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Securities Law Alert

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Second Circuit: Creates a Circuit Split by Holding That Section 47(b) of the Investment Company Act Provides a Private Right of Action

On August 5, 2019, the Second Circuit held that Section 47(b) of the Investment Company Act ("ICA") "creates an implied private right of action for a party to a contract that violates the ICA to seek rescission of that violative contract." *Oxford University Bank v. Lansuppe Feeder*, 933 F.3d 99 (2d Cir. 2019) (Leval, C. J.). The Second Circuit expressly disagreed with the Third Circuit's decision in *Santomenno ex rel. John Hancock Trust v. John Hancock Life Ins. Co.*, 677 F.3d 178 (3d Cir. 2012), which held that there is no private right of action under Section 47(b) of the ICA.

Background

Section 47(b) of the ICA provides in relevant part as follows:

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Validity of Contracts

(1) A contract that is made, or whose performance involves, a violation of this subchapter . . . is unenforceable by either party . . .

(2) To the extent that a contract described in paragraph (1) has been performed, a court may not deny rescission at the instance of any party unless the court finds that under the circumstances the denial of rescission would produce a more equitable result than its grant and would not be inconsistent with the purposes of this subchapter.

15 U.S.C. § 80a-46(b).

In *Bellikoff v. Eaton Vance Corp.*, 481 F.3d 110 (2d Cir. 2007), the Second Circuit held that certain other provisions of the ICA do not create a private right of action. The district court in *Lansuppe Feeder v. Wells Fargo Bank*, 2016 WL 5477741 (S.D.N.Y. 2016), relied on the three "*Bellikoff* factors" to find that there is also no private right of action under Section 47(b). First, the court found "the ICA explicitly provides for enforcement of all ICA provisions by the SEC." Second, the court noted that "[t]he explicit creation of a private right of action in Section 35(b) of the ICA . . . suggests that Congress's omission of an explicit right of action from Section 47(b) was intentional." Third, the court found that "there is no implication [in Section 47(b)] of an intent to confer rights on . . . a protected particular class of persons."

Second Circuit Finds Section 47(b)(2) Reflects a Clear Congressional Intent to Provide a Private Right of Rescission

The Second Circuit determined that the district court "erred in its application of the third *Bellikoff* factor, and in so doing, overlooked clear evidence of Congressional intent to provide a right of action: the text of § 47(b) itself." *Oxford University Bank*, 933 F.3d 99. The Second Circuit explained that "[a]lthough Congress did not expressly state [in Section 47(b)(2)] that a party to an illegal contract may sue to rescind it, the clause that begins 'a court may not deny rescission at the instance of either party' necessarily presupposes that a party may seek rescission in court by filing suit." The court concluded that "[t]he language Congress used is thus effectively equivalent to providing an express cause of action."

The Second Circuit found that "§ 47(b)(2) also identifies a 'class of persons' who benefit from the availability of the right of action." The court reasoned that "[t]he most natural reading of the clause providing for rescission, which appears in a section entitled 'Validity of Contracts' and provides a remedy that benefits a party to an illegal contract, is that 'any party' refers to parties *to a contract whose provisions violate the ICA*." The court deemed "unpersuasive" the argument that the term "any party" refers to a governmental actor, such as the SEC. The court reasoned, *inter alia*, that "Section 47(b)(2) cannot be read in isolation from § 47(b)(1), which provides that contracts that violate the ICA are unenforceable by parties to the contract." The court explained that Section 47(b)(2) "provides the parallel remedy—rescission rather than non-enforcement—for violative contracts that have already been performed."

The Second Circuit found it significant that the Supreme Court reached the same conclusion with respect to a similar provision in the Investment Advisors Act ("IAA"), companion legislation to the ICA. In *Transamerica Mortgage Advisors v. Lewis*, 444 U.S. 11 (1979), the Court held that "in providing that contracts violating the IAA were void, Congress intended to include a right to seek rescission as well." *Oxford University Bank*, 933 F.3d 99 (discussing *Transamerica Mortgage Advisors*, 444 U.S. 11).

