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Eighth Circuit: Descriptions Such as "Unmatched Quality" Are Inactionable Puffery

On July 25, 2017, the Eighth Circuit held that statements touting a product's "unmatched speed, reliability, quality and connectivity" were too "vague and nonverifiable" to constitute actionable misstatements. *In re Stratasys Ltd. S'holder Sec. Litig.*, 2017 WL 3139438 (8th Cir. 2017) (Benton, J.).

The Eighth Circuit explained that "[n]o reasonable investor would rely on soft, puffing statements—which encompass optimistic rhetoric and promotional phrases used to champion the company but [are] devoid of any substantive information." The court further stated that "[o]ptimistic statements are not actionable if they cannot be supported by objective data or [are not] otherwise subject to verification by proof." Applying these standards, the court held the statements in question were "such obvious hyperbole that no reasonable investor would rely upon them."

The Eighth Circuit rejected plaintiffs' contention that the statements at issue were "material" because they were made in connection with "a highly anticipated product launch" and "in the context of [the company's] SEC filings." The court found the statements too "indeterminate" to be "plausibly understood as a description of historical fact."

In so holding, the Eighth Circuit distinguished the Supreme Court's decision in *Virginia Bankshares v. Sandberg*, 501 U.S. 1083 (1991). There, the Court deemed potentially actionable a representation by a bank's directors that the purpose of a planned merger was "to achieve a 'high' value, which [the directors] elsewhere described as a 'fair' price." *Virginia Bankshares*, 501 U.S. 1083. The *Virginia Bankshares* Court stated that "such conclusory terms in a commercial context are reasonably understood to rest on a factual basis," and held the directors' statement could give rise to liability under the securities laws even though it "did not express a reason in dollars and cents." The Eighth Circuit found the *Virginia Bankshares* "holding does not preclude statements, like the ones here, from being so vague" as to be inactionable. *Stratasys*, 2017 WL 3139438.

Ninth Circuit: (1) PSLRA's Safe Harbor Does Not Protect Non-Forward-Looking Representations Included in a Forward-Looking Statement, and (2) Cautionary Language Must Specifically Address the Possible Inaccuracy of Such Non-Forward-Looking Representations

On July 28, 2017, the Ninth Circuit held that "a defendant may not transform non-forward-looking statements into forward-looking statements that are protected by the safe harbor provisions of the" Private Securities Litigation Reform Act ("PSLRA") "by combining non-forward-looking statements about past or current facts with forward-looking statements about projected revenues and earnings." *In re Quality Sys. Sec. Litig.*, 2017 WL 3203558 (9th Cir. 2017) (Fletcher, J.).

If a Statement of Current Facts Includes Predictions or Projections, the PSLRA's Safe Harbor Only Applies to the Forward-Looking Aspects of That Statement

The PSLRA's safe harbor provides that "a defendant will not be liable for a false or misleading statement if it is forward-looking and *either* is accompanied by cautionary language *or* is made without actual knowledge that it is false or misleading."[1]

The Ninth Circuit explained that it has "not previously addressed … the status of mixed statements under the PSLRA." However, the court noted that "[t]he First, Second, Third, Fifth, and Seventh Circuits have all concluded that where defendants make mixed statements containing non-forward-looking statements as well as forward-looking statements, the non-forward-looking statements are not protected by the safe harbor of the PSLRA."

The Ninth Circuit stated that it "agree[d] with these circuits." The court explained that "[t]he mere fact that a statement contains some reference to a projection of future events cannot sensibly bring the statement within the safe harbor if the allegation of falsehood relates to non-forward-looking aspects of the statement." *Id.* (quoting *In re Stone & Webster Sec. Litig.*, 414 F.3d 187 (1st Cir. 2005)).

The Ninth Circuit found the First Circuit's decision in *Stone & Webster* offered a "useful example of an unprotected false or misleading non-forward-looking statement embedded in a mixed statement." The First Circuit considered the applicability of the PSLRA's safe harbor to representations that the company "has on hand and has access to sufficient sources of funds to meet its anticipated operating, dividend and capital expenditure needs." The court found "the alleged falsehood" was "not that the [c]ompany was understating its future cash needs," but rather, "in the fact that the statement claimed that the [c]ompany had access to ample cash at a time when the [c]ompany was suffering a dire cash shortage." *Stone & Webster*, 414 F.3d 187. The First Circuit held "the safe harbor of the PSLRA does not confer a *carte blanche* to lie in such representations of current fact."

