Simpson Thacher

# Securities Law Alert

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Simpson Thacher's "deep bench of trial and appellate lawyers" is "regularly retained to act on multibillion-dollar securities class actions and derivative suits."

*– Chambers USA*

## Eighth Circuit: No Strong Inference of Severe Recklessness Where "Confidential Former Employee" and His Sources Lacked Insight into What, If Anything, Defendant CEO Knew

On October 18, 2021, the Eighth Circuit affirmed the dismissal of a securities fraud class action alleging that a media conglomerate and certain of its executives made false or misleading statements concerning its post-merger integration with a magazine company. *City of Plantation Police Officers Pension Fund v. Meredith Corp.*, 2021 WL 4823411 (8th Cir. 2021) (Gruender, J.). The court determined that "the complaint fails to satisfy the heightened pleading standards with respect to the misrepresentation and mental-state requirements of [Section] 10(b) liability." The court further determined that, even assuming *arguendo* that the CEO's February 2019 statement that the company had "fully integrated its HR, finance, legal and IT functions" was false, a confidential former employee's allegation that he had heard otherwise did not "give rise to a strong inference of severe recklessness."

In support of its claim that the CEO's statement was a material misrepresentation, plaintiff alleged that a former employee "indicated confidentially that he had heard that legacy [acquirer] employees and legacy [target] employees operated on different finance software systems until August 2019." The court stated that "severe recklessness" is enough to establish scienter for non-forward-looking statements, but explained that a defendant is severely reckless "only if, in an extreme departure from the standards of ordinary care, he disregards a risk so obvious that he must have been aware of it." *In re K-tel Int'l Sec. Litig.*, 300 F.3d 881 (8th Cir. 2002).

The court found that nothing in the complaint suggested that either the confidential former employee or his sources had any insight into what, if anything, the CEO knew about the software the various legacy employees were using. The court also noted that the complaint did not state with particularity "facts suggesting that it would have been so obvious that two software systems were in use that it was an extreme departure from the standards of ordinary care for [the CEO] to turn a blind eye to this fact[.]" The court explained that "[t]he more plausible inference to draw from the allegations is that [the CEO] made the statement because, as is typical for an executive overseeing an ongoing corporate consolidation, he had limited information about the inner workings of the legacy firms' finance departments." The court concluded that "[b]ecause the inference of severe recklessness is not at least as compelling as any opposing inference one could draw from the facts alleged, it is not the strong inference that [Section] 10(b)'s heightened pleading standard requires."

Separately, the court determined that the various other statements at issue were "clearly either (1) statements identified as forward looking and accompanied by meaningful cautionary statements, (2) corporate puffery, or (3) forward-looking statements that the complaint's allegations do not imply by strong inference were made with actual knowledge of their falsity." The court characterized the following statements as "paradigmatic examples of the kind of vague and optimistic rhetoric that constitutes corporate puffery[,]" including: "hitting the ground running"; "implementing . . . proven strategies, standards, and discipline"; being "on track"; being "very pleased with the integration work so far"; and having an "industry-leading position[.]"

# Northern District of California: Misleading Statements and Omissions Alleged Where Due Diligence Fell Short of What an Investor Would Believe Defendants' Assurances Meant

On October 19, 2021, the Northern District of California denied dismissal of a putative securities fraud class action alleging that a pharmaceutical company and certain current or former executives made misstatements and omissions concerning the company's due diligence efforts prior to acquiring the manufacturer of a herbicide alleged to cause cancer. *Sheet Metal Workers Nat'l Pension Fund v. Bayer*, 2021 WL 4864421 (N.D. Cal. 2021) (Seeborg, J.). The court held that plaintiffs adequately pled that defendants made misleading statements and omissions concerning the acquirer's pre-acquisition due diligence efforts.

## Background

Before, during, and after the acquisition, the target faced litigation alleging that the active ingredient in its herbicide causes cancer. After the acquisition, lawsuits against the target concerning the herbicide reached trial, resulting in verdicts against it and tens of millions of dollars in damages in the first two trials. Subsequently, more lawsuits were filed and consolidated in the Northern District of California. In response to the acquirer's 2020 offer to pay up to $10.9 billion in a global settlement for current and future claims, the presiding judge indicated that he was unlikely to approve the settlement as to future claims. The instant complaint was filed soon after, asserting that defendants deceived investors about lapses in the acquirer's due diligence before pursuing the merger.

## Section 10(b) Claim Adequately Pled Where Plaintiff Alleged Assurances as to Due Diligence Were Misleading

The acquirer's CEO stated before the acquisition closed that the acquirer had "confirmed in due diligence" the deal's "significant potential for sales and cost synergies" of $1.5 billion. The CEO also stated before the closing that "the [target's] people went out of their way to provide us with transparency, data and visibility to the most critical questions we had." Plaintiffs alleged that these statements were misleading because the acquirer had not reviewed any of the target's internal documents and accepted at face value the target's characterization of its litigation risks.