The Second Circuit recognized that "the Third Circuit and several lower courts have reached the opposite result" with respect to the availability of a private right of action under Section 47(b). The court explained that it "respectfully disagree[d]" with the Third Circuit's decision in *Santomenno*, 677

F.3d 178, because the Third Circuit "relied on interpretive canons that are intended to help resolve ambiguity" rather than "focusing on the text of the statute." The Second Circuit noted that "the Third Circuit failed to mention the strongest textual indication of Congressional intent to provide a private right of action: the clear language of § 47(b)(2) that 'a court may not deny rescission *at the instance of any party*.'" The Second Circuit similarly disagreed with district court decisions holding that Section 47(b)'s "'language is not sufficient to find an implied private right of action' because 'it contains a remedy but not a substantive right.'" *Id.* (quoting *Smith v. Oppenheimer Funds Distrib.*, 824 F. Supp. 2d 511 (S.D.N.Y. 2011)).[1] The court found "[t]hese district court decisions effectively read § 47(b)(2) out of the ICA."

Third Circuit: SLUSA Does Not Preclude Opt-Out Actions That Were Never Actually Combined With a "Covered Class Action"

On September 12, 2019, the Third Circuit held that the Securities Litigation Uniform Standards Act ("SLUSA") does not preclude plaintiffs from bringing individual suits under state law after opting out from a securities-related class action unless the opt-out suit and the class action were "somehow combined, in whole or in part, for case management or for resolution of at least one common issue." *North Sound Capital v. Merck & Co.*, 2019 WL 4309663 (3d Cir. 2019) (Krause, C. J.). The court found that SLUSA generally does not preclude opt-out suits that did not "coincide for some period" with a class action because "[i]f two cases never overlap, a court cannot combine them."

Background

SLUSA precludes a "covered class action" alleging state law-based securities claims. 15 U.S.C. § 78bb(f)(1). SLUSA's "mass action provision" defines a "covered class action" to include "any group of lawsuits filed in or pending in the same court and involving common questions of law or fact, in which . . . (I) damages are sought on behalf of more than 50 persons; and (II) the lawsuits are joined, consolidated, or otherwise proceed as a single action for any purpose." 15 U.S.C. § 78bb(f)(5)(B)(ii).

The district court held that SLUSA precluded opt-out suits that were filed after the dismissal of the relevant class actions, even though the cases were at no point combined and were never pending at the same time. *North Sound Capital LLC v. Merck & Co.*, 314 F. Supp. 3d 589 (D.N.J. 2018). The court reasoned that the absence of "a carve-out for opt-out actions" in SLUSA "indicates that Congress envisioned the aggregation of opt-out suits with related class actions under SLUSA's grouping provision." The court noted that SLUSA's mass action provision refers to suits that "proceed as a single action for any purpose," and determined that "the phrase 'for any purpose' should be given an expansive construction . . . consistent with [SLUSA's] legislative history." The court concluded that the opt-out suits had "proceeded as a single action" with the class actions because of "the procedural history of, and degree of informal coordination between" the opt-out suits and the class actions. Plaintiffs appealed.

SLUSA Preclusion Does Not Generally Apply to Opt-Out Suits That Did Not "Coincide for Some Period" With a Covered Class Action

The Third Circuit "consider[ed] what Congress meant by the broader phrase 'otherwise proceed as a single action for any purpose.'" The court found that "[b]y qualifying 'single action' with the prepositional phrase 'for any purpose,' Congress clarified that the lawsuits need not proceed together for all—or even most—purposes; a group of lawsuits may satisfy the statutory requirement even if a court contemplates separate trials, judgments, or hearings." However, the court determined that "at a minimum, suits do not 'proceed as a single action' unless they are somehow combined for the joint management of a common stage of the proceedings (such as discovery) or the resolution of a common question of law or fact."

1. *See also Smith v. Franklin/Templeton Distribs.*, 2010 WL 2348644 (N.D. Cal. 2010) ("By its terms, § 47(b) provides a remedy . . . rather than a distinct cause of action or basis for liability."); *Stegall v. Ladner*, 394 F. Supp. 2d 358 (D. Mass. 2005) ("ICA § 47(b) provides a remedy rather than a distinct cause of action or basis of liability").

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The court found that "as a general matter, cases cannot 'proceed as a single action' unless they coincide for some period." The court explained that it was "hard-pressed to imagine any scenario in which two cases that never overlap could function as a single lawsuit on any dimension, as the mass action provision requires." The court made it clear that it did "not read the single action requirement to mean that cases must be coextensive with one another but rather that they be at least partially coordinated, which would seem invariably to require that they coincide for some period."

