Simpson Thacher

# Securities Law Alert

## In This Edition:



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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*

## Supreme Court: Grants Certiorari to Determine Whether Purchasing Shares in a Direct Listing Creates Standing Under the Securities Act

On December 13, 2022, the Supreme Court granted certiorari to consider whether Sections 11 and 12(a) of the Securities Act require a plaintiff who purchased shares through a direct listing to plead and prove that he bought shares registered under a specific allegedly misleading registration statement. *Slack Techs. v. Pirani*, No. 22-200. Petitioners (defendants below) are appealing a 2021 Ninth Circuit decision interpreting the "such security" language in Section 11[1] and Section 12(a)[2] to mean any share, registered or unregistered, and holding that plaintiff need not prove that he bought registered shares. *Pirani v. Slack Techs.*, 13 F.4th 940 (9th Cir. 2021).[3]

Petitioners claimed that the Ninth Circuit's reading threatens to dramatically expand liability under the Securities Act, will lead to forum shopping, and departs from well-established law. Petitioners noted that in the past, "seven other courts of appeals had uniformly held that 'such security' means a share registered under the registration statement challenged by the plaintiff as misleading." They argued against the Ninth

1. Section 11 of the Securities Act provides, in relevant part: "In case any part of the registration statement . . . contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security . . . may, either at law or in equity, in any court of competent jurisdiction, sue . . . ." 15 U.S.C. § 77k(a).

2. Section 12(a) provides, in relevant part: "Any person who . . . offers or sells a security . . . by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading . . . and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable, subject to subsection (b), to the person purchasing such security from him, who may sue . . . to recover the consideration paid for such security . . . ." 15 U.S.C. § 77*l*(a).

3. Please click here to read our discussion of the Ninth Circuit's decision in *Pirani*.

Circuit's reliance on policy concerns to expand the meaning of "such security" to include unregistered shares and claimed that departing "from the settled understanding of Section 11 is irreconcilable with numerous other court of appeals decisions."

Petitioners further warned that the Ninth Circuit's rule would apply not only to direct listings, but also to traditional IPOs. Petitioners explained that six months after a typical IPO the lockup expires, allowing unregistered shares to be sold on an exchange. Petitioners point out that under the approach adopted by other courts of appeal, the expiration of the lockup generally cuts off Section 11 liability.[4] However, petitioners claimed that under the Ninth Circuit's rule, any shareholder would have standing to sue under Section 11 until the statute of limitations expires.

By contrast, respondent claimed that the Ninth Circuit's decision does not conflict with other circuit courts' decisions. Although other circuits have found that "to have standing under Section 11 purchasers must 'trace' their securities to a particular registration statement," they have done so in the context where there were multiple registration statements. Brief for Respondent, *Slack Techs. v. Pirani* (No. 22-200). Respondent argued that the "judge-made tracing requirement made sense in those instances" because to have standing, in the case of more than one registration statement, purchasers needed to trace their securities back to the registration statement with the alleged misstatement or omission. By contrast in this case respondent noted there was only one registration statement and, therefore, no chance that purchasers bought shares based on a registration statement that did not contain the alleged misrepresentations or omissions.

Respondent also argued that the Ninth Circuit properly considered the policy and legislative history underlying the statute because Section 11's reference to "such security" is unclear on its face. Further, claiming that petitioners overstate the consequences and reach of the Ninth Circuit's decision, respondent argued that the holding is limited to direct listings and only those instances where registered and unregistered shares are simultaneously sold to the public under a single registration statement. Respondent claimed that the Ninth Circuit observed the difference between a traditional IPO with its lockup period and a direct listing where all of the shares are released at the same time.

The Supreme Court will hear and rule on *Slack Techs. v. Pirani* later this term; a date for oral argument has not yet been set.