Cautionary Language for a "Mixed Statement" Must Specifically Address the Possibility That the Non-Forward-Looking Portion of the Statement May Be False

The Ninth Circuit determined that in order "[f]or cautionary language accompanying a forward-looking portion of a mixed statement to be adequate under the PSLRA, that language must accurately convey appropriate, meaningful information about not only the forward-looking statement but also the non-forward-looking statement." The court found that "[w]here … forward-looking statements are accompanied by non-forward-looking statements," the possibility "that the non-forward-looking statements are, or may be, untrue is clearly an 'important factor' of which investors should be made aware."

The Ninth Circuit underscored that "[i]f the non-forward-looking statement is materially false or misleading, it is likely that no cautionary language—short of an outright

1. The Ninth Circuit noted that this issue arose in *Police Retirement System of St. Louis v. Intuitive Surgical*, 759 F.3d 1051 (9th Cir. 2014). However, the *Intuitive Surgical* court did not reach the question of the applicability of the PSLRA's safe harbor to "mixed statements" because the court found the statements at issue were forward-looking when "examined as a whole."

admission of the false or misleading nature of the non-forward-looking statement—would be 'sufficiently meaningful' to qualify the statement for the safe harbor."

Delaware Supreme Court: (1) Deal Price "Will Often Be" the Best Evidence of Fair Value in an Arm's-Length Transaction Following a "Robust" Sale Process, and (2) There Is No Basis for a "Private Equity Carve Out" to Reliance on the Merger Price

On August 1, 2017, the Delaware Supreme Court stated that "the sale value resulting from a robust market check will often be the most reliable evidence of fair value, and that second-guessing the value arrived upon by the collective views of many sophisticated parties with a real stake in the matter is hazardous." *DFC Global Corp. v. Muirfield Value Partners*, 2017 WL 3261190 (Del. 2017) (Strine, C.J.). However, the court did not adopt a presumption that the sale price is the best evidence of fair value "in certain cases involving arm's-length mergers" because it found that 8 *Del. C.* § 262(h),[2] the Delaware appraisal statute, vests the Chancery Court with discretion to determine fair value "in the first instance."

Significantly, the Delaware Supreme Court rejected two arguments frequently used to challenge reliance on the merger price. First, the court held that market forces can adequately account for regulatory risk. Second, the court found no basis for a "private equity carve out" to deference to the deal price.

No Presumption in Favor of the Deal Price Applies in Arm's-Length Mergers

The Delaware Supreme Court rejected the company's contention that the court "should establish, by judicial gloss, a presumption that in certain cases involving arm's-length mergers, the price of the transaction giving rise to appraisal rights is the best estimate of fair value." The court determined that such a presumption "has no basis in the statutory text [of 8 *Del. C.* § 262(h)], which gives the Court of Chancery … the discretion to 'determine the fair value of the shares' by taking into account 'all relevant factors.'"

In reaching its decision, the Delaware Supreme Court "adhere[d] to [its] prior ruling in" *Golden Telecom v. Global GT LP*, 11 A.3d 214 (Del. 2010). There, the court expressly declined to "adopt a standard requiring conclusive or, in the alternative, presumptive deference to the merger price in an appraisal proceeding." *Golden Telecom*, 11 A.3d 214. The *Golden Telecom* court found "Section 262(h) unambiguously calls upon the Court of Chancery to perform an *independent* evaluation of 'fair value' at the time of a transaction." The court reasoned that "[r]equiring the Court of Chancery to defer—conclusively or presumptively—to the merger price, even in the face of a pristine, unchallenged transactional process, would contravene" the statutory language and "inappropriately shift the responsibility to determine 'fair value' from the court to the private parties."