The court found that its "common-sense interpretation" of the phrase at issue "draws further support from the time-honored canon *ejusdem generis*, which teaches that where general words follow an enumeration of two or more things, those successive words refer only to persons or things of the same general kind or class specifically mentioned." The court noted that "[t]he preceding verbs 'joined' and 'consolidated' are nearly synonymous when used to refer to the union of lawsuits," and "illustrate[ ] what Congress meant by the phrase 'otherwise proceed as a single action.'"

The court held that the mass action provision's "single-action requirement cannot be contorted enough to cover 'functional coordination,' as opposed to actual coordination." The court reasoned that requiring only "functional coordination" would mean that "the mere existence of a class action would preclude individual plaintiffs from bringing state-law claims, even if individual plaintiffs do not participate at all in the class proceedings and, when presented with the opportunity, opt out of the class action." Such an interpretation would "foster the complete preemption of state-law securities claims—precisely what Congress chose *not* to do in adopting SLUSA."

Moreover, the court observed that "it would raise serious due process concerns if Congress conditioned the extinguishment of opt-out investors' state-law claims on whether an unaffiliated party had elected to bring a putative class action." The court found "the mass action provision evinces no intent to press these constitutional boundaries."

Fifth Circuit: Defendants' Alleged Awareness of Excess Inventory Levels Was Insufficient to Raise a Strong Inference of Scienter Concerning a Significant Markdown Risk

On August 19, 2019, the Fifth Circuit affirmed the dismissal of a securities fraud action alleging that a home furnishings company and its executives failed to disclose "the risk that [the company] had so much inventory that it could get rid of it only by lowering prices dramatically." *Municipal Emps. Ret. Sys. of Mich. v. Pier 1 Imports*, 2019 WL 3886843 (5th Cir. 2019) (Elrod, C.J.). Plaintiffs did not claim that defendants "misrepresented [the company's] inventory" but instead asserted that defendants "misled the public about [the company's] ability to offload that excessive inventory *without significant markdown risk*." The court held plaintiffs failed to allege scienter because "[k]nowledge of high inventory does not necessarily equate to knowledge of significant markdown risk."

In *Novak v. Kasaks*, 216 F.3d 300 (2d Cir. 2000), the Second Circuit found plaintiffs adequately pled scienter by alleging that a women's apparel retailer failed to mark down the inventory value of out-of-style clothing. Plaintiffs relied on *Novak* to argue that the company's "products are particularly subject to markdown risk" because the company "is a trend-based [home] fashion retailer that is subject to the whims of consumer trends." But the Fifth Circuit found the company "operates largely in the sturdier business of style" rather than the ever-changing business of fashion. The court pointed out that the company does not characterize itself as a "trend-based [home] fashion retailer," and a substantial percentage of its inventory consists of "rebuy" goods. The court determined that plaintiffs' allegations therefore did "not create a strong inference that *all* (or even most) of [the company's] inventory is *so trend driven* that it could not be sold without significant markdowns."

The Fifth Circuit also noted that plaintiffs offered no explanation for why defendants "kept ordering more inventory when they supposedly knew deep down that they would not be able to sell it." The court found defendants' "conduct belied any attempt to conceal the impact of that problem: were [defendants] attempting to conceal significant markdown risk, continuing to order inventory would be counterproductive." Rather than raising a strong inference of scienter [as to a significant markdown risk], the court found it "equally plausible . . . that [defendants] reasonably believed they could fix the excessive inventory problem without resorting to markdowns."

Eleventh Circuit: (1) The Puffery Defense Applies in the Securities Fraud Context, and (2) Statements Conveying Future Plans Are Entitled to Safe Harbor Protection Even If They "Implicitly Communicate Information About the Present"

On August 15, 2019, the Eleventh Circuit affirmed the dismissal of a securities fraud action alleging that a financial services company made material misstatements concerning its prospects for achieving regulatory compliance. [*Carvelli v. Ocwen Fin. Corp.*, 2019 WL 3819305 (11th Cir. 2019) (Newsom, C.J.)](). The court found that some of the alleged misstatements "are immaterial puffery, some are mere statements of opinion, some fall within the [Private Securities Litigation Reform Act's ("PSLRA")] safe harbor for forward-looking statements, and still others are simply not alleged to be false." The court's ruling marks the first published Eleventh Circuit decision applying the puffery defense in the securities fraud context.