The court determined that defendants' statements concerning its due diligence could have "given a reasonable investor the impression of a state of affairs that differs in a material way from the one that actually exists, namely that [the acquirer] had assessed [the target's] litigation risks, and had reviewed non-public information to inform that review." The court noted that while merely failing to conduct due diligence is a claim of mismanagement that alone is not an actionable securities fraud claim, that plaintiffs did "more than just aver that Defendants did not fully conduct due diligence; instead, they aver that Defendants assured investors about their diligence, even though their diligence was less than what an investor would believe their statement meant." The court then stated that "[d]eception concerning mismanagement is actionable under [Section] 10(b) . . . and misleading statements concerning due diligence may be actionable in securities fraud litigation[.]"

## Southern District of New York: Motive to Defraud Shown by Pointing to Concrete Benefits That Could Be Realized From the Allegedly Misleading Statements or Nondisclosures, Not "Nominal Boons"

On September 27, 2021, the Southern District of New York dismissed without prejudice a putative securities fraud class action alleging that a pharmaceutical/cannabis company, its CEO and its CFO made materially false and misleading statements to artificially inflate the company's stock price. *Kasilingam v. Tilray*, 2021 WL 4429788 (S.D.N.Y. 2021) (Crotty, J.). The court held that plaintiffs failed to adequately allege scienter through the CEO's purported motive to defraud investors, pointing to plaintiffs' failure to allege concrete benefits that the CEO could have realized from one or more of the allegedly misleading statements or nondisclosures.

### Background and Plaintiffs' Allegations

After the company's 2018 IPO, the defendant CEO and his partners had an 82% ownership stake in the company and 93% voting power over the company's management through a corporation they formed to invest in the cannabis industry. In 2019, the company executed a downstream merger[1] with the CEO's corporation (the "Share Exchange"). Plaintiffs alleged that defendants made materially false and misleading statements to inflate the company's stock price until the Share Exchange closed. Plaintiffs further alleged that the Share Exchange was part of a scheme intended to provide the CEO and his partners with: (i) ongoing voting control of the company; and (ii) a reduced tax burden if they later sold their shares. Plaintiffs also alleged that after the Share Exchange closed, the CEO engineered various company announcements prompting a stock price collapse.

### Scienter Not Adequately Alleged by Mere "Nominal Boon"

Beginning with the standard for scienter, the court explained that "[t]o survive a motion to dismiss, a plaintiff must demonstrate scienter by pleading facts (1) showing that the defendants had both motive and opportunity to commit the fraud or (2) constituting

1. A downstream merger is a merger of a parent into its subsidiary where the subsidiary survives and the parent disappears.

strong circumstantial evidence of conscious misbehavior or recklessness." *ATSI Commc'ns v. Shaar Fund*, 493 F.3d 87 (2d Cir. 2007). The court further explained that "[m]otive can be shown by pointing to the concrete benefits that could be realized from one or more of the allegedly misleading statements or nondisclosures; opportunity can be shown by alleging the means used and the likely prospect of achieving concrete benefits by the means alleged." *In re Agnico-Eagle Mines Ltd. Sec. Litig.*, 2013 WL 144041 (S.D.N.Y. Jan. 14, 2013).

Concluding that plaintiffs failed to adequately allege scienter through the CEO's purported motive to defraud investors, the court stated that "[w]hile [plaintiffs'] narrative is perhaps not implausible, it raises as many questions as it answers." The court emphasized that plaintiffs did not allege that the CEO had sold any of his own stock during the relevant period, or that he received any direct financial benefit from the alleged scheme prior to the company announcements, "which immediately, dramatically, and foreseeably tanked [the company's] stock price." The court noted plaintiffs' position was "that the plan's aim was to allow [the CEO and his partners] to offload [company] shares free of a hefty tax bill, while hoarding voting control of the company." However, the court stated that plaintiffs conceded that the CEO and his partners already controlled the company prior to the Share Exchange, and that the tax advantages the Share Exchange unlocked were shared by all the shareholders, not just the CEO and his partners.

The court then stated, "without articulating any theory for how these nominal boons would have been to [the CEO's] actual benefit after [the company's] share price foreseeably plummeted, Plaintiffs leave their motive narrative unfinished. They fail to explain how, when [the CEO] was forming his plan, there was any 'likely prospect' that the future post-collapse tax benefits would outweigh the foreseeable post-collapse loss in value of the stock he apparently intended to hold onto." The court stated that plaintiffs' "pleadings suggest that among those most harmed by the natural and intentional consequences of this purported scheme was the schemer himself." The court observed that "[w]hen the purported fraudster 'miss[es] the boat this dramatically,' or in this case, opts to go down with the ship, the fraud inference is weakened." Quoting *Ronconi v. Larkin*, 253 F.3d 423 (9th Cir. 2001).

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