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Spotlight

The Justices' Securities Rulings, Dismissals That Defined '24

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Key Points

- In 2024, securities litigation remained consistent with historical averages, with a slight increase in core filings and cases related to COVID-19 and artificial intelligence.
- The U.S. Supreme Court had an unusually high number of securities cases on its docket in 2024, but notably dismissed two of these cases after oral arguments, leaving significant issues unresolved.
- The Supreme Court also made impactful rulings, such as in *Macquarie Infrastructure Corp. v. Moab Partners LP*, clarifying that pure omissions are not actionable under Rule 10b-5(b), and in *SEC v. Jarkesy*, ruling that the SEC cannot seek civil penalties in its administrative courts.
- Supreme Court precedents, particularly the 2021 *Goldman Sachs* decision, have increasingly influenced class certification denials, with courts applying these rulings to challenge the presumption of classwide investor reliance.

In 2024, securities litigation remained active with filing trends in line with historic averages. What made this year somewhat different was the U.S. Supreme Court had four securities cases on its docket. What was even more unusual is that the Supreme Court then dropped two of those cases from its docket after oral argument.

The Supreme Court's rulings in securities litigation can have a significant impact on developments and trends as illustrated by the increasing success that defendants had in 2024 with price impact arguments based on recent Supreme Court precedent. The justices' decision not to weigh in on recurring and important issues relating to the pleading requirements of the Private Securities Litigation Reform Act may be just as impactful, if not more so, as discussed below.

Securities litigation in 2024 was on pace with historic averages.

Since the PSLRA was enacted nearly 30 years ago, just over 200 securities class actions have been filed each year on average.[1] Based on midyear estimates from Cornerstone Research, filings in 2024 were trending close to that historical average.[2]

[1] *See* Cornerstone Research Cornerstone Research, Securities Class Action Filings 2024 Mid-Year Assessment (July 31, 2024) at 7.

[2] Cornerstone Mid-Year Assessment.

Of the suits filed to date, so-called core filings — those defined as not involving allegations challenging merger transactions — were up slightly year-over-year. The likelihood of a company traded on a U.S. exchange being sued this year is approximately 3.9%, slightly above the historic average.[3]

Securities class actions predicated on issues relating to COVID-19 increased significantly, with seven filed in the first half of 2024.[4] The number of suits against companies involving artificial intelligence also increased this year,[5] which likely tracks with an increase in the number of public companies involved in the AI space.

Securities class actions involving special-purpose acquisition companies continued a downward trend, as with actions challenging merger transactions.[6] These declines may be attributable to a decline in SPAC and de-SPAC transactions, as well as general malaise in the capital markets during 2024.

The Supreme Court considered four securities cases in 2024.

In calendar year 2024, the Supreme Court had four securities cases on its docket, an unusually high number when compared to prior years. That activity underscores that what happens at the Supreme Court inevitably affects filing activity and how lower courts adjudicate securities class actions.

What the Supreme Court refrains from doing may be equally impactful. After oral arguments, the Supreme Court issued orders dismissing two of those cases from its docket, letting purported circuit splits persist. A brief description of each case follows.

Half-Truths And Known Trends

On April 12, the Supreme Court unanimously reversed and vacated the U.S. Court of Appeals for the Second Circuit's decision in *Macquarie Infrastructure Corp. v. Moab Partners LP*.[7]

In *Macquarie*, the Supreme Court was asked to determine whether an alleged failure to make a disclosure pursuant to Item 303 of U.S. Securities and Exchange Commission Regulation S-K can serve as the basis for a securities fraud claim under Section 10(b) of the Exchange Act, even in the absence of an otherwise misleading statement.

Item 303 requires an issuer to disclose "any known trends or uncertainties that have had or that are reasonably likely to have a material favorable or unfavorable impact" on the issuer's "financial condition or results of operation[s]."[8] The plaintiffs alleged that Macquarie had made material misstatements and omissions concerning the potential impact of new international fuel regulations on the company's fuel storage business.

The Supreme Court held that "[p]ure omissions are not actionable under Rule 10b-5(b)." The court explained that its decision "confirms that the failure to disclose information required by Item 303 can support a Rule 10b-5(b) claim only if the omission renders affirmative statements made misleading."[9]

Pure omissions, including omissions of information required to be disclosed by Item 303, are not actionable. Rather, Rule 10b-5(b) only "requires disclosure of information necessary to ensure that statements already made are clear and complete." This rule, therefore, proscribes so-called half-truths.[10]

The Supreme Court's decision in *Macquarie* resolved a circuit split in favor of the rule that had been followed by the U.S. Courts of Appeals for the Third, Ninth and Eleventh Circuits, which had held that Item 303 does not create an independent duty to disclose under Section 10(b). The Second Circuit rule that was reversed had allowed lawsuits premised on mere alleged violations of Item 303.