Excessively Vague and Optimistic Corporate Statements Are Typically Immaterial as a Matter of Law

The Eleventh Circuit noted that although it has "accepted the puffery defense in the common-law context," the court had "yet to apply it in a reported securities-fraud case." The court found that "the defense seems a particularly good fit in the securities context" because Rule 10b-5 prohibits only "untrue statements of a *material* fact, with 'material' defined to mean something that a reasonable investor would view as having significantly altered the total mix of information made available." The court explained that "[e]xcessively vague, generalized, and optimistic comments—the sorts of statements that constitute puffery—aren't those that a 'reasonable investor,' exercising due care, would view as moving the investment decision needle—that is, they're not material."

The court cautioned that "[a] conclusion that a statement constitutes puffery doesn't absolve the reviewing court of the duty to consider the possibility—however remote—that in context and in light of the 'total mix' of available information, a reasonable investor might nonetheless attach importance to the statement." The court instructed that "when considering a motion to dismiss a securities-fraud action, a court shouldn't grant unless the alleged misrepresentations—puffery or otherwise—are so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance."

The court found that many of the compliance-related statements at issue—such as assertions that the company "was taking a 'leading role' and making 'progress' toward

compliance"—were "quintessential puffery" and "immaterial as a matter of law." The court rejected plaintiffs' contention that the statements "can't be nonactionable puffery because [the company] did not genuinely or reasonably believe them." The court explained that "[w]hether a statement was made in bad faith or without a reasonable basis is irrelevant to the question [of] whether the statement is nonetheless so airy as to be insignificant."

A Statement Concerning Future Plans Is Not Ineligible for Safe Harbor Protection Merely Because It Includes Implicit Statements Concerning Present Facts

The court found the company's forward-looking statements were entitled to safe harbor protection even though they included "statements about the [c]ompany's present condition and intentions." The court explained that "a present-tense declaration is, in some cases, an inextricable part, rather than an easily severed ancillary, of a forward-looking statement." For instance, the statement that the company "would 'continue to provide strong servicing results' . . . impl[ies] both that servicing results are currently strong and that [the company] commits to provide strong results in the future." The court found "[t]hese types of statements, when accompanied by meaningful cautionary language, are properly sheltered under the safe-harbor because they convey management plans for yet-to-be proven future operations and goals."

The court reasoned that "[i]t would be illogical to bar forward-looking statements from protection simply because they implicitly communicate information about the present—indeed, many plans and projections are conveyed in just this way." The court noted, for example, that the statement, "'I'll leave my desk in 5 minutes," includes an implicit statement that the speaker is "*presently* at work." The court found statements of this nature "are intended, first and foremost, to communicate a future plan."

The court clarified that its decision did not stand for the proposition "that false misrepresentations of present fact can be 'smuggled' in under the cover of forward-looking statements." But the court did specifically hold that "when a forward-looking statement is of the sort that, by its nature, rolls in present circumstances—that is, when a statement forecasts in a tentative way a future state of affairs in which a present commitment unfolds into action—the statement isn't barred from safe harbor protection solely on that ground."

A Statement of Opinion Is Not Actionable Simply Because the Speaker "Should Have Known" the Opinion Was Objectively Inaccurate

The court also deemed inactionable a number of the company's statements of opinion. The court found plaintiffs failed to allege either that the company did not actually believe these statements of opinion, or that the statements "contained embedded false statements of fact," as required under the Supreme Court's decision in *Omnicare v. Laborers District Council Construction Industry Pension Fund,* 135 S. Ct. 1318 (2015).[2] The court found the company's optimistic statements concerning its compliance efforts were not "mutually exclusive of—or even inconsistent with—[the company's] alleged knowledge that it had persistent software problems" that hampered its compliance attempts. The court reasoned that the company "could have believed *both* that [its software] was a mess—even a 'train wreck'—*and* that it had made progress towards compliance." The court found plaintiffs' allegations might "[a]t best . . . giv[e] rise to an inference that [the company] perhaps *could* or *should* have known that it would have difficulty improving results." But the court underscored that this is "not enough" to state a securities fraud claim based on a statement of opinion.

