Simpson Thacher

Securities Law Alert

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Simpson Thacher's securities litigation team has "a deep bench with top talent, and their young lawyers and associates provide a depth of experience."

– Chambers USA

Supreme Court: Constitutional Challenges to Agency Proceedings Can Be Brought Directly in Federal District Court

On April 14, 2023, the Supreme Court issued a unanimous opinion[1] settling a circuit split concerning whether a party to an administrative enforcement action can sue directly in federal district court to challenge the agency's constitutional authority to proceed, or whether the party must first complete the administrative process before seeking review in a federal court of appeals. *Axon Enter. v. FTC*, 2023 U.S. LEXIS 1500 (2023) (Kagan, J.). Affirming *Cochran v. SEC*, 20 F.4th 194 (5th Cir. 2021) and reversing *Axon Enterprise v. FTC*, 986 F.3d 1173 (9th Cir. 2021), the Court held that federal district courts have jurisdiction to hear lawsuits challenging the constitutionality of agency proceedings and to resolve such constitutional challenges.

1. Chief Justice Roberts and Justices Alito, Barrett, Jackson, Kavanaugh, Sotomayor and Thomas joined in the majority opinion written by Justice Kagan. Justices Gorsuch and Thomas each filed separate concurring opinions.

The *Thunder Basin* Factors Signal That District Courts Have Jurisdiction

In *Cochran*, the SEC brought an administrative enforcement action against a CPA alleging that she failed to comply with PCAOB auditing standards, while in *Axon*, the FTC brought an action against a manufacturer, alleging that its purchase of its closest competitor violated the FTC Act's ban on unfair methods of competition. *Cochran* and *Axon* both challenged the constitutionality of agency proceedings before administrative law judges ("ALJs") on the theory that the ALJs' dual-layer tenure protection unconstitutionally insulated them from presidential removal.

Justice Kagan, writing for the Court, concluded that "each of the three *Thunder Basin* factors signals that a district court has jurisdiction to adjudicate [these] sweeping constitutional claims." In *Thunder Basin Coal v. Reich*, 510 U.S. 200 (1994), the Court set forth three factors designed to determine whether a claim was "of the type" Congress intended to be reviewed within a statutory review scheme. A court should consider whether: (i) precluding district court jurisdiction "could foreclose all meaningful judicial review" of the claim; (ii) the claim is "wholly collateral to the statute's review provisions"; and (iii) the claim is "outside the agency's expertise." If the answer to all three questions is yes, it is presumed that Congress did not intend to limit jurisdiction.

As to the first factor, Justice Kagan focused on the interaction between the alleged injury and the timing of review. Justice Kagan contrasted situations where an appellate court could undo an agency action (such as revoking a fine) with situations where a party faces allegedly unconstitutional agency authority that "is impossible to remedy once the proceeding is over, which is when appellate review kicks in." The Court concluded that "[j]udicial review of [these] structural constitutional claims would come too late to be meaningful."

As to the second factor, the Court concluded that the claims "have nothing to do with the enforcement-related matters the Commissions 'regularly adjudicate'—and nothing to do with those they would adjudicate in assessing the charges against [the CPA and the manufacturer]." Therefore, the claims were "collateral" to any orders or rules from which review might be sought.

Regarding the third factor, the Court determined that the parties' claims were outside the agencies' expertise. The Court noted that dual-layer tenure protection claims "raise standard questions of administrative and constitutional law, detached from considerations of agency policy." The Court stated that the manufacturer's separate constitutional challenge to the combination of prosecutorial and adjudicative functions was "distant from the FTC's competence and expertise" regarding competition policy. Thus, the claims were not "of the type" that the statutory review schemes reach and a district court could review them.

The Court's decision could open the district courts to a wave of new constitutional challenges to administrative adjudications and stall government enforcement actions.

Fourth Circuit: Affirms Dismissal of Securities Fraud Class Action Alleging Misrepresentations or Omissions Regarding a Clinical Trial Drug

On March 2, 2023, the Fourth Circuit affirmed the dismissal of a putative securities fraud class action alleging that a drug company, its president/CEO and its CFO made material misrepresentations or omissions concerning a new drug, in violation of Section 10(b) of the Exchange Act and Rule 10b-5. *Emps. Ret. Sys. v. MacroGenics, 61 F.4th 369 (4th Cir. 2023) (Gregory, J.)*. The court held that plaintiffs failed to sufficiently allege any actionable misrepresentations or omissions that would give rise to a duty to disclose.

Background and Procedural History

Prior to this litigation, the company developed a new drug and began a Phase 3 clinical trial. The trial required two primary "endpoints" (or pre-determined key measures of the study's success). The first endpoint was prolongation of the progression free survival ("PFS"), which measures the length of time after a patient receives a particular trial treatment where the disease does not progress. The second endpoint was prolongation of trial patients' overall survival ("OS"), which measures how long a patient survives regardless of whether their disease progresses.

In February 2019, the company issued a press release announcing that in October 2018 the clinical trial reached its first PFS-related endpoint and included the CEO's statement that the new drug had "demonstrated a superior outcome in a head-to-head study" against the standard-of-care drug. In May 2019, the company issued a press release disclosing a preliminary positive trend for OS and that the company expected such positive trend would continue, but also that subsequent results could fluctuate as additional events accrue.

In June 2019, the company presented data from the October 2018 period at a scientific conference, including a graph that provided a visual depiction of the interim OS data. The company's stock price fell nearly 22% after the June 2019 conference and after an analyst described the OS data as "underwhelming."

Plaintiffs commenced a suit, asserting violations of Section 10(b) and Rule 10b-5 and Sections 11 and 12(a)(2) of the Securities Act. Plaintiffs alleged that the graph presented at the June 2019 conference was available to, and should have been disclosed by, the company earlier and showed that the OS data was not on track to generate a statistically significant OS result when the data fully matured.

Defendants Had No Duty to Disclose the Interim OS Results

Plaintiffs argued that defendants' prior statements concerning the PFS results put the trial's interim OS results "in play" and triggered an ongoing duty of the company to disclose at an earlier time the data the company eventually disclosed at the June 2019 scientific conference. The Fourth Circuit determined that, while a company must disclose information when "necessary to make statements made, in light of the circumstances under which they were made, not misleading," *Matrixx Initiatives v. Siracusano*, 563 U.S. 27 (2011), defendants "did not have a duty to disclose the interim OS results because their written and oral statements prior to the May [2019] Press Release, did not 'speak' about the OS data." Instead, the company's statements had "primarily focused" on the clinical trial's success in reaching the PFS endpoint and "[a]ny language concerning the OS endpoint was preliminary and focused on the ongoing nature of the OS data's accumulation." The court further noted that the February 2019 press release "explicitly stated" that follow-up to determine the impact of OS was "ongoing." Reading this statement as a whole, "clearly indicated to all reasonable investors that, although the PFS results experienced success, one could not (and should not) draw a conclusion on the OS data's performance as [the company] continued to track OS performance."

The court also rejected plaintiffs' contention that defendants had a duty to disclose the graph as a result of their oral communication of the OS interim data earlier than the June 2019 conference. The court explained that plaintiffs did not challenge the OS interim data itself, but rather defendants' interpretation of it. While plaintiffs asserted that the graph was inconsistent with defendants' positive statements, the court found that defendants accurately interpreted the OS interim data and that the graph was not in fact contrary to defendants' prior positive statements. The court further determined that "[b]ecause Defendants' positive OS-related statements were not false or misleading, or an omission of the interim OS data, we cannot conclude that they had a duty to disclose the graph itself" prior to June 2019.

Seventh Circuit: Specifies the Correct Pleading Standard for a Breach of the Duty of Prudence Under ERISA in the Wake of *Hughes*

On March 23, 2023, on remand from the Supreme Court's decision last year in *Hughes v. Northwestern*, 142 S.Ct. 737 (2022),[2] the Seventh Circuit reexamined plaintiffs' allegations that the defendant plan fiduciary breached its duty of prudence under ERISA. [*Hughes v. Northwestern*, 63 F.4th 615 (7th Cir. 2023) (Brennan, J.)]. Under the Supreme Court's decision in *Hughes*, to plead a breach of the duty of prudence under ERISA, a plaintiff must plausibly allege fiduciary decisions outside a range of reasonableness. The plan fiduciary argued that plaintiffs must plead that a prudent alternative action was "actually available." Rejecting this, the Seventh Circuit held that "[a]t the pleadings stage, a plaintiff must provide enough facts to show that a prudent alternative action was plausibly available, rather than actually available."

The Seventh Circuit observed that *Hughes* "offers some guidance but stops short of pronouncing a concrete standard" for a breach of the duty of prudence under ERISA. The court noted that *Hughes* directed it "to reevaluate plaintiffs' allegations based on the duty of prudence articulated in *Tibble v. Edison International*, 575 U.S. 523 (2015), applying the pleading standard discussed in *Ashcroft v. Iqbal*, 556 U.S. 662 (2009), and *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007)." *Iqbal* and *Twombly* establish that an obvious alternative explanation for a defendant's conduct that precludes liability can undermine the claim's plausibility. The court stated that "[o]nly *obvious* alternative explanations must be overcome at the pleadings stage, and only by a plausible showing that such alternative explanations may not account for the defendant's conduct." The court then concluded that "whether a claim survives dismissal necessarily depends on the strength or obviousness of the alternative explanation that the defendant provides."

Rejecting the plan fiduciary's standard, the court found that it would go beyond the plausibility standard of *Iqbal* and *Twombly*. The court explained that "[t]o the extent that the prudent course of action was unavailable, that will foreclose the claim. But if a course of action was only possibly unavailable, further factual development on the pleadings will be necessary to resolve the claim on that explanation."

In applying this standard, the Seventh Circuit concluded that plaintiffs plausibly alleged that the plan fiduciary violated its duty of prudence by incurring unreasonable recordkeeping fees. The court noted that plaintiffs alleged that recordkeeping services are fungible, that the market for such services is highly competitive and that the fees were excessive relative to the recordkeeping services rendered.

The Seventh Circuit also denied dismissal of plaintiffs' second claim that the plan fiduciary failed to swap out retail shares for identical, lower-cost institutional shares of the same funds. The court noted plaintiffs' allegations that the plan fiduciary retained more expensive retail-class shares of 129 mutual funds, when less expensive but otherwise

2. Please click here to read our discussion of *Hughes*.

identical institutional-class shares were available to the plans.

In their third claim, plaintiffs alleged that the plan fiduciary's retention of multiple duplicative funds had led to investor confusion. The court affirmed dismissal of this aspect of the third claim because plaintiffs failed to identify how plaintiffs were confused and personally injured by the multiplicity of funds. The court stated that "[u]nspecific allegations that a fiduciary provided too many funds, without more, do not state a claim for breach of the duty of prudence." However, the court remanded this claim to the extent that it concerned plaintiffs' theory that if the plan fiduciary had consolidated the funds into a single investment option, it would have led to lower-cost investments, noting that plaintiffs' allegations suggested that a 2016 restructuring had accomplished that.

Eastern District of Virginia: Plaintiffs Failed to Allege That a Parent Company Was the Maker of Company Name-Change Statements But Given Leave to Amend

On March 14, 2023, the Eastern District of Virginia dismissed without prejudice a securities fraud class action alleging: (i) that the U.S. subsidiary of a global auto manufacturer, the subsidiary's CEO/President, and its Head of Product and Technology Communications violated Section 10(b) and Rule 10b-5 by making false and misleading statements that it would be changing its name; and (ii) control person liability against the parent company. *In re Volkswagen AG Sec. Litig.*, 2023 U.S. Dist. LEXIS 43031 (E.D. Va. 2023) (Alston, J.).

Background

The parent company is a global auto manufacturer that sells gas-powered vehicles in the U.S. through its wholly owned subsidiary and has been expanding into electric vehicles. On March 30, 2021, the subsidiary published a press release announcing that in May it would be changing its name to emphasize its electric vehicle products.[3] Reporters confirmed the authenticity of the name change with the parent company. The March 30 press release remained on the subsidiary's website until after market close on March 30, 2021 and was then removed. Subsequently, the *Wall Street Journal* reported that the parent company intended the name change to be "an April Fools' gag" and that it was intended "to get people talking." Plaintiffs allege that the press releases led to an increase in the parent company's American Depositary Share price, which fell following the name change retraction.

The Parent Company's Liability Was Not Established for Purposes of Rule 10b-5

Defendants argued that plaintiffs did not allege any statement by the parent company and that any subsidiary statement was not legally attributable to the parent company under Rule 10b-5. The Supreme Court determined in *Janus Capital v. First Derivative Traders*, 564 U.S. 135 (2011) that "for purposes of Rule 10b-5, the maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it." The district court explained that the Supreme Court "held that a *Janus* defense is available in a private plaintiff Rule 10b-5 case even for the parent of a wholly owned subsidiary insofar as the entities retain independent boards and the parent is

3. The day before, on March 29, 2021, the subsidiary published on its website a draft press release dated April 29, 2021 announcing that it would be changing its name beginning in May. Various news outlets reported on the name change even though the draft only remained on the website for approximately one hour.

acting in a 'speechwriter' assisting capacity rather than as a 'speaker who takes credit—or blame—for what is ultimately said.'"

The court noted plaintiffs' allegations that the parent company owns 100% of the subsidiary, appoints all of the subsidiary's directors and executive officers, directly monitors its day-to-day operations, financial reporting and accounting, and participates in its public statement preparation and dissemination. Plaintiffs alleged more specifically that a parent company official told the *Wall Street Journal* that, "There will be no name change," in response to an inquiry, which the court stated "further suggest[ed the parent company's] role as the chief speaker in these circumstances." However, the court determined that plaintiffs failed to allege with particularity that the parent company "provided final approval over the press release and its details." Citing *Noto v. 22nd Century Grp.*, 35 F.4th 95 (2d Cir. 2022), the court concluded that "[m]erely alleging a daily monitoring function and the participation in the preparation of public statements does not allow this Court to infer that [the parent company] 'collaborated with the authors to such an extent that they controlled the press release's publication.'"[4] The court held that plaintiffs failed to allege that the subsidiary's executive defendants and the subsidiary "lacked final control over the press release's contents or did not make the ultimate decision as to what specific information to include." (quoting *Noto*, 35 F.4th at 104).

The court gave plaintiffs leave to amend their allegations finding plaintiffs' claim to not be implausible as a matter of law. On March 28, 2023, plaintiffs filed a motion for leave to amend and a proposed second amended complaint, alleging that on March 29, 2021, the parent company also published the draft press release on its own global media website and that this website explicitly attributed the statements in this draft press release to the parent company. The court has yet to rule on plaintiffs' motion.

4. Please click here to read our discussion of *Noto*.

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