Pursuing Civil Claims in Federal Courts Rather Than SEC's Administrative Courts

On June 27, the Supreme Court issued a landmark ruling in *SEC v. Jarkesy*, holding that the commission can no longer seek civil penalties in the SEC's administrative courts: "[T]he Seventh Amendment entitles a defendant to a jury trial when the SEC seeks civil penalties against him for securities fraud."[11]

The *Jarkesy* decision does not bear directly on the scope of private securities litigation, but is nevertheless relevant to the subject given the Supreme Court's long-standing view that private litigation is a necessary supplement to action by the SEC.[12]

[3] *Id.* at 5.
[4] *Id.*
[5] *Id.*
[6] *Id.*
[7] 601 U.S. 257 (2024).
[8] *Id.* at 260.
[9] *Id.* at 265.
[10] *Id.*
[11] 144 S. Ct. 2117, 2127 (2024).
[12] *Tellabs, Inc. v. Makor Issues & Rts., Ltd.*, 551 U.S. 308, 324 (2007).

In a 6-3 opinion, the justices explained that the Seventh Amendment guarantees "the right of trial by jury" in suits for common law. As applied to statutory claims like those asserted by the SEC, a right to a jury trial exists so long as the claim is not based in "equity or admiralty jurisdiction."

The determination of whether a claim is legal or equitable requires looking at the type of remedy sought. The opinion reasoned that money damages are a legal remedy implicating the Seventh Amendment jury right whenever they are meant to punish or deter a defendant, as contrasted from money damages that only seek to "restore the status quo," an equitable remedy.

Jarkesy stripped the SEC of one of its most powerful and frequently used tools to enforce federal securities laws. Going forward, the SEC will no longer be able to use its own in-house courts to pursue civil penalties for securities fraud violations.

Instead, the SEC will need to bring cases in federal courts. Alternatively, the SEC may need to be more selective regarding what claims to pursue in federal court, while continuing to prosecute claims seeking equitable remedies — such as injunctive relief — in its administrative courts.

Expert Opinions and Internal Reports

In *Nvidia Corp. v. E. Ohman J:or Fonder AB*, the Supreme Court was asked to resolve two related questions: (1) whether plaintiffs seeking to allege scienter under the PSLRA based on allegations about internal company documents must plead with particularity the contents of those documents; and (2) whether plaintiffs can satisfy the PSLRA's falsity requirement by relying on an expert opinion to substitute for particularized allegations of fact.

In the case under review, a divided U.S. Court of Appeals for the Ninth Circuit panel ruled that plaintiffs can satisfy the PSLRA's heightened pleading standard by relying on an expert report and without having to plead the details of internal reports cited in a complaint.[13] The expert report at issue in the *Nvidia* case relied on generic market data and made a series of estimates that the Ninth Circuit credited for the purposes of finding falsity and scienter sufficiently pled.[14]

Nvidia and a host of *amici* urged the Supreme Court to reverse, arguing that the Ninth Circuit's approach provides the plaintiffs' bar a road map to circumvent the PSLRA's demanding standards for pleading falsity and scienter.

The Ninth Circuit's endorsement of expert reports at the pleading stage conflicts with the approach taken by the U.S. Courts of Appeal for the Second and Fifth Circuits. Expert opinions "cannot substitute for facts under the PSLRA" unless the opinion "was based on particularized facts sufficient to state a claim for fraud," according to the Second Circuit's 2022 decision in *Arkansas Public Employees Retirement System v. Bristol-Myers Squibb Co*.[15]

During oral argument, the justices expressed reservations about adopting any bright-line rules, and even voiced doubts about their decision to review the case. Several justices noted that it appeared that Nvidia was seeking some form of "error correction," an apparent retreat from arguments in its briefing advocating for a categorical rule that prohibits the use of experts where they offer opinions rather than the type of particularized facts of fraud required by the PSLRA.

Not surprisingly, then, the Supreme Court issued an order on Dec. 11 dismissing the appeal as improvidently granted.

The Supreme Court's decision not to decide *Nvidia* on the merits will leave a purported circuit split in place. It is likely that plaintiffs will feel emboldened to rely on more expert reports, and that there will be increased litigation over whether, when and how expert reports can be used to satisfy the PSLRA's pleading standards.

The Recurring Risk Of Risk Factor Disclosures

Just as in *Nvidia*, the Supreme Court issued an order following oral argument in *Facebook Inc. v. Amalgamated Bank* determining that the court had improvidently agreed to review a decision from the Ninth Circuit.

In *Facebook*, the Supreme Court was asked to decide whether risk disclosures are false or misleading when they do not disclose that a risk has materialized in the past, even if that past event presents no currently known risk of ongoing or future business harm.

The Ninth Circuit held in October 2023 that liability can arise where a company describes a risk in "purely hypothetical" language "when that exact risk had already transpired."[16]

The Ninth Circuit's rule conflicts with the rule in the U.S. Courts of Appeals for the First, Second and Tenth Circuits, which have adopted the so-called virtual certainty test. Under that test, risk disclosures only implicitly certify that the company is unaware

[13] 81 F.4th 918 (9th Cir. 2023).

