Simpson Thacher

Securities Law Alert

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2018

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–*Chambers USA* 2018

Supreme Court Decisions

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 Securities Act"). *Cyan v. Beaver Cty. Emp. Ret. Fund*, 138 S. Ct. 1061 (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.

Prior to SLUSA's enactment, federal and state courts had concurrent jurisdiction over actions asserting Securities Act claims pursuant to 15 U.S.C. § 77v(a). SLUSA amended Section 77v(a) to add the italicized language: "The district courts of the United States . . . shall have jurisdiction . . . concurrent with State and

Territorial courts, *except as provided in [S]ection 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 Securities Act. The central dispute in *Cyan* was whether Section 77v(a)'s reference to "covered class actions" pointed to the definition of that term in 15 U.S.C. § 77p(f)(2) of SLUSA. If it did, the issuer argued, state courts would not have jurisdiction over such class actions brought under the Securities Act.

The Court determined that if Congress had wanted to refer to § 77p(f)(2), it would have done so. The Court further explained that § 77p(f)(2) provides a definition (of "covered class action"), not an exception to concurrent jurisdiction. The Court found that, by its terms, § 77p only prevents certain class actions based on state law from being heard in state courts, and that nothing in the text prevents a state court from hearing class actions based exclusively on federal law.

The Court also held that § 77p(c) of SLUSA does not permit the removal of class actions alleging only Securities Act claims from state to federal court because that provision addresses class actions described in § 77p(b). The Court found that § 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 Securities Act claims.

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 resolved a split between the Second, Fifth and Ninth Circuits.[1]

1. *Compare Somers v. Digital Realty Trust*, 850 F.3d 1045 (9th Cir. 2017) (Dodd-Frank Act's anti-retaliation provisions apply to employees who report alleged misconduct internally), and *Berman v. Neo@Ogilvy*, 801 F.3d 145 (2d Cir. 2015) (same) *with Asadi v. G.E. Energy (USA)*, 720 F.3d 620 (5th Cir. 2013) (Dodd-Frank Act's anti-retaliation provisions apply only to individuals who provide information to the SEC).

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 purposes of the Dodd-Frank Act's 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).

The Supreme Court found 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." 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.

American Pipe Does Not Permit Unnamed Class Members to Bring a New Class Action After the Expiration of the Applicable Limitations Period

On June 11, 2018, the Supreme Court unanimously held that the tolling of individual claims established in *American Pipe & Constr. Co. v. Utah*, 414 U.S. 538 (1974), does not toll limitations periods for successive class claims.[2] *China Agritech v. Resh*, 138 S. Ct. 1800 (2018) (Ginsburg, J.). Thus, individual claimants who could invoke *American Pipe* tolling for their individual claims may not bring putative class claims if such class claims would be barred by the applicable statute of limitations.

The Court explained that the goals of "'efficiency and economy of litigation' that support tolling of individual claims" under *American Pipe* "do not support maintenance of untimely successive class actions." Instead, the Court noted that class claims should be made soon after the first action seeking class certification. The Court reasoned that while economy of litigation favors delaying the limitation period until class certification is denied because certification would eliminate the need for individually asserted claims, the opposite is true for competing class representative claims: when class treatment is appropriate, it is best for all possible representatives to be known so the district court can select the best plaintiff.

The Court also explained that plaintiffs usually must show they have been diligent in pursuing their claims to benefit from equitable tolling. The Court stated that a "would-be class representative who commences suit after expiration of the limitation period . . . can hardly qualify as diligent in asserting claims and pursuing relief." In addition, the Court expressed concern that applying *American Pipe* tolling to successive class claims would permit the statute of limitations to be extended indefinitely, noting that "[e]ndless tolling of a statute of limitations is not a result envisioned by *American Pipe*."

2. The *American Pipe* Court held that "the commencement of a class action suspends the applicable statute of limitations as to all asserted members of the class who would have been parties had the suit been permitted to continue as a class action." 414 U.S. 538 (1974).

Circuit Court Decisions Addressing Class Certification

Second Circuit: Courts Must Consider Price Impact Evidence at the Class Certification Stage

On January 12, 2018, the Second Circuit vacated class certification in a securities fraud action based, *inter alia*, on its determination that the district court "erred in declining to consider" defendants' price impact evidence at the class certification stage. *Arkansas Teachers Ret. Sys. v. Goldman Sachs Grp.*, 879 F.3d 474 (2d Cir. 2018) (Wesley, J.). The Second Circuit found the district court erroneously "construed this evidence as an inappropriate truth on the market defense or as evidence of the statements' lack of materiality, neither of which the court thought it could consider at the class certification stage."

