme Court's decision in *Corwin v. KKR Fin. Holdings*, 125 A.3d 304 (Del. 2015)[6] "as a vote in favor of a merger by a fully informed, disinterested, uncoerced stockholder majority." *In re Volcano Corp. Stockholder Litig.*, 143 A.3d 727 (Del. Ch. 2016) (Montgomery-Reeves, V.C.).[7]

Delaware Chancery Court: Plaintiff Seeking Corporate Books and Records in a Section 220 Suit Must Be a Stockholder at the Time the Complaint is Filed

On February 27, 2017, in a case of first impression, the Delaware Chancery Court held that a plaintiff seeking corporate books and records in an action brought pursuant to Section 220 of the Delaware General Corporation Law must be a stockholder at the time the complaint is filed. *Weingarten v. Monster Worldwide*, 2017 WL 752179 (Del.

6. Please click here to read our prior discussion of the Delaware Supreme Court's decision in *Corwin*.

7. Please click here to read our prior discussion of the Chancery Court's decision in *Volcano*.

Ch. 2017) (Glasscock, V.C.). The court found "the unambiguous language of Section 220(c) compels a finding that a former stockholder squeezed out in a merger thereafter lacks standing to bring an action under the [s]tatute."

The Delaware Chancery Court explained that pursuant to Section 220(b), a stockholder has the right, "upon written demand," to inspect the corporation's business records "for any proper purpose." *Id.* (quoting 8 *Del. C.* § 220(b)). If "a stockholder has complied with subsection (b) and demand is refused by the corporation," a stockholder may then bring suit "to the extent she has complied with subsection (c) of Section 220." The court stated that subsection (c) "requires a stockholder seeking records to 'first establish' … that she 'has' complied with the demand requirement of subsection (b), and … that she 'is' a stockholder." *Id.* (quoting 8 *Del. C.* § 220(c)). The Chancery Court found that "[b]y requiring that a plaintiff under Section 220 … demonstrate both that [the plaintiff] 'has'—past tense—complied with the demand requirement, and that [the plaintiff] 'is'—present tense—a stockholder, the legislature has made clear that only those who are stockholders at the time of filing have standing" to bring suit under Section 220.

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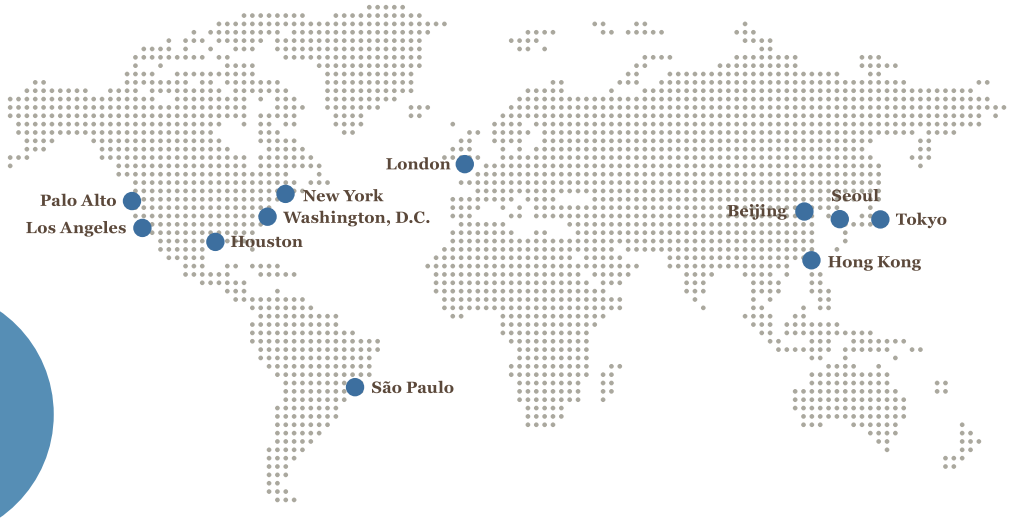

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