[14] *Id.* at 940.

[15] *Arkansas Pub. Emps. Ret. Sys. v. Bristol-Myers Squib Co.*, 28 F. 4th 343, 354 (2d Cir. 2022); accord *Fin. Acquisition Partners LP v. Blackwell*, 440 F.3d 278, 285-86 (5th Cir. 2006).

[16] 84 F.4th 844, 859–60.

of any previous occurrence of a triggering event if it is almost certain to cause the warned-of harm to the company's business.[17]

In light of the Supreme Court's decision not to rule in the *Facebook* case, this purported circuit split will persist, leaving companies with heightened risk relating to potential claims in the risk disclosure sections of their annual reports and other periodic filings.

Supreme Court precedent has an increasing impact at class certification.

The justices' decision not to decide *Nvidia* and *Facebook* on the merits means that litigants and courts will not have the type of clarity that helps resolve securities cases, as illustrated by the impact of Supreme Court precedent on other securities issues. During 2024, for example, there was a marked uptick in class certification denials based on the application of the Supreme Court's 2021 decision in *Goldman Sachs Group Inc. v. Arkansas Teacher Retirement System*,[18] and the decisions issued on remand in its wake.

Goldman gives defendants an opportunity to defeat class certification by showing that an alleged misrepresentation had no price impact — that is, an impact on an issuer's stock price. That can be done by showing there is a mismatch between the challenged statement and a purported corrective disclosure. A successful price impact challenge rebuts the presumption of classwide investor reliance that is a prerequisite to class certification.

Decisions issued this year showed the importance of Supreme Court rulings in securities cases, and that defendants' opportunities to defeat class certification are increasing.

In *Shupe v. Rocket Cos. Inc.* in the U.S. District Court for the Eastern District of Michigan,[19] U.S. District Judge Judge Thomas L. Ludington on Oct. 1 denied class certification holding that the defendants' showing of a lack of price impact rebutted the presumption of reliance. He reasoned that "a considerable mismatch exists between the generic nature of the alleged misrepresentations and the specific revelation" of the alleged fraud at the end of the proposed class period.[20]

Similarly, U.S. District Judge J. Paul Oetken ruled against class certification in *In re: Kirkland Lake Gold Ltd. Securities Litigation*.[21] In a case challenging statements about merger activity in the U.S. District Court for the Southern District of New York, he concluded on March 29 that, "a truthful, but equally generic, substitute for the M&A Statements would not have impacted Kirkland's share price."[22] The court was persuaded that another public statement about merger and acquisition activity was even more specific than the challenged statement, and that it was undisputed that it "did not cause a statistically significant decline in Kirkland's share price."[23]

In the U.S. District Court for the Northern District of California, U.S. District Judge Edward Chen on March 11 denied class certification in part with respect to the last four months of a proposed 30-month class period in *In re: FibroGen Securities Litigation*.[24] He ruled that certification for the last part of the class period was not proper "due to a lack of predominance because Plaintiffs in this period would need to individually allege reliance and not Fraud on the Market."[25]

The Ninth Circuit recently granted an interlocutory appeal in *Jaeger v. Zillow Group Inc.* to decide how district courts within the circuit should apply the *Goldman* case.[26] The forthcoming opinion in the Ninth Circuit in a matter of first impression should provide meaningful guidance for courts and litigants on class certification challenges in securities litigation.

Conclusion

The PSLRA was enacted to create uniform, heightened pleading standards. The Supreme Court's decision not to decide *Nvidia* and *Facebook* on the merits followed several justices expressing hesitation during oral argument about the Supreme Court involving itself in determining what type of pleading allegations pass muster under the PSLRA. The justices eschewed the adoption of any bright-line rules.

In light of the Supreme Court's decision not to rule in *Nvidia* and *Facebook*, it is likely that defendants will seek future opportunities to raise the undecided questions in cases that are better vehicles for the justices to articulate clear, uniform rules. Until then, purported circuit splits may persist, leading to potential forum shopping and vigorous litigation about when risk factor disclosures give rise to liability, and whether and when expert reports can be used to satisfy the PSLRA's pleading standards.

[17] *See, e.g.,* Indiana Pub. Ret. Sys. v. Pluralsight, Inc., 45 F4th 1236 (10th Cir. 2022); Karth v. Keryx Biopharmaceuticals, Inc., 6 F.4th 123, 137 (1st Cir. 2021); Wilson v. Merrill Lynch & Co., 671 F.3d 120, 133-34 (2d Cir. 2011).

[18] 594 U.S. 113 (2021).

[19] 2024 WL 4349172, at *24 (E.D. Mich. Sept. 30, 2024).

[20] *Id.* at *26.

[21] 2024 WL 1342800, at *9 (S.D.N.Y. Mar. 29, 2024).

[22] *Id.*

[23] *Id.*

[24] 2024 WL 1064665, at *15 (N.D. Cal. Mar. 11, 2024).