2. Please click here to read our discussion of the Supreme Court's decision in *Omnicare*.

Delaware Chancery Court: The Entire Fairness Standard of Review Applies to Compensation Awards to Controlling Stockholders That Were Not Conditioned on *MFW*'s Procedural Protections

On September 20, 2019, the Delaware Chancery Court held that the business judgment standard of review did not apply to a board's decision to award sizable incentive compensation to a controlling stockholder, even though a majority of the disinterested stockholders voted in favor of the award. *Tornetta v. Musk*, 2019 WL 4566943 (Del. Ch. 2019) (Slights, V.C.). The court held that "stockholder ratification, without more, does not counterpoise the risk of coercion" by the controlling stockholder. The court found that "*MFW* provides the answer" to protecting against this risk.[3] The court held that if a board preconditions a compensation award to a controlling stockholder on the satisfaction of *MFW*'s dual procedural safeguards, "[b]usiness judgment deference at the pleadings stage would then be justified."

The court recognized that "[a] board of directors' decision to fix the compensation of the company's executive officers" is generally "entitled to great judicial deference," particularly if "the board submits its decision to grant executive incentive compensation to stockholders for approval, and secures that approval." However, the court stated that its "earnest deference to board determinations relating to executive compensation does not jibe with [its] reflexive suspicion when a board transacts with a controlling stockholder." The court observed that "[b]ecause the conflicted controller, as the 800 pound gorilla, is able to exert coercive influence over the board and unaffiliated stockholders, [Delaware] law has required that transactions with conflicted controllers be reviewed for substantive fairness even if the transaction was negotiated by independent directors or approved by the minority stockholders."

The court rejected defendants' contention that this "concern is less pressing, and less worthy of protection, in transactions, like the [a]ward, that do not alter the corporate contract." The court found "[t]he controlling stockholder's potentially coercive influence is no less present, and no less consequential, in instances where the board is negotiating the controlling stockholder's compensation than it is when the board is negotiating with the controller to effect a 'transformational' transaction." The court held that "[i]n [both] circumstances, stockholder approval of the conflicted controller transaction, alone, will not justify business judgment deference."

The court then considered whether "the [b]oard could have structured the approval process leading to the [a]ward [at issue] in a way that provides a feasible way for defendants to get cases dismissed on the pleadings." The court acknowledged that "neither the Chancery nor Supreme Court opinions in *MFW* can be read to endorse an application of *MFW* beyond the squeeze-out merger." Nevertheless, the court found this did "not mean that *MFW*'s dual protections cannot be potent neutralizers in other applications." The court determined that "[j]ust as in the squeeze-out context, preconditioning a controller's compensation package on both the approval of a fully functioning, independent committee *and* an informed, uncoerced vote of the majority of the minority stockholders will dilute the looming coercive influence of the controller." The court reasoned that with these procedural protections in place, "the minority stockholders will have far less reason to fear that the controller will retaliate if the committee or minority stockholder votes do not go his way."

3. In *Kahn v. M & F Worldwide Corp.*, 88 A.3d 635 (Del. 2014) (*MFW*), the Delaware Supreme Court held that the business judgment standard of review applies to a controlling stockholder transaction if the transaction "is conditioned *ab initio* upon the approval of both an independent, adequately-empowered Special Committee that fulfills its duty of care, and the uncoerced, informed vote of a majority of the minority stockholders." Please click here to read our discussion of *MFW*.

Although the board conditioned the compensation award on the approval of a majority of the minority stockholders, the board did not condition the award on the approval of an independent special committee. The court therefore reviewed the allegations under the entire fairness standard of review. The court found it "reasonably conceivable" that the award was unfair because plaintiff alleged that "[t]he [a]ward has a potential value that is orders of magnitude higher than what other highly paid CEOs earn." The court therefore denied defendants' motion to dismiss the plaintiff's breach of fiduciary duty claims.

Delaware Chancery Court: (1) There Is No Violation of *Caremark*'s First Prong If a Board-Level Reporting System Exists, and (2) A Class Action Settlement Does Not, Standing Alone, Constitute a Red Flag Under *Caremark*'s Second Prong

On July 29, 2019, the Delaware Chancery Court dismissed with prejudice a derivative action because the plaintiff failed to allege that a majority of the directors faced a substantial likelihood of personal liability in connection with the claims at issue, which concerned the company's price comparison advertising policy and practices. *Rojas v. Ellison*, 2019 WL 3408812 (Del. Ch. 2019) (Bouchard, C.). The court found the plaintiff could not allege a violation under the first prong of *Caremark* because the plaintiff conceded the existence of a board-level reporting system.[4] With respect to the plaintiff's failure-to-monitor allegations under the second prong of *Caremark*, the court found that a settlement without admission of wrongdoing or liability does not, standing alone, constitute a "red flag."