## Western District of New York: Denies Dismissal of Class Action Claiming That a Company and Two Executives Hid an SEC Investigation

On January 6, 2023, the Western District of New York denied dismissal of a putative securities fraud class action against a biotechnology company and two of its executives alleging that they made materially false or misleading statements in violation of Rule 10b-5(b) in various SEC filings,

4. As petitioners stated in their petition for a writ of certiorari, the expiration of the lockup, which causes a mix of unregistered and registered shares to be available for trading on an exchange, "cuts off Section 11 liability by precluding post-lockup buyers from proving that they bought registered shares."

which disclosed issues with the company's accounting practices but failed to mention an ongoing SEC investigation into purported material weaknesses in the company's internal accounting practices. *Noto v. 22nd Century Grp.*, 2023 WL 122305 (W.D.N.Y. 2023) (Sinatra, J.). The court held that based on defendants' motive and opportunity to defraud, plaintiffs sufficiently plead scienter against defendants with respect to some of the allegedly false or misleading SEC filings but not others.

## Procedural History

After the district court initially dismissed the class action complaint, the Second Circuit vacated the lower court's dismissal of plaintiffs' material misrepresentation claims under 10b-5(b), "holding that Defendants had a duty to disclose the SEC investigation because they addressed their accounting weaknesses in their 10-Ks and 10-Qs and, therefore, disclosing the SEC Investigation was necessary to tell the whole truth." *Noto v. 22nd Century Grp.*, 35 F.4th 95 (2d Cir. 2022).[5] The Second Circuit concluded that "the complaint adequately alleged that defendants violated Rule 10b-5(b) both by first omitting mention of the SEC investigation and then by affirmatively denying its existence." After remand, defendants sought dismissal, in part, for failure to allege scienter.

## Alleged Misrepresentations Could Have Been Motivated By a Desire to Bolster Capital Gained From Specific Stock Offerings

The court held that plaintiffs alleged sufficient facts to meet the scienter requirement for their 10b-5(b) claims. Citing *Tellabs v. Makor Issues & Rights*, 551 U.S. 308 (2007), the court stated that the issue is "whether all of the facts alleged, taken collectively, give rise to a strong inference of scienter . . . ." The court explained that "[t]o meet this standard, a plaintiff may allege facts (1) showing that the defendants had both motive and opportunity to commit the fraud or (2) constituting strong circumstantial evidence of conscious misbehavior or recklessness." *ASTI Commc'ns v. Shaar Fund*, 493 F.3d 87 (2d Cir. 2007).

More specifically, "[a]s to motive, a plaintiff must allege concrete benefits that could be realized by one or more of the false statements and wrongful nondisclosure alleged." *Shields v. Citytrust Bancorp*, 25 F.3d 1124 (2d Cir. 1994). And as to opportunity under *Shields*, "a plaintiff must allege the means and likely prospect of achieving concrete benefits by the means alleged." The court continued that under *In re Time Warner Securities Litigation*, 9 F.3d 259 (2d Cir. 1993), "potential increases in raised revenue from specific stock offerings establishes a concrete benefit sufficient to establish motive."

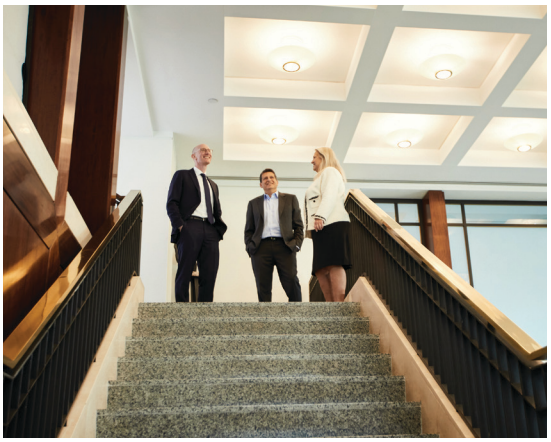
The court determined that plaintiffs alleged sufficient facts indicating that defendants had motive and opportunity to commit fraud with respect to some of the SEC filings.[6] During the period in question, the company executed multiple stock offerings, the last of which was on October 19, 2016. The court concluded that "[a]lleged misrepresentations *before* this final stock offering could have been motivated by a desire to bolster capital gained from the stock offering." By contrast, the alleged misrepresentations *after* that date could not actually affect any specific stock offerings, meaning that they could not have been motivated by a desire to bolster nonexistent future stock offerings. The court concluded that, while defendants were authorized to raise more capital until January 2020, a general authorization to raise more capital (as opposed to a specific stock offering) did not rise to the level of a concrete benefit sufficient to establish motive.

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

6. Specifically, the company's 2015 10-K, Q1 2016 10-Q, and Q2 2016 10-Q filings.

## Court of Chancery of Delaware: Denying Dismissal, Court Could Not Conclude That De-SPAC Merger Was the Product of Fair Dealing

On January 4, 2023, the Court of Chancery of Delaware denied dismissal of a putative class action alleging breach of fiduciary duty claims against the sponsor and directors of a SPAC who allegedly undertook a value destructive merger and impaired the public stockholders' ability to decide whether to redeem or to invest in the post-merger company. *Delman v. GigAcquisitions3*, 2023 WL 29325 (Del. Ch. 2023) (Will, V.C.). The court determined that it could not conclude that the de-SPAC merger was the product of fair dealing because plaintiff sufficiently pleaded that the proxy contained material misstatements and omitted material, reasonably available information.



Citing *In re MultiPlan Shareholders Litigation*, 268 A.3d 784 (Del. Ch. 2022)[7] where Vice Chancellor Will first applied the entire fairness standard in the SPAC context, the court determined that entire fairness applied here "due to inherent conflicts between the SPAC's fiduciaries and public stockholders in the context of a value-decreasing transaction." The essence of the alleged conflicts was that defendants undertook a value-decreasing transaction to obtain "colossal" returns on the sponsor's investment although the public stockholders would have been better served by liquidation. Defendants also allegedly provided inadequate disclosures to discourage redemptions and ensure greater deal certainty.

The court explained that compliance with the duty of disclosure is included within the fair dealing facet of the fairness test. *Weinberger v. UOP*, 457 A.2d 701 (Del. 1983). The court rejected defendants' contention that the proxy contained all material information. The court stated that the complaint provided "some facts" that the public stockholders' redemption decisions were compromised because defendants failed to disclose the cash per share that the SPAC would invest in the combined company, and made an incomplete disclosure of the value that the SPAC and its non-redeeming stockholders could expect to receive in exchange. The court noted that "[b]oth pieces of information would be essential to a stockholder deciding whether it was preferable to redeem her funds from the trust or to invest them in [the combined company]."

The court pointed out that if non-redeeming stockholders were exchanging SPAC shares worth $10 each, "they could reasonably expect to receive equivalent value in return." However, plaintiff alleged that net cash per share to be invested in the combined company was approximately $5.25 per share at the time the proxy was filed after accounting for "considerable dilution."[8] The court reasoned that if the SPAC had less than $6 per share to contribute to the merger, the proxy's statement that its shares were worth $10 each was false or at least materially misleading. The court concluded that "[b]ecause the Proxy allegedly misstated and obfuscated the net cash—and thus the value—underlying [the SPAC's] shares, public stockholders could not make an informed choice about whether to redeem or invest."