[25] *Id.*

[26] *See* Jaeger v. Zillow Grp., Inc., 2024 WL 3924557 (W.D. Wash. Aug. 23, 2024), petition for interlocutory appeal granted, Case No. 24-6605 (9th Cir. 2024).

Automotive

Ninth Circuit Holds Arbitration Decisions Can Preclude Sarbanes-Oxley Claims in Federal Court

Hansen v. Musk (9th Cir. Dec. 10, 2024)

What to know: The Ninth Circuit held that an arbitration award can preclude relitigating issues in cases brought under the Sarbanes-Oxley Act of 2002 (SOX), even though SOX claims are not themselves subject to pre-dispute arbitration agreements.

The Ninth Circuit affirmed a U.S. District Court for the District of Nevada decision granting the defendants' motion to dismiss a Sarbanes-Oxley Act of 2002 (SOX) claim against them. In March 2018, plaintiff Karl Hansen began working as an investigation case specialist at Tesla's Nevada Gigafactory. While there, Mr. Hansen identified and reported what he believed to be wrongdoing at the company. In June 2018, Tesla terminated Mr. Hansen's employment, citing restructuring, and Mr. Hanson began working at a security company that contracted with Tesla.

At the security company, Mr. Hanson continued investigating his theories of supposed wrongdoing until Tesla CEO Elon Musk requested Mr. Hansen's removal. Mr. Hansen filed a complaint against Tesla, Mr. Musk and the security company in the District of Nevada alleging he was removed in retaliation for reporting misconduct to management and the Securities and Exchange Commission (SEC).

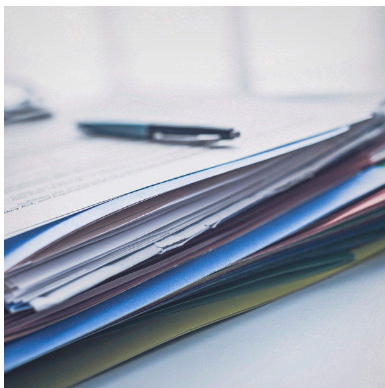
Pursuant to a mandatory arbitration agreement, the district court compelled most of Mr. Hansen's claims to arbitration. However, Mr. Hansen's SOX claim remained in federal court because federal law precludes SOX claims from being subject to a "predispute arbitration agreement." The district court stayed the SOX claim pending the arbitration's resolution.

On June 8, 2022, the arbitrator found in favor of the defendants on Hansen's non-SOX claims, concluding that Mr. Hansen was not fired from either of his positions as retaliation. Specifically, the arbitrator found (i) Mr. Hansen had no contractual right to work at the Gigafactory, and all employees with his title were outsourced to the security company; (ii) the security company dismissed Mr. Hansen because he was caught emailing confidential information to third parties; and (iii) in connection with a Dodd-Frank claim, Mr. Hansen failed to show a reasonable belief that the reported activities violated securities law.

On July 25, 2022, the district court lifted the stay regarding Mr. Hansen's SOX claim. The defendants moved to dismiss, arguing that the arbitrator's findings precluded relitigating the same issues and were fatal to Mr. Hansen's SOX claim. The district court agreed and granted the defendants' motion, reasoning that Mr. Hansen had a full and fair opportunity to litigate the common underlying issues.

The Ninth Circuit affirmed, holding that a federal court order confirming an arbitration award has the same force and effect as a final judgment on the merits. While SOX claims may not themselves be compelled to binding arbitration, an arbitrator may still resolve issues when ruling on other claims that bear directly on the merits of a SOX claim. The Ninth Circuit reasoned that giving such findings preclusive effect does not circumvent the statutory restriction against arbitrating SOX claims.

Insurance



Second Circuit Vacates in Part, Affirms in Part Dismissal of Securities Claims Brought Against Property and Casualty Insurer by Investors

New England Carpenters Guaranteed Annuity & Pension Funds v. AmTrust Fin. Servs. Inc. (2d Cir. Oct. 31, 2024)

What to know: The Second Circuit vacated in part and affirmed in part the dismissal of securities claims brought against a large property and casualty insurer by its investors, holding that the insurer's accounting treatment of extended warranty contracts and discretionary employee bonuses were actionable statements under the securities laws. The Second Circuit denied a request for a rehearing.

The Second Circuit affirmed the district court's grant of the defendants' motion to dismiss claims brought under Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act), but reinstated claims under Sections 11 and 12(a). The plaintiffs — investors of an insurer — alleged that the insurer and its officers and underwriters violated Sections 10(b), 11 and 12(a) of the Exchange Act with two types of misstatements about the defendants' financials.

First, the defendants conceded in a corrective disclosure that the insurer mistakenly recognized revenue from extended warranty contracts upfront, rather than over the life of the contract. Second, the defendants acknowledged that the insurer incorrectly recognized discretionary bonuses when they were paid rather than earned.