The court rejected what it found to be a "faint-hearted attempt to argue that the members of the Demand Board face a substantial likelihood of personal liability under the first prong of *Caremark* for 'utterly failing' to implement any reporting or information system or controls with respect to the [c]ompany's advertising and pricing policies." The court noted that the Delaware Supreme Court in *Stone v. Ritter*, 911 A.2d 362 (Del. 2006), was "quite deliberate in its use of the adverb 'utterly'—a 'linguistically extreme formulation'—to set the bar high when articulating the first way to hold directors personally liable for a failure of oversight under *Caremark*." More recently, in *Marchand v. Barnhill,* 212 A.3d 805 (Del. 2019), the Delaware Supreme Court held that *Caremark* imposes "a bottom-line requirement" that "the board must make a good faith effort—*i.e.*, try—to put in a place a reasonable board-level system of monitoring and reporting."[5] The *Marchand* court observed that "[i]n decisions dismissing *Caremark* claims, the plaintiffs usually lose because they must concede the existence of board-level systems of monitoring and oversight such as a relevant committee, a regular protocol reporting board-level reports about the relevant risks, or the board's use of third-party monitors, auditors, or consultants." The *Rojas* court found "[t]hat is the case here," as the plaintiff admitted that the board did in fact have a reporting system in place.

The *Rojas* court found similarly meritless plaintiff's allegations that the directors knew or should have known the company was violating the law, but failed to monitor the company's operations under the second prong of *Caremark*. The plaintiff claimed the settlement of a consumer class action "put the full [b]oard on notice that the [c]ompany's pricing policies violated Consumer Protection Laws." But the court found "[a] settlement of litigation or a warning from a regulatory authority . . . [does not necessarily] demonstrate that a corporation's directors knew or should have known that the corporation was violating the law." The court explained that the issue of "[w]hen such

4. In *In re Caremark Int'l Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996), the court addressed the scope of directors' obligations to monitor corporate operations. The court held that directors must "attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists." The court further held that directors may be liable for "failing adequately to control" the company's employees if "the directors knew or . . . should have known that violations of law were occurring" and "took no steps in a good faith effort to prevent or remedy that situation" and "such failure proximately resulted in . . . losses" to the corporation.

5. Please click here to read our discussion of the Delaware Supreme Court's decision in *Marchand*.

events become a 'red flag' depends on the circumstances."

Here, the court found the settlement was made without any admission of liability. The court observed that the class action "was not brought against the backdrop of a prior settlement where clear, repeated violations of a law had been found." Rather, the suit "was a purely civil matter of the type that commercial parties routinely settle after motion practice." The court rejected the plaintiff's contention that "the sheer amount of the settlement payment . . . and the fact that the [c]ompany lost multiple motions . . . should satisfy his pleading burden" to allege demand futility. The court found the plaintiff's allegations "far from sufficient in the context of the overall circumstances to support the inference of scienter necessary to demonstrate that [the company's] directors acted in bad faith."

Delaware Chancery Court: In Appraisal Actions, the Acquirer Must Prove That a Deduction From the Deal Price for Merger-Related Synergies Is Warranted

In two recent decisions, the Delaware Chancery Court held that the fair value in a statutory appraisal proceeding brought pursuant to Section 262 of the Delaware General Corporation Law was the deal price, without any deduction for merger-related synergies. *See* *In re Appraisal of Stillwater Mining Co.*, 2019 WL 3943851 (Del. Ch. Aug. 21, 2019) (Laster, V.C.); *In re Appraisal of Columbia Pipeline Grp.*, 2019 WL 3778370 (Del. Ch. Aug. 12, 2019) (Laster, V.C.). In both cases, the court found that the acquirer failed to meet its burden of proving that a downward adjustment for synergies was warranted.