Separately, as a second category of disclosure violations, plaintiff alleged that defendants overstated the value of the target. Noting that this value would be highly relevant to the public stockholders' investment decisions, the court concluded that the target's "lofty projections were not counterbalanced by

7. Please click here to read our discussion of the Court of Chancery's decision in *MultiPlan*.

8. To determine net cash per share, the court subtracted the costs plaintiff alleged from the SPAC's total cash (*i.e.*, the funds in the trust account plus certain PIPE funds), and divided that figure by the number of pre-merger shares. The costs plaintiff alleged included, among other things, transaction costs of approximately $40 million and the market value of public warrants totaling approximately $38 million.

impartial information." The court "inferred that the defendants knew (and should have disclosed) or should have known (but failed to investigate)" that the target's production would be difficult to scale as predicted. Therefore, the court concluded that it was reasonably conceivable that the board deprived the public stockholders of an accurate portrayal of the target's financial health, and consequently the public stockholders could not fairly decide whether it was preferable to redeem or invest.

## District of Columbia: SEC Seeks Names of Law Firm Clients Impacted by a 2020 Cyberattack

On January 10, 2023, the SEC filed a request seeking a court order that would force a multinational law firm based in Washington, D.C. to reveal the names of its public company clients that were impacted by a 2020 cyberattack. Memorandum of Applicant, *SEC v. Covington & Burling*, No. 1:23-mc-00002 (D.D.C. 2023). The cyberattack affected 298 of the firm's clients, although the firm has claimed that based on its review only seven of those clients had material, nonpublic information affected by the attack. The SEC is seeking to enforce its March 2022 administrative subpoena demanding the firm disclose the names of the 298 clients impacted by the attack.

The SEC is seeking the client names as part of an investigation into "whether any persons or entities involved in or impacted by the Cyberattack have been or are engaging in violations of the federal securities laws." The SEC has explained that it seeks information from public companies victimized by cyberattacks for various reasons, including to identify potential illegal trading either based on information gathered during the attack or on the fact of the attack itself and to determine if affected companies have made all required investor disclosures concerning any material cybersecurity events.

The SEC claimed that the identity of the firm's impacted clients is not protected by the work product doctrine, because the firm compiled the list with the business intention of reaching out to clients in the wake of the cyberattack, not in anticipation of litigation. The SEC also argued that compliance with the subpoena would not violate D.C. Rule of Professional Conduct 1.6(a)(1), which generally prevents a lawyer from revealing a client confidence or secret, because that rule is subject to Rule 1.6(e)(2)(a), which "permits the lawyer to reveal client confidences or secrets when required by law or court order."

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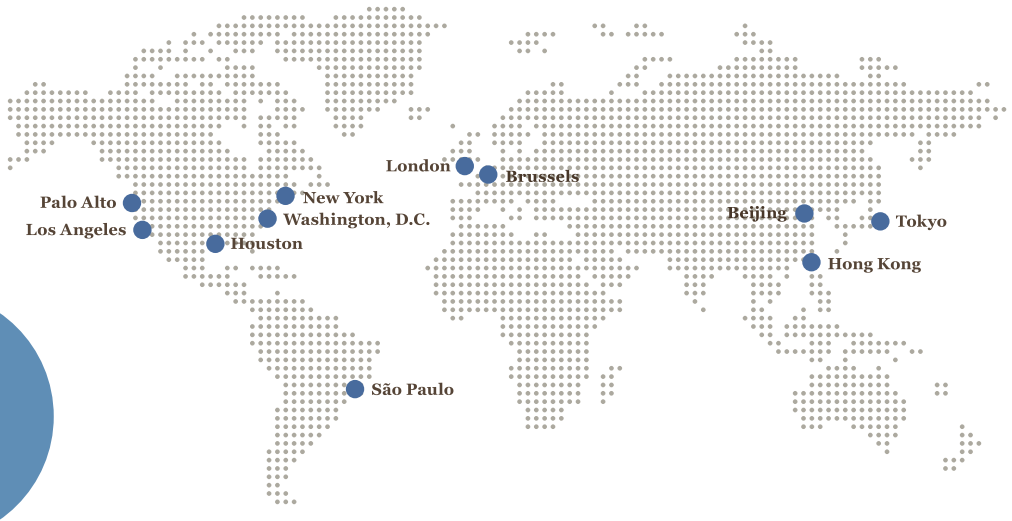


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