The Second Circuit affirmed the district court's dismissal of the plaintiffs' Section 10(b) claims against the defendants, finding that the complaint did not adequately plead facts giving rise to a strong inference of scienter. The appeals court reasoned that the plaintiff's allegations that the accounting misstatements were made to create the "appearance of corporate profitability" were insufficient to raise an inference of scienter, and that the plaintiffs' claims alleging the defendants consciously made the accounting mistakes were not compelling.

Concerning the Sections 11 and 12(a) claims against the defendants, the Second Circuit reversed the district court's decision. The district court concluded that the accounting errors were nonactionable statements of opinion; however, the appeals court held that statements of opinion that contain "embedded statements of fact that are untrue" or "omit[] information whose omission conveys false facts" are actionable under the securities laws. "This occurs where, for example, there is an accepted method for assessing whether the statement is true, but the statement is not justified by the accepted method." Here, the Second Circuit reasoned, the accounting treatment of the extended warranty contracts misled investors about the defendants' revenue and accounting procedures. Similarly, the appeals court reasoned that the accounting treatment of the discretionary bonuses misleadingly suggested that the defendants would probably not pay future bonuses. Thus, the Second Circuit concluded that the statements were actionable and that the complaint stated a claim under Sections 11 and 12(a).

SDNY Dismisses Class Action Against Insurance Underwriter Over Alleged Misstatements on Construction Defect Claims

The Police and Fire Ret. Sys. City of Detroit v. Argo Grp. Int'l Holdings, LTD. (S.D.N.Y. Dec. 12, 2024)

What to know: The Southern District of New York dismissed a putative class action alleging an insurance company and certain of its officers failed to disclose key risks concerning the company's underwriting construction defect claims from 2011-17.

Judge Lewis A. Kaplan of the U.S. District Court for the Southern District of New York dismissed a putative class action against an insurance underwriter and certain of its officers alleging they failed to disclose key risks related to the underwriting of construction defect claims from 2011-17, which led to significant financial losses for the company's shareholders when those risks materialized in August 2022. In particular, the plaintiffs claimed that the defendants made false or misleading statements about its reserves, financial performance and corporate outlook.

First, the court held that the plaintiffs failed to adequately plead any materially false or misleading statements or omissions resulting from the defendants' statements regarding the sufficiency of its reserves. The court noted that the statements about the defendants' reserves were inherently subjective and constituted opinions rather than facts, including because estimating loss reserves is "extremely conjectural" in nature. The court further noted that the creation of a task force in 2017 to review underwriting guidelines and later decisions to revise reserves did not imply that the defendants knew the reserves were previously inadequate.

Second, the court held that various statements regarding the defendants' "financial performance, strength and growth," as well as statements of general corporate optimism, were not actionable. In particular, the court noted that the plaintiffs failed to specify why each statement was misleading and relied on generic explanations that did not address the specific context of each statement.

Third, the court held that the plaintiffs did not adequately plead scienter, noting that the plaintiffs' allegations of motive and opportunity were insufficient, as they were based on general motives like compensation and stock price. The court further noted that the plaintiffs likewise were unable to demonstrate fraudulent intent relating to trades in the company's stock made by the defendants during the class period. Finally, the court held that the plaintiffs did not provide strong circumstantial evidence of conscious misbehavior or recklessness, including because the confidential witness statements were vague and lacked direct connection to the defendants.

Life Sciences and Health Care

District of Colorado Certifies Stockholder Class in Securities Suit Alleging Senior Care Services Provider Made Pre-IPO Misstatements

El Paso Firemen & Policemen's Pension Fund v. InnoVage Holding Corp. (D. Colo. Jan. 8, 2025)

What to know: The District of Colorado certified a class of stockholders in a securities suit against a senior care services provider, alleging the provider made false and misleading statements in its public filings in connection with an IPO.

Judge William J. Martinez of the U.S. District Court for the District of Colorado certified a purported class of individuals who brought claims against a senior care services company and certain of its officers in connection with the company's March 2021 IPO under Sections 10(b) and 20(a) of the Exchange Act, and Rule 10b-5 as promulgated thereunder, as well as Sections 11, 12(a)(2) and 15 of the Securities Act of 1933 (Securities Act). The amended class action complaint alleged that several statements in the company's pre-IPO registration statement were materially false, and several communications — including press releases, earnings calls and quarterly reports — were materially false. The plaintiffs alleged that the defendants were not providing the level of care they purported to in their public statements and were not in compliance with several requirements of the PACE program, an elder care program administered by the federal government.

Although the defendants argued that the plaintiffs failed to satisfy the predominance requirement under Rule 23(b) because the plaintiffs "have not presented any reliable methodology for calculating" damages, the court disagreed. It held that the plaintiffs' "out-of-pocket" methodology is able to "separate the effects of actionable misrepresentations from non-actionable" factors.

The defendants also argued that the plaintiffs failed to satisfy the adequacy requirement under Rule 23(a) because the plaintiffs lacked "sufficient knowledge of the case to adequately protect the interests of the class." The court disagreed and held that the lead plaintiffs "are sophisticated institutional investors who manage billions in assets" and have "capably demonstrated" their understanding of the matter through the testimony they had provided.