The Second Circuit explained that "[t]he 'truth on the market' defense attacks the timing of the plaintiffs' purchase of shares" on the theory that "the market was already aware of the truth regarding defendants' misrepresentations at the time the class members purchased their shares." Here, it was "undisputed that plaintiffs purchased their shares after the misstatements were made but before the truth was revealed." The Second Circuit found that "defendants did not present a 'truth on the market' defense" but instead presented evidence that alleged "conflicts of interest 'did not actually affect the stock's market price.'" *Id.* (quoting *Halliburton Co. v. Erica P. John Fund*, 134 S. Ct. 2398 (2014)).

The Second Circuit also distinguished price impact from materiality. The court observed that while "price impact touches on materiality, which is not an appropriate consideration at the class certification stage, it differs from materiality" insofar as price impact concerns "the effect of a misrepresentation on a stock price." The court explained that "[w]hether a misrepresentation was reflected in the market price at the time of the transaction—whether it had price impact—'is *Basic*'s fundamental premise. It … has everything to do with the issue of predominance at the class certification stage.'" *Id.* (quoting *Halliburton*, 134 S. Ct. 2398). The Second Circuit emphasized that if an alleged misrepresentation did not affect the stock price, there would be no basis for plaintiffs to assert that they indirectly relied on that misrepresentation through the market price. On remand, the district court found that defendants "failed to establish, by a preponderance of the evidence, that the alleged misstatements had no price impact." *In re Goldman Sachs Grp. Sec Litig.*, 2018 WL 3854757 (S.D.N.Y. Aug. 14, 2018). Defendants have appealed.

Circuit Court Decisions Addressing Actionable Misstatements and Omissions

Third Circuit: A Company Has No Stand-Alone Obligation to Disclose Alleged Regulatory Violations by an Affiliated Entity

On November 14, 2018, the Third Circuit affirmed dismissal of a securities fraud action alleging that a company failed to disclose regulatory violations by an affiliated entity. *City of Cambridge Ret. Sys. v. Altisource Asset Mgmt. Corp.*, 908 F.3d 872 (3d Cir. 2018) (Fisher, J.). The Third Circuit found "no authority to support the conclusion that [the defendant company] was obligated to disclose the flaws of a separate entity in its own filings."

The Third Circuit further determined that alleged misstatements made by any entities affiliated with the defendant company had no "legal significance" with respect to plaintiffs' Rule 10b-5 claims under the Supreme Court's decision in *Janus Capital Grp. v. First Derivative Traders*, 564 U.S. 135 (2011), which limits Rule 10b-5(b) liability to "the person or entity with ultimate authority over the statement."[3]

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

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 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 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."

Fifth Circuit: Statements Concerning Transparency, Quality and Corporate Responsibility Are Inactionable Puffery

On October 3, 2018, the Fifth Circuit affirmed dismissal of a securities fraud action alleging that a grocery retailer made misstatements concerning the company's "commitment to transparency, quality and corporate responsibility," among other alleged

misstatements. *Emps. Ret. Sys. v. Whole Foods Mkt.*, 905 F.3d 892 (5th Cir. 2018) (King, J.). The court held these "generalized statements" constituted inactionable puffery even though the retailer had "built a brand around holding itself to higher ethical standards than its competitors." The court found that a "reasonable investor" would not assess the company's value based on such "self-serving statements." Rather, reasonable investors would "rely on facts to determine whether" the company is in fact "transparent and otherwise holds itself to high standards."

Tenth Circuit: A Company Has No Duty to Disclose Preliminary Merger Discussions Provided It Does Not Say Anything "Inconsistent" With the Existence of Such Discussions

On May 11, 2018, the Tenth Circuit held that an energy company and its executives had no duty to disclose preliminary merger discussions with a competing energy firm because defendants had not made any statements that were "inconsistent" with the possibility that the company was engaging in such discussions. *Emps. Ret. Sys. of Rhode Island v. Williams Cos.*, 889 F.3d 1153 (10th Cir. 2018) (Hartz, J.). The court emphasized that "Rule 10b-5 does 'not create an affirmative duty to disclose any and all material information.'" *Id.* (quoting *Matrixx Initiatives v. Siracusano*, 563 U.S. 27 (2011)). Rather, Rule 10b-5 requires disclosure "only when necessary to make statements made, in the light of the circumstances in which they were made, not misleading." *Id.* (quoting *Matrixx*, 563 U.S. 27).