In *Columbia Pipeline*, the court recognized that "'[i]t is widely assumed that the sale price in many M&A deals includes a portion of the buyer's expected synergy gains, which is part of the premium the winning buyer must pay to prevail and obtain control.'" 2019 WL 3778370 (quoting *DFC Glob. Corp. v. Muirfield Value Partners*, 172 A.3d 347 (Del. 2017)). The court noted that "Section 262(h) requires that the Court of Chancery discern the going concern value of the company irrespective of the synergies involved in a merger." The court explained that in order "[t]o derive an estimate of fair value, the court must exclude any synergies or other value expected from the merger giving rise to the appraisal proceeding itself."

The court found that it was "not able to credit [the acquirer's] position that [the target] received 100% of synergies worth $4.64 per share" out of a total deal price of $25.50 per share. The court found that the acquirer "likely could have justified a smaller synergy deduction, but it claimed a larger and unpersuasive one" for which it "did not meet its burden of proof." The *Stillwater Mining* court similarly found that the acquirer "failed to meet its burden of proof to establish a quantifiable amount that the court should deduct from the deal price." 2019 WL 3943851. In both cases, the court declined to make a downward adjustment to the deal price to account for merger-related synergies.

New York Supreme Court: Courts Are Split on Whether the PSLRA's Discovery Stay During the Pendency of a Motion to Dismiss Applies to State Court Actions

In *Cyan v. Beaver Cty. Emps. Ret. Fund*, 138 S. Ct. 1061 (2018), the Supreme Court held that SLUSA did not "strip state courts of jurisdiction over class actions alleging violations of only the Securities Act of 1933" (the "1933 Act" or "'33 Act").[6] However, the

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

Court did not address whether all of the procedural rules governing 1933 Act claims brought in federal court also apply when plaintiffs bring such claims in state court. New York state courts have since reached differing conclusions on whether the PSLRA's stay of discovery during a pending motion to dismiss applies in state court actions asserting 1933 Act claims.[7] *Compare* *Matter of PPDAI Grp. Sec. Litig.*, 2019 WL 2751278 (N.Y. Sup. Ct. July 1, 2019) (Scarpulla, J.) (PSLRA's discovery stay inapplicable in state court actions), *and* *In re Dentsply Sirona, Inc. S'holders Litig.*, 2019 WL 3526142 (N.Y. Sup. Ct. Aug. 2, 2019) (Scarpulla, J.) (same), *with* *In re Everquote, Inc. Sec. Litig.*, 2019 WL 3686065 (N.Y. Sup. Ct. Aug. 7, 2019) (Borrok, J.) (PSLRA's discovery stay applies in state court actions). These rulings have furthered a growing division of authority on this question.[8]

In *Matter of PPDAI*, 2019 WL 2751278, the court found that "[a]pplication of the federal PSLRA automatic discovery stay would undermine *Cyan*'s holding that '33 Act cases may be heard in state courts." The court therefore concluded that "the PSLRA's automatic discovery stay is not applicable to an action brought in New York State court." In reaching this conclusion, the court noted that "in the Commercial Division discovery generally continues during motion practice." In *In re Denstply Sirona*, 2019 WL 3526142, a decision issued by the same judge, the court reached the same conclusion.

But in *In re Everquote*, 2019 WL 3686065, a different New York state court judge applied the PSLRA's discovery stay during a pending motion to dismiss an action alleging 1933 Act claims. The court found that *Cyan* "does not control the outcome of" whether PSLRA's discovery stay applies in state court actions. But the court found *Cyan* "helpful" insofar as it "underscores the most basic and fundamental rule in statutory interpretation—the court must start with the express language of the statute and presume that it means what it says." The *Everquote* court explained that "[t]he simple, plain and unambiguous language [of the PSLRA] expressly provides that discovery is stayed during a pending motion to dismiss 'in *any private action* arising under this subchapter.'" *Id.* (quoting 15 U.S.C. § 77z-1(b)(1)). The court observed that "[t]he statute simply does not say that the automatic stay is limited to claims brought pursuant to the 1933 Act in federal court." Quoting *Cyan*, the court found that Section 77z-1(b)(1) "says what it says—or perhaps better put here, does not say what it does not say."

The *Everquote* court rejected plaintiffs' contention that "state court practices and procedures would be constrained" if the PSLRA's discovery stay were to apply in state court actions. The court explained that "[t]his is not an issue of federal common law being applied to supply a rule of decision." Rather, "[i]t was Congress that created the specific rights covered by the 1933 Act including affording concurrent jurisdiction to state courts to adjudicate claims brought under the 1933 Act." The court found that "the critical issue is not how a stay of discovery squares in the abstract with either Commercial Division Rule 11 or CPLR 3214 or case assignment." Instead, "the controlling issue is how this court implements the congressional mandate regarding how it is to manage 1933 Act claims that find their way into state courts." The court held that this "mandate requires a stay" during a pending motion to dismiss

7. 15 U.S.C. § 77z-1(b)(1) provides that "[i]n any private action arising under this subchapter, all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss, unless the court finds, upon the motion of any party, that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to that party."

8. In *City of Livonia Retiree Health and Disability Benefits Plan v. Pitney Bowes*, 2019 WL 2293924 (Conn. Super. Ct. May 15, 2019), a Connecticut state court found that the "plain meaning" of 15 U.S.C. § 77z-1(b)(1) "compels the conclusion that [it] . . . applies to actions commenced in state court under the [1933] Act, as well as such actions commenced in federal court." (Please click here to read our discussion of the Connecticut Superior Court's decision in *City of Livonia*.) But in *Switzer v. Hambrecht & Co.*, 2018 WL 4704776 (Cal. Super. Ct. Sept. 19, 2018), a California state court determined that "the PSLRA's provision for a discovery stay [during a pending motion to dismiss] is of a procedural nature, and therefore only applies to actions filed in federal court, not state court."

when plaintiffs bring 1933 Act claims in state courts.

The *Everquote* court reasoned that holding otherwise would "run afoul of the well-recognized purpose of [the PSLRA] and SLUSA." The court explained that the "specific abuses that Congress decided to curtail in enacting the [PSLRA] . . . includ[ed] the filing of lawsuits and making significant discovery requests in otherwise meritless lawsuits (*i.e.*, lawsuits that will not survive a motion to dismiss) in the hope of encouraging early settlement." The court found that "Congress enacted the automatic stay of discovery during a pending motion to dismiss to address this concern." The court determined that there "simply is no basis to find that Congress intended for this provision to only apply to actions brought in federal court." The court observed that "a divergence in the application of the [PSLRA] discovery stay in state and federal court would create the undesirable . . . and absurd incentive for lawsuits brought under the 1933 Act to be brought in state court as opposed to federal court to avoid the very protection supporting the enactment of the [PSLRA]." The court found that this would "confound[] Congress' acknowledged intention that the lion's share of securities litigation would occur in the federal courts."

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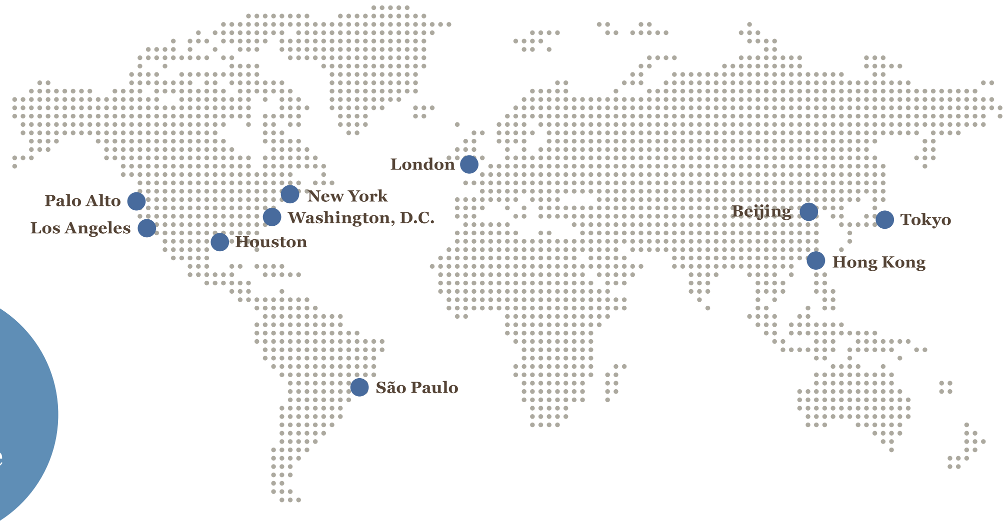

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