M&A

Delaware Supreme Court Reinforces High Bar To Assert Aiding and Abetting Liability Against Acquirer

In re Mindbody, Inc. S'holder Litig. (Del. Dec. 2, 2024)

What to know: The Delaware Supreme Court reversed judgment against a third-party acquirer for aiding and abetting a target company's CEO in breaching his fiduciary duties, even while upholding the decision on the CEO's breach. In doing so, the Supreme Court noted that it had never found a third-party acquirer liable for aiding and abetting, and reinforced the high bar necessary for such a claim.

The Delaware Supreme Court upheld a Court of Chancery decision finding a CEO breached his fiduciary duties, but cleared the third-party acquirer of aiding and abetting liability. The Court of Chancery found that the CEO of Mindbody, Inc. had breached his fiduciary duties by disloyally skewing a transaction in favor of his preferred bidder and causing Mindbody to issue misleading disclosures. Relying on a provision in the merger agreement providing the acquirer the opportunity to comment on Mindbody's merger-related proxy statement, and requiring the acquirer to notify Mindbody if it were aware of any omitted material facts in the proxy statement, the trial court held the acquirer liable for aiding and abetting the CEO's disclosure breach.

The Supreme Court focused its analysis on the requirement that the acquirer knowingly participated in the disclosure's breach and held that this requirement comprises two separate analyses: knowledge and participation. It reiterated that, under Delaware law, an aiding and abetting claim against a third-party acquirer negotiating at arms' length faces a very high bar because acquirers are entitled to bargain hard in their own interests. The Supreme Court also noted that it had never found a buyer in the acquirer's position liable for aiding and abetting.

Examining the knowledge component, the Supreme Court reversed the trial court's finding that the acquirer knew its conduct was wrongful because neither the contract provision nor the other facts proven at trial met that showing. Examining the participation component, the Supreme Court found that "passive awareness" of an omission in the proxy statement is insufficient to establish participation by a third-party acquirer and that the acquirer "took no action that actively furthered" the misleading disclosures breach.

The Supreme Court also reversed the trial court's holding that the proxy-related contract provisions provided the necessary evidence of participation. Relatedly, the Supreme Court noted that the proxy-related contract provisions could not create any direct duty between the acquirer and the Mindbody stockholders, and that imposing such a duty would require a third-party buyer to second-guess the disclosure determinations and legal judgment of the target board and its advisers.

Delaware Court of Chancery Applies Business Judgment Rule to Unconflicted All-Cash Sale of Controlled Company

Manti Holdings, LLC v. The Carlyle Grp. Inc. (Del. Ch. Jan. 7, 2025)

What to know: The Court of Chancery found plaintiff minority stockholders failed to prove breach of fiduciary duty claims against a private equity firm and other defendants. The plaintiffs claimed the defendants approved a company sale at an unfair price in order to satisfy the controlling stockholder's need for liquidity.

The Delaware Court of Chancery found plaintiff minority stockholders failed to prove private equity firm Carlyle and other defendants approved a company sale at an unfair price in order to satisfy Carlyle's need for liquidity. Carlyle was the majority equity holder of both preferred and common stock in Authentix, a company that "traces" products to provide easier authentication. The Carlyle fund holding its Authentix investment expired in 2017. In late 2017, Authentix was sold to Blue Water Energy LLP and, following the sale, minority stockholders of Authentix sued, alleging that Carlyle's "business model required it to sell Authentix in 2017, regardless of price[.]" According to the plaintiffs, but-for the allegedly unfair sales process, had Authentix deferred selling itself until 2018, the stockholders could have received double the consideration. Furthermore, because of Carlyle's alleged controller status, and that it "extracted a unique benefit, a timely exit from Authentix[,]" entire fairness was the applicable standard of review. In June 2022, the court denied Carlyle's motion to dismiss and trial followed.

The court stated that if the plaintiffs had proven at trial that Carlyle "thought it necessary to sell immediately, consequences (and price) be damned" — *i.e.*, had plaintiffs proved a disabling conflict — then the entire fairness standard of review would have applied. However, the court found the plaintiffs did not prove their theory that Carlyle sought a "fire sale" that "would sacrifice value for speed."

Among other things, the court found that the plaintiffs failed to prove that Carlyle faced sufficient pressure to seek a fire sale from its limited partners or the structure mechanisms in the fund. To the contrary, the record showed that Carlyle was interested in moving quickly because of the volatility in Authentix's business. Further, the sales process itself weighed against the finding of a fire sale. Authentix ran a year-long process, during which time its financial advisor contacted 127 potential buyers and there was no evidence that Authentix refused to work with any particular buyer.