The court further found that the merger discussions were not material under the probability/magnitude test set forth in *Basic v. Levinson*, 485 U.S. 224 (1988). The Tenth Circuit explained that *Basic*'s "fact-specific" inquiry requires courts to "analyze the probability that a merger will succeed and the magnitude of the transaction." The Tenth Circuit stated that "merger discussions are generally not material in the absence of a serious commitment to consummate the transaction." In the case before it, the court noted that there were no allegations of "concrete offers, specific discussions, or anything more than vague expressions of interest." The Tenth Circuit determined that the allegations were "fully consistent with there being no commitment whatsoever."

Circuit Court Decisions Addressing Scienter

First Circuit: Allegations That a Pharmaceutical Company Was Dependent on Offerings to Fund Its Operations Were Insufficient to Plead Scienter

On April 4, 2018, the First Circuit rejected plaintiffs' efforts to plead scienter by alleging that a pharmaceutical company was "dependent upon offerings to fund its operations" because it was "in a race for FDA approval" and was "generating no significant revenue." *Kader v. Sarepta Therapeutics*, 887 F.3d 48 (1st Cir. 2018) (Torruella, J.). The court explained that it has "set a high bar for arguments of this sort." To plead scienter based on a motive to boost the company's stock price, plaintiffs must allege "something more than the ever-present desire to improve results, such as allegations that the very survival of the company was on the line."

In the case before it, the First Circuit found the complaint "bereft of allegations that [the company] was financially on the ropes, or that it would shutter its doors unless it padded earnings by deceiving investors." The court recognized that the company's initial public offering may have "generated revenue that proved useful to [the company] in its race for FDA approval, so as to secure the first-mover advantage." However, the First Circuit held that this "alone cannot bear the weight of an inference of scienter that is at least as compelling as any other."

Third Circuit: Affirms Dismissal of a Securities Fraud Class Action Where the Allegations Suggested Mismanagement Rather Than Fraud

On September 20, 2018, the Third Circuit affirmed dismissal of a securities fraud class action against a car rental company brought on the heels of an acknowledgement in an SEC filing that a "sometimes inappropriate tone at the top . . . may have led to inappropriate accounting decisions." *In re Hertz Global Holdings*, 905 F.3d 106 (3d Cir. 2018) (Jordan, J.). The Third Circuit held the district court did not err in interpreting this statement as "an admission of 'mismanagement,' as opposed to an admission of 'misconduct.'" The Third Circuit found the allegations did not "necessarily suggest" that defendants were "engaged in a systematic fraud." The court determined that it was "[m]ore plausible . . . that the [i]ndividual [d]efendants were just bad leaders."

The Third Circuit found that "any inference of scienter was circumscribed by the fact that the accounting errors were spread across myriad accounting categories." The court also placed no weight on the allegation that the individual defendants certified the accuracy of the company's SEC filings, as plaintiffs did not allege that any defendant "knew he was signing a false SEC filing or recklessly disregarded inaccuracies" in the filings. The court also determined that the alleged insider trading activity did not support a strong inference of scienter because the individual defendants did not sell their holdings when the stock was trading at its peak. Moreover, the court placed no weight on allegations that the individual defendants "each resigned in close proximity to the public release of bad news." The court reasoned that "[c]hanges in leadership are only to be expected when leadership fails."

Ninth Circuit: Generalized Allegations of an IPO-Related Motive to Boost Profitability Are Insufficient to Plead Scienter

On March 8, 2018, 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. *Webb v. SolarCity Corp.*, 884 F.3d 844 (9th Cir. 2018) (Smith, Jr., J.). In the case before it, the Ninth Circuit found that plaintiffs' IPO-related motive 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."

Circuit Court Decisions Addressing Loss Causation

Fourth Circuit: Allegations of Partial Disclosures May Be Sufficient to Plead Loss Causation

On February 22, 2018, the Fourth Circuit found plaintiffs adequately alleged loss causation based on partial disclosures concerning a government subpoena into the company's reimbursement practices. *Singer v. Reali*, 883 F.3d 425 (4th Cir. 2018) (King, J.). The court stated 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 "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."

Ninth Circuit: Disclosure of the Alleged Fraud Is Not a Prerequisite for Loss Causation

On January 31, 2018, the Ninth Circuit held that "a general proximate cause test . . . is the proper test" for loss causation under Section 10(b) and Rule 10b-5 and that disclosure of the fraud is not a prerequisite for loss causation. *Mineworkers' Pension Scheme v. First Solar*, 881 F.3d 750 (9th Cir. 2018) (per curiam).

The Ninth Circuit stated that in order "[t]o prove loss causation, plaintiffs need only show a causal connection between the fraud and the loss, by tracing the loss back to the very facts about which the defendant lied." The court explained that "[r]evelation of

fraud in the marketplace is simply one of the infinite variety of causation theories a plaintiff might allege to satisfy proximate cause." The court noted that if "a stock price drop comes immediately after the revelation of fraud," this "can help to rule out alternative causes." However, the Ninth Circuit stated that "[a] plaintiff may also prove loss causation by showing that the stock price fell upon the revelation of an earnings miss, even if the market was unaware at the time that fraud had concealed the miss."

Circuit Court Decisions Addressing the Application of *Morrison*

Ninth Circuit: *Morrison* Does Not Preclude Section 10(b) Claims Concerning Domestic Transactions in Unsponsored ADRs

On July 17, 2018, the Ninth Circuit found the district court "misapplied" *Morrison v. Nat'l Australia Bank*, 561 U.S. 247 (2010), in holding that Section 10(b) does not reach securities fraud claims involving domestic transactions in unsponsored American Depositary Receipts and Shares ("ADRs"), which are issued with little or no involvement by the foreign issuer.[4] *Stoyas v. Toshiba Corp.*, 896 F.3d 933 (9th Cir. 2018) (Wardlaw, J.). The Ninth Circuit emphasized that under *Morrison*, courts must "examine the location of the transaction[;] it does not matter that a foreign entity was not engaged in the transaction." The court stated that the possibility that a foreign issuer "may ultimately be found not liable for causing the loss in value to the ADRs does not mean that the [Exchange] Act is inapplicable to the transactions."

The Ninth Circuit expressly disagreed with the Second Circuit's holding in *Parkcentral Global Hub v. Porsche Automobile Holdings*, 763 F.3d 198 (2d Cir. 2014), that "a domestic transaction is necessary but not necessarily sufficient to make § 10(b) applicable."[5] The Ninth Circuit found *Parkcentral*'s approach "contrary to Section 10(b) and *Morrison* itself" because it "carves out 'predominantly foreign' securities fraud claims from Section 10(b)'s ambit, disregarding Section 10(b)'s text." The Ninth Circuit further found that "*Parkcentral*'s analysis relies heavily on the foreign location of the allegedly deceptive conduct, which *Morrison* held to be irrelevant to the Exchange Act's applicability, given Section 10(b)'s exclusive focus on transactions."

Circuit Court Decisions Addressing Insider Trading Liability

Second Circuit: Gifting Confidential Information With an Intent to Benefit the Tippee Satisfies *Dirks*' Personal Benefit Requirement, Even If the Tipper Does Not Have a Relationship With the Tippee

On June 25, 2018, the Second Circuit held that *Dirks*' personal benefit requirement can be satisfied with evidence that the tipper gifted confidential information with an intent to benefit the tippee, even in the absence of evidence of a personal relationship between the tipper and the tippee.[6] *U.S. v. Martoma*, 894 F.3d 64 (2d Cir. 2018) (Katzmann, C. J.). The court reasoned that *Dirks*' "personal benefit requirement is designed to test the propriety of the tipper's purpose." The court found that "it makes perfect sense to

4. In *Morrison*, 561 U.S. 247, the Supreme Court held that Section 10(b) applies only to (1) "transactions in securities listed on domestic exchanges," and (2) "domestic transactions in other securities."

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

6. In *Dirks v. S.E.C.*, 463 U.S. 646 (1983), the Supreme Court held that the "test" for tippee liability is "whether the insider [the tipper] personally will benefit, directly or indirectly, from his disclosure." The *Dirks* Court stated that "there may be a relationship between the insider and the recipient that suggests a *quid pro quo* from the latter, or an intention to benefit the particular recipient."

permit the government to prove a personal benefit with objective evidence of the tipper's intent, without requiring in every case some additional evidence of the tipper-tippee relationship." The court stated that "[t]he tipper's intention to benefit the tippee proves a breach of fiduciary duty because it demonstrates that the tipper improperly used inside information for personal ends and thus lacked a legitimate corporate purpose."

Circuit Court Decisions Addressing ERISA Claims

Fifth Circuit: (1) *Fifth Third* Applies to Claims of Excessive Riskiness, and (2) Failure to Disclose Inside Information Does Not Constitute a "Special Circumstance" Under *Fifth Third*

On February 6, 2018, the Fifth Circuit held that the Supreme Court's decision in *Fifth Third Bancorp v. Dudenhoeffer*, 134 S. Ct. 2459 (2014), applies to ERISA claims alleging that company stock was excessively risky in addition to claims that the stock was overvalued.[7] *Singh v. RadioShack Corp.*, 882 F.3d 137 (5th Cir. 2018) (per curiam). The Fifth Circuit found "'illusory'" the "distinction between" these two types of ERISA claims. The court reasoned that "[i]n an efficient market, market price accounts for risk." The Second, Sixth and D.C. Circuits have also held that *Fifth Third* applies to ERISA claims alleging claims based on allegedly excessive risk.[8]

The Fifth Circuit further held that plaintiffs cannot satisfy *Fifth Third*'s "special circumstances" exception for claims based on publicly available information by alleging that defendants "withheld material information from the market, skewing the stock price." The court found that failure to disclose inside information does not constitute a "special circumstance" because *Fifth Third* established a separate standard for analyzing insider-information claims, pursuant to which "'a plaintiff must plausibly allege an alternative action that the defendant could have taken that would have been consistent with the securities laws and that a prudent fiduciary in the same circumstances would not have viewed as more likely to harm the fund than to help it.'" *Id.* (quoting *Fifth Third*, 134 S. Ct. 2459).

7. In *Fifth Third*, the Court outlined the standards for pleading an ERISA breach of the duty of prudence claim against the fiduciary of an employee stock ownership plan. Please click here to read our discussion of the Supreme Court's decision in *Fifth Third*.

8. *See Pfeil v. State Street Bank and Trust Co.*, 806 F.3d 377 (6th Cir. 2015); *Rinehart v. Lehman Bros. Holdings*, 817 F.3d 56 (2d Cir. 2016); *Coburn v. Evercore Trust Co.*, 844 F.3d 965 (D.C. Cir. 2016).

Other Notable Circuit Court Decisions

Ninth Circuit: Misstatement Claims Under Section 14(e) of the Exchange Act Require Only Proof of Negligence, Not Scienter

On April 20, 2018, the Ninth Circuit held that the first clause of Rule 14(e), which prohibits material misstatements in connection with tender offers, requires only proof of negligence, rather than scienter.[9] *Varjabedian v. Emulex Corp.*, 888 F.3d 399 (9th Cir. 2018) (Marguia, J.). Five other circuits to consider this question have relied on similarities between the first clause of Rule 14(e) and Rule 10b-5(b) to hold that a scienter requirement applies to Rule 14(e) claims.[10] The Ninth Circuit departed from these decisions based on its determination that "important distinctions exist between Rule 10b-5 and Section 14(e)" that "strongly militate against importing the scienter requirement from the context of Rule 10b-5 to Section 14(e)."

9. Rule 14(e), titled *Untrue statement of material fact or omission of fact with respect to tender offer*, provides in relevant part:

> It shall be unlawful for any person to make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation.

15 U.S.C. §78n(e). Rule 14(e) was added as an amendment to the Securities Exchange Act of 1934 pursuant to the Williams Act.

10. *See Chris-Craft Indus. v. Piper Aircraft Corp.*, 480 F.2d 341 (2d Cir. 1973); *Smallwood v. Pearl Brewing Co.*, 489 F.2d 579 (5th Cir. 1974); *In re Digital Island Sec. Litig.*, 357 F.3d 322 (3d Cir. 2004); *SEC v. Ginsburg*, 362 F.3d 1292 (11th Cir. 2004); *Adams v. Standard Knitting Mills*, 623 F.2d 422 (6th Cir. 1980).