Economic Realities Suggest That the Deal Price from a "Robust" Sales Process Will Generally Provide the Best Evidence of Fair Value

The *DFC Global* court made it clear that its "refusal to craft a statutory presumption in favor of the deal price when certain conditions pertain does not in any way signal" its disagreement with the economic principles underlying such a presumption. The court stated that it had "little quibble with the economic argument that the price of a merger that results from a robust market check, against the back drop of a rich information base and a welcoming environment for potential buyers, is probative of the company's fair value."

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2. Delaware's appraisal statute provides in relevant part as follows:

> [T]he Court shall determine the fair value of the shares exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation, together with interest, if any, to be paid upon the amount determined to be the fair value. In determining such fair value, the Court shall take into account all relevant factors.

8 *Del. C.* § 262(h).

The Delaware Supreme Court explained that "[m]arket prices are typically viewed [as] superior to other valuation techniques because, unlike … a single person's discounted cash flow model, the market price should distill the collective judgment of the many based on all the publicly available information about a given company and the value of its shares." The court found that "real world transaction prices can be the most probative evidence of fair value even through appraisal's particular lens," which requires consideration of the petitioner's "pro rata share of the appraised company's value as a 'going concern.'" The court underscored that "the purpose of an appraisal is not to make sure that the petitioners get the highest conceivable value that might have been procured had every domino fallen out of the company's way." Rather, the court stated that "fair value is just that, 'fair.'"

Market Forces Adequately Take Into Account Regulatory Uncertainty

In the case before it, the Delaware Supreme Court found the Chancery Court had erred in finding the deal price "unreliable" because the company's "future performance [was] dependent upon the outcome of regulatory actions." The Delaware Supreme Court explained that publicly-traded companies in a broad range of industries "are subject to close regulation, the development of which can affect their future cash flows." The court stated that "[p]recisely because of that reality, the market's assessment of [a company's] future cash flows necessarily takes regulatory risk into account as it does with all the other reasonable uncertain factors that affect a company's future."

There Is No Basis for a "Private Equity Carve Out" to Deference to the Deal Price in Appraisal Actions

The Delaware Supreme Court held the Chancery Court had further erred by concluding that it could "not give dispositive weight to the deal price because the prevailing buyer" was a private equity firm that "required a specific rate of return on its transaction." The court found no basis in the "economic literature" or the record for the imposition of a "'private equity carve out' … in which the deal price resulting in a transaction won by a private equity buyer is not a reliable indication of fair value."

The Delaware Supreme Court explained that "all disciplined buyers, both strategic and financial, have internal rates of return that they expect in exchange for taking on the large risk of a merger, or for that matter, any sizeable investment of its capital." The court found the fact "[t]hat a buyer focuses on hitting its internal rate of return has no rational connection to whether the price it pays as a result of a competitive process is a fair one."

The Chancery Court Must Justify Its Reasons for Weighting Each Valuation Metric

In the case before the Delaware Supreme Court, the Chancery Court had "afford[ed] equal weight to the deal price, its discounted cash flow model, and its comparable companies analysis" without explaining the basis for its approach.

The Delaware Supreme Court recognized that when faced with competing valuation methods, the Chancery Court may be "tempted to … take[ ] every valuation method put in the record, give[ ] each equal weight, and then divide[ ] by the number of them."

However, the Delaware Supreme Court instructed that the Chancery Court must "explain its weighting in a manner that is grounded in the record before it" when "exercis[ing] its considerable discretion" in an appraisal action. The Delaware Supreme Court observed that "laying down … fixed rules that state how competing approaches are to be weighted is impossible." "In some cases, it may be that a single valuation metric is the most reliable evidence of fair value" while "[i]n other cases, it may be necessary to consider two or more factors." The court stated that "[w]hat is necessary in any particular case" is for the Chancery Court to set forth its rationale for the weight it accorded to each competing valuation.

Southern District of New York: A Company Has No Duty to Disclose a Dispute with a Significant Customer Until the Customer Terminates the Relationship

On August 1, 2017, the Southern District of New York held that a company had no duty to disclose a contractual pricing dispute with one of its largest customers even though it had publicly described the parties' relationship as "very, very, solid." *In re Express Scripts Holding Co. Sec. Litig.*, 2017 WL 3278930 (S.D.N.Y. 2017) (Ramos, J.). The court found dispositive the absence of any allegation of a "definitive statement" of the customer's intent to terminate the contract during the class period.

According to the complaint, "the parties had a fundamental $15 billion difference of opinion on the contract; were refusing to negotiate that gap at all; and repeatedly accused each other of acting in bad faith." Twice before the end of the class period, the customer served the company with formal notifications of breach of contract. The customer ultimately filed suit against the company for breach of contract.

Plaintiffs contended that because defendants chose to discuss the "purported strength" of the customer relationship and the parties' "allegedly productive negotiations," defendants were then "obligated to speak fully and truthfully" about all aspects of those negotiations. The court recognized that "[u]nder certain circumstances, … a company could have a duty to disclose a breach of contract that puts an important, publicly-touted business relationship at great risk." *Id.* (quoting *In re Hi-Crush Partners L.P. Sec. Litig.*, 2013 WL 6233561 (S.D.N.Y. Dec. 2, 2013)). But "[w]here an outcome is merely speculative," as in the instant action, "the duty to disclose does not attach."

The *Express Scripts* court distinguished its prior decision in *Hi-Crush*. There, a company allegedly "publicly hyped the importance of its relationship" with one of its customers even after that customer had terminated the contract. *Hi-Crush*, 2013 WL 6233561. The *Express Scripts* court explained that "*Hi-Crush* does not hold that a party has an obligation to disclose all disputes with a major customer." Rather, the *Hi-Crush* court found that "the dispute 'ripened' as to trigger a duty to disclose on the date" the customer notified the company of its termination of the agreement. *Express Scripts,* 2017 WL 3278930 (quoting *Hi-Crush*, 2013 WL 6233561).

The *Express Scripts* court emphasized that in the case before it, "the actual contractual negotiations were ongoing" during the class period "and no termination right was exercised." The court found that there was no duty to disclose "because no intent of termination was provided during the [c]lass [p]eriod." The court also rejected plaintiffs' contention that the company "should have revised its accounting treatment" of the contract at issue. The court found the complaint did not "plausibly allege that [the company] did not believe its statements regarding the useful life of the [c]ontract for accounting purposes at the time the statements were made," as required under the Second Circuit's decisions in *Fait v. Regions Financial Corp.*, 655 F.3d 105 (2d Cir. 2011) and *City of Omaha Civilian Employees' Retirement System v. CBS Corp.*, 679 F.3d 64 (2d Cir. 2012).

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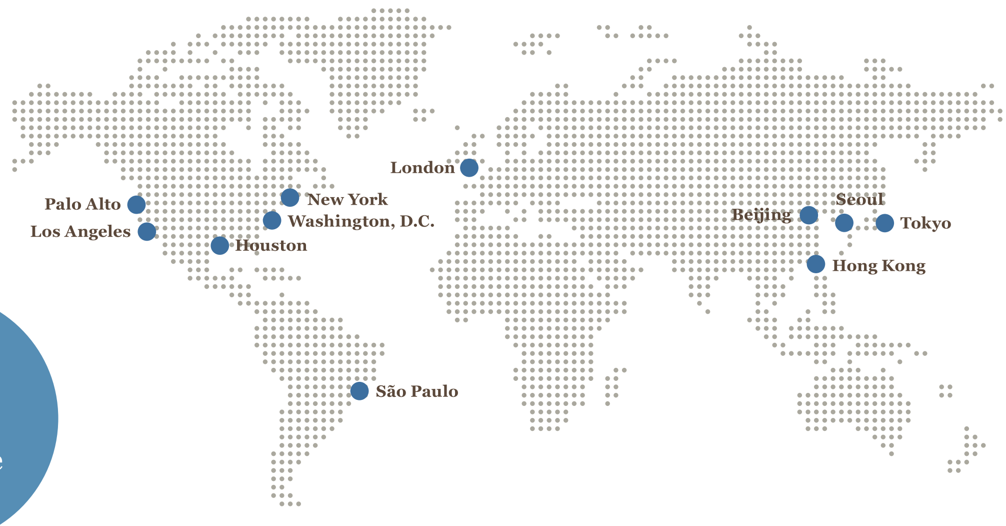

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