While the court conceded that "perhaps" Authentix could have achieved a higher price had it waited a year, it refused to substitute its own judgment for the board's: "To sell now or wait for a better opportunity later? Absent a showing of a conflicted transaction, this is the very stuff of which business judgment is made." Because Carlyle received the same consideration as other common stockholders, Carlyle was not a "conflicted controller." Notably, rather than applying enhanced scrutiny under *Revlon* to the transaction — as was done in a recent Court of Chancery opinion involving a controller sale with no conflict — the court applied the business judgment rule. As a result, the court deferred to the Authentix board's judgment in entering into the transaction and ruled in favor of the defendants.

Real Estate

Northern District of Illinois Grants in Part, Denies in Part Motion To Dismiss Securities Fraud Suit Related to Real Estate Fund Action

Magnuson v. Window Rock Residential Recovery Fund, L.P. (N.D. Ill. Dec. 9, 2024)

What to know: The Northern District of Illinois granted in part and denied in part a motion to dismiss a securities fraud suit relating to a real estate fund's closure.

Judge Manish S. Shah of the U.S. District Court for the Northern District of Illinois granted in part and denied in part a motion to dismiss an amended securities fraud complaint against Window Rock Residential Recovery Fund, L.P. and its officers. The plaintiffs alleged the defendants violated Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, by including materially false and misleading statements in the presentations used to promote the fund and quarterly updates distributed to existing investors. The plaintiffs also asserted control-person liability claims under Section 20(a) of the Exchange Act against two officers of the fund and related state law claims against all the defendants. The court dismissed the claims against one of the officers, but allowed the claims against Window Rock and its other officer to move forward.

Around 2018, the plaintiffs invested in a Window Rock fund that focused on distressed real estate assets. Throughout the life of the fund, Window Rock distributed quarterly reports and presentations that showed the fund was performing positively with rates of return between 12% and 43%. However, in February 2020, the fund was closed with little notice to investors, citing historically poor performance. The plaintiffs allege they lost nearly two-thirds of their investment as part of the closure.

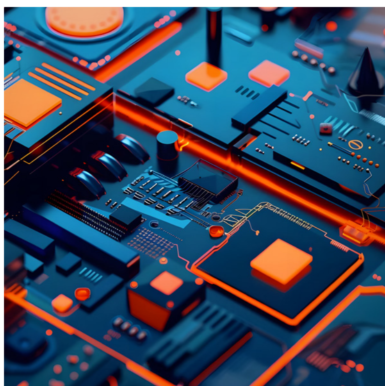
The plaintiffs subsequently brought federal and state securities fraud claims against the defendants based on alleged false and misleading statements in a PowerPoint presentation used to promote the fund and in quarterly account statements. The plaintiffs argued that, given the poor performance of the fund, the promotional materials must have been false at the time they were issued. The plaintiffs further alleged that Window Rock knew that overly positive statements in the quarterly updates obscured the fund's true financial condition.

The court rejected the plaintiffs' assertion that the alleged misrepresentations in the pre-investment presentation were actionable, stating that accepting the plaintiffs' reasoning would cause the court to accept a "must be" fraud argument that skirts Fed. R. Civ. P. 9(b)'s requirements. On the other hand, the court found that the plaintiffs stated a claim for securities fraud based on the statements made in the quarterly updates to investors. The court reasoned that the allegations, if accepted as true, clearly established Window Rock's knowledge of poor performance and contradicted the affirmative representations that the fund was performing positively. The court also determined that an officer's admission that the fund was performing poorly in prior years when announcing that the fund would be closed supported a compelling inference of fraudulent intent as opposed to mere carelessness.

While the court permitted control-person claims to proceed against the officer who admitted personal knowledge and responsibility over the quarterly reports, the court granted the motion to dismiss with respect to the other officer, the fund's chief financial officer. The court held that the plaintiffs had not established the CFO's scienter with particularity and explained that the plaintiffs must allege something more than simply the officer's position as CFO.

The court also denied the defendants' motion to dismiss with respect to the plaintiffs' claims under the Illinois Securities Act but granted the motion as to claims asserted under the Illinois Uniform Deceptive Trade Practices Act.

Technology



Ninth Circuit Holds Securities Fraud Plaintiffs Bear Burden of Pleading Facts To Define Terms Lacking Ordinary or Plain Meaning

In re Cloudera, Inc. Sec. Litig. (9th Cir. Nov. 19, 2024)

What to know: The Ninth Circuit held that where a plaintiff alleges securities fraud based on an interpretation of terms that lack a plain or ordinary meaning, it is the plaintiff's burden to plead facts that support his or her definition of those terms.

The Ninth Circuit affirmed the dismissal of a putative class action against data management and analytics software company Cloudera, Inc. and several of its officers and directors alleging they made materially misleading statements. On June 5, 2019, Cloudera's stock dropped 40% after a negative quarterly earnings announcement. Following the drop, a Cloudera shareholder brought a putative class action in the U.S. District Court for the Northern District of California alleging the company and its leaders misrepresented Cloudera by claiming it possessed a "cloud-native platform" and "original cloud native architecture." The complaint alleged that these statements were misleading because Cloudera's software was not "cloud-native" and lacked key attributes of cloud products.