The Ninth Circuit explained that Rule 10b-5(b)'s scienter requirement is based not on the text of the rule itself but on the language of Section 10(b), pursuant to which Rule 10b-5 was promulgated. The court found that "Section 14(e) differs fundamentally from Section 10(b)" because the SEC may regulate non-fraudulent conduct under Section 14(e). The Ninth Circuit observed that "[i]f the SEC can prohibit acts themselves not fraudulent under Section 14(e), then it would be somewhat inconsistent to conclude that Section 14(e) itself reaches only fraudulent conduct requiring scienter." The court concluded that "because the text of the first clause of Section 14(e) is devoid of any suggestion that scienter is required, . . . the first clause of Section 14(e) requires a showing of only negligence, not scienter."

Ninth Circuit: Limits the Extent to Which Courts Can Rely on Judicial Notice and the Incorporation-by-Reference Doctrine to Consider Extrinsic Documents at the Pleading Stage

On August 13, 2018, the Ninth Circuit addressed what it found to be a "concerning pattern in securities cases" in which defendants "improperly" utilize judicial notice and the incorporation-by-reference doctrine "to defeat what would otherwise constitute adequately stated claims at the pleading stage." *Khoja v. Orexigen Therapeutics*, 899 F.3d 988 (9th Cir. 2018) (Tashima, J.). The Ninth Circuit "clarif[ied] when and how the district court[s] should consider materials extraneous to the pleadings at the motion to dismiss stage."

First, the Ninth Circuit stated that "a court cannot take judicial notice of disputed facts contained in . . . public records." The Ninth Circuit reasoned that "[j]ust because [a] document itself is susceptible to judicial notice does not mean that every assertion of fact within that document is judicially noticeable for its truth."

Second, the Ninth Circuit reaffirmed that "a defendant may seek to incorporate a document into the complaint 'if the plaintiff refers extensively to the document or the document forms the basis of the plaintiff's claim.'" *Id.* (quoting *United States v. Ritchie*, 342 F.3d 903 (9th Cir. 2003)). The court stated that there are "rare instances when assessing the sufficiency of a claim requires that [a] document [not mentioned in the complaint] be reviewed, even at the pleading stage." But the Ninth Circuit instructed that "if the document merely creates a defense to the well-pled allegations in the complaint, then that document did not necessarily form the basis of the complaint." The Ninth Circuit further stated that "it is improper to assume the truth of an incorporated document if such assumptions only serve to dispute facts stated in a well-pleaded complaint."

Significant Delaware Supreme Court Decisions

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 alleging that the board of directors failed to disclose the reasons why the chairman of the board, who was also the company's founder, abstained from a board vote on the sale of the company. *Appel v. Berkman*, 180 A.3d 1055 (Del. 2018) (Strine, C. J.). 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 wrestling with whether to accept the board's recommendation."

The Delaware Supreme Court emphasized that its "decision in no way implies that the reason for a particular director's dissent or abstention 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." In the case before it, the Delaware Supreme Court determined that "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."

Corwin's Cleansing Rule Is Inapplicable If the Disclosures Omitted Material Facts That a Reasonable Stockholder Would Have Considered Important in Deciding How to Vote

On July 9, 2018, the Delaware Supreme Court reversed dismissal of a shareholder class action challenging a take-private transaction on the grounds that the disclosures omitted material information concerning a side agreement between the company's founder and the acquiror. *Morrison v. Berry*, 191 A.3d 268 (Del. 2018) (Valihura, J.). The Delaware Supreme Court held that "partial and elliptical disclosures cannot facilitate the protection of the business judgment rule under the *Corwin* doctrine," particularly in transactions involving the sale of the company.

The Delaware Supreme Court explained that the key inquiry is "whether the stockholder vote was fully informed—that is, whether the [c]ompany's disclosures apprised stockholders of all material information and did not materially mislead them." The court stated that "this materiality test does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote." Rather, "[o]mitted information is material if there is a substantial likelihood that a reasonable stockholder would have considered the omitted information important when deciding whether to tender her shares or seek appraisal." The Delaware Supreme Court cautioned that "[c]areful application of *Corwin* is important due to its potentially case-dispositive impact."

MFW's *Ab Initio* Requirement Is Satisfied if the Controller Conditions the Transaction on *MFW*'s Procedural Protections Before the Commencement of Substantive Economic Negotiations

On October 9, 2018, the Delaware Supreme Court held that *MFW* does not impose a bright-line rule requiring a controlling stockholder to condition a proposed transaction on the satisfaction of *MFW*'s two "key procedural protections" in the controller's initial offer. *Flood v. Synutra Int'l*, 195 A.3d 754 (Del. 2018) (Strine, C.J.). The court found *MFW*'s *ab initio* requirement is satisfied if the controller "conditions its bid on [these] protections at the beginning stages of the process . . . before any economic negotiations commence."

The Delaware Supreme Court further held that if the transaction satisfies the *MFW* standard, then plaintiffs can state a duty of care claim only by alleging that the independent special committee acted with gross negligence. Plaintiffs cannot plead a duty of care violation based solely on an allegedly inadequate deal price. Notably, the Delaware Supreme Court expressly overruled *MFW*'s footnote 14 to the extent it suggests that "a due care violation can be premised . . . on a court's after the fact sense that the committee should have extracted more price concessions."

Significant New York Court of Appeals Decisions

New York Court of Appeals: Three-Year Statute of Limitations Applies to Martin Act Claims

On June 12, 2018, the New York Court of Appeals (the "Court of Appeals") held that claims brought under the Martin Act, New York's blue sky law, are governed by the three-year statute of limitations set forth in New York Civil Practice Law and Rules ("CPLR") 214(2), which applies to actions "to recover upon a liability, penalty or forfeiture created or imposed by statute." *People by Schneiderman v. Credit Suisse Sec. (USA)*, 31 N.Y.3d 622 (N.Y. 2018) (DiFiore, C.J.). The Court of Appeals reversed the ruling of the Appellate Division, First Department, which held that the six-year statute of limitations set forth in CPLR 213(8) for actions "based upon fraud" applies to Martin Act claims. The Court of Appeals also found CPLR 213(1), which establishes a six-year statute of limitations for actions "for which no limitation is specifically prescribed by law," inapplicable to Martin Act claims.

The Court of Appeals explained that CPLR 214(2)'s three-year statute of limitations applies "where liability would not exist but for a statute." CPLR 214(2) does not apply to "claims which, although provided for in a statute, merely codify or implement an existing common law liability." The Court of Appeals found that "the Martin Act covers some fraudulent practices not prohibited elsewhere in statutory or common law." Consequently, the Court of Appeals held that the three-year statute of limitations set forth in CPLR 214(2) "governs Martin Act claims."

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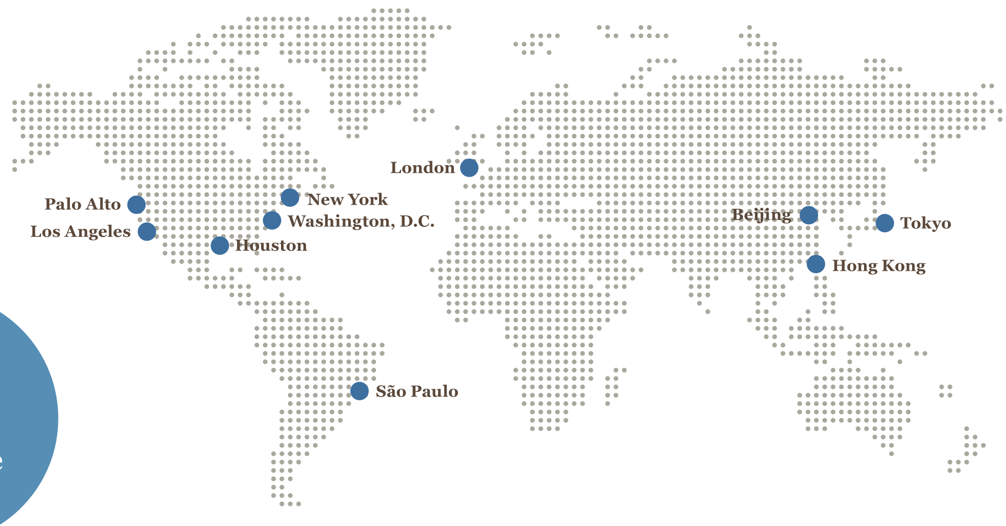

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