

# Securities Law Alert

## KEY DEVELOPMENT IN SHAREHOLDER LITIGATION

### Ninth Circuit: Writing and Disseminating Favorable Articles Is Solicitation Within the Meaning of a Securities Purchase Agreement

April 25, 2024

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On April 5, 2024, the Ninth Circuit largely reversed the dismissal of a putative securities fraud class action alleging that a company misled investors when it represented in a securities purchase agreement (“SPA”) that it had not compensated any entity to solicit its securities, when, in fact, it had retained a stock promoter to write and disseminate favorable articles about it. *In re Genius Brands Int’l*, 2024 U.S. App. LEXIS 8211 (9th Cir. 2024) (Mendoza, J.). Relying on plain meaning of solicit and *Pino v. Cardone Capital*, 55 F.4th 1253 (9th Cir. 2022), which defined “solicitation” broadly, the Ninth Circuit concluded that writing and disseminating favorable articles amounted to solicitation within the meaning of the SPA.

#### Background and Procedural History

In 2019, the company retained a stock promoter to promote its securities in exchange for shares of the company’s common stock after its shares fell below NASDAQ’s minimum trading requirement. In the following months, the stock promoter wrote and published several favorable articles about the company. The company subsequently conducted a direct offering of shares subject to an SPA, which stated that the company “has not . . . paid or agreed to pay any Person any compensation for soliciting another to purchase” its securities. After a published short seller report suggested that the company had engaged an undisclosed stock promoter, the company experienced a stock drop. Plaintiffs sued alleging that the company had fraudulently concealed its relationship with the stock promoter in violation of Section 10(b) and Rule 10b-5(b). The district court dismissed finding that plaintiffs “did not allege that anything in the [stock promoter’s] articles themselves was false or misleading and because [the stock promoter] had no duty to disclose [the company] as the source of its funding.”

#### The Stock Promoter Solicited the Purchase of the Company’s Securities

Noting that the claim did not concern the articles’ veracity or the sources of the stock promoter’s funding, the Ninth Circuit stated that the dispositive question was whether the company, by representing in its SPA that it did not hire anyone to solicit its securities, had made a misleading statement when it compensated the stock promoter to publish favorable articles about it. The Ninth Circuit explained that “[t]o determine whether a statement or

omission is misleading, our central inquiry is whether a reasonable investor would have been misled about the nature of his investment.” The Ninth Circuit stated that this is an objective inquiry in which the court must assess “whether an investor who had been reasonably diligent in reviewing the statement or omission at issue would have been misled.”

As to whether writing and disseminating favorable articles amounted to “solicitation” within the meaning of the SPA, the Ninth Circuit examined the plain meaning of “solicit” and concluded that “a person solicits the sale of a security where she petitions, entices, lures or urges another to purchase a security.” The Ninth Circuit also considered *Pino v. Cardone Capital*, where the court considered whether a company, alleged to have made misleading statements on social media to encourage people to invest in its equity funds, was a statutory seller within the meaning of Section 12(a)(2) of the Securities Act. In considering this, the court considered the definition of solicitation. Defining solicitation broadly, the Ninth Circuit applied “it to various mechanisms used to urge or persuade another to buy a particular security” and concluded that “a person can solicit a purchase, within the meaning of the Securities Act, by promoting the sale of a security in a mass communication.”

Drawing on the plain meaning of solicit and *Pino*, Ninth Circuit concluded that the stock promoter solicited the purchase of the company’s securities. The court noted that plaintiff alleged that the company retained the stock promoter “to publish and disseminate favorable information about [the company’s] shares.” Further, the court stated that the articles solicited the purchase of the securities because “they urged or lured readers into purchasing [the company’s] stock.” The court reasoned that it “plausibly follows” that the company misled investors when it represented in the SPA that it “had not paid or agreed to pay to any Person any compensation for soliciting another to purchase any other securities of the Company.” The court concluded that reasonable investor would have taken the company’s statements to mean that it had not retained any person or any entity to promote its securities, when the company had, in fact, done so.

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