The district court dismissed the case for failure to state a claim, reasoning that the complaint failed to plead facts showing that the terms "cloud-native" and "cloud-native architecture" actually had the meaning the plaintiff ascribed to them at the time the challenged statements were made. The court cautioned that any future amended complaint needed to plead facts to support their proffered meanings.

The plaintiff then repled and included a definition of the cloud-related terms at issue. The district court dismissed once again, reasoning that the plaintiff still failed to plead sufficient facts supporting his definitions of those key terms.

The plaintiff appealed the dismissal, and the Ninth Circuit affirmed. The panel agreed that courts are unable to evaluate the truth or falsity of allegedly false statements without understanding how industry-specific phrases like "cloud-native" and "original cloud native architecture" are generally understood among those who use such terms. As applied here, the court explained that the plaintiff could not rely on the plain meaning of the cloud-related terms because those terms are not universally understood, and cloud computing has evolved so quickly that, even if those terms had a plain meaning today, that current understanding may not reflect how those terms were generally understood at the time of the alleged misstatements. Having agreed with the district court that "the relevant cloud-related terms in the challenged statements lack a plain or ordinary meaning," and that the plaintiff failed "to 'plead facts' supporting his definitions of those terms," the court affirmed the dismissal with prejudice.

SDNY Partially Dismisses Untimely Securities Claims Against Software Vendor, Allows Competition-Related Allegations To Proceed

In re UiPath, Inc. Sec. Litig. (S.D.N.Y. Nov. 4, 2024)

What to know: The Southern District of New York allowed securities fraud claims concerning statements about market competition to proceed based on allegations supported by confidential witnesses. Separately, the court dismissed other securities fraud claims, including a Section 11 claim that was declared untimely because it was omitted from the initial complaint and not added within one year.

Judge Denise Cote of the U.S. District Court for the Southern District of New York dismissed, in part, claims brought under Sections 11 and 15 of the Securities Act, and Section 20 of the Exchange Act, and allowed claims brought under Section 10(b) and 10b-5 under the Exchange Act to proceed. The defendant, a software vendor, went public on April 23, 2021, and the lawsuit was filed after the defendant disclosed slowing revenue on September 6, 2022. The complaint alleged that the defendant's public statements presented a rosier-than-reality picture concerning (i) operating metrics, (ii) subscription expansions and (iii) the competitive threat from another software vendor. As to the first two categories, the court found that the public statements were not false or misleading and dismissed the claims. The court allowed the plaintiffs to maintain their claims concerning the defendant's competition with another software vendor.

On an earnings call, the defendant's CEO stated that the company rarely competed against Microsoft and that such competition did not impact the defendant's "win rate." Relying on confidential witnesses, the complaint alleged that the company often competed against the other software vendor ("about half" the time) and that the defendant usually lost. The court rejected the defendant's argument that the statements at issue were mere corporate optimism, and instead found that they were statements of fact the veracity of which was challenged by the confidential witnesses. The court noted that the plaintiff had sufficiently pled scienter where confidential witnesses stated that the defendant's CEO instructed employees to create a response plan concerning the competing software vendor and where the CEO hired a former employee from the same competing vendor to serve as the defendant's chief business officer.

Separately, the court dismissed the Section 11 claim as untimely. The court noted that a challenge to a company's registration statement must be filed within one year of discovery. At issue was the plaintiff's argument that the time it took to bring the claim was tolled once the litigation was filed, pursuant to *American Pipe*. The court rejected this argument and held that because the original complaint did not include a § 11 claim, *American Pipe* did not apply, and the claim was time-barred where the plaintiff did not add his § 11 claim within one year of discovery.

Web3 and Digital Assets

Third Circuit Orders SEC To Provide Clearer Guidance Regarding Digital Assets and Securities Regulation

Coinbase, Inc. v. SEC (3d Cir. Jan. 13, 2025)

What to know: The Third Circuit ordered the SEC to provide more clarity about how and when securities laws apply to digital assets like cryptocurrencies, emphasizing that the commission must provide a well-reasoned explanation if it declines to engage in notice-and-comment rulemaking.

The Third Circuit sided with Coinbase Global, Inc. in its petition to the SEC to clarify how and when federal securities laws apply to transactions in digital assets like cryptocurrencies. Coinbase Global, through its subsidiary Coinbase, Inc., operates a trading platform that facilitates the exchange of digital assets. Coinbase argued that these digital assets do not fit squarely within the existing securities law framework due to their unique attributes, and noted that the SEC has not articulated or maintained a consistent position on the issue. The SEC denied Coinbase's rulemaking petition, stating in a short, one-paragraph order that it disagreed with Coinbase's concerns.

Coinbase petitioned the Third Circuit to review whether the Administrative Procedures Act (APA) or another authority required the SEC to either engage in notice-and-comment rulemaking or, at a minimum, provide a more well-reasoned explanation regarding its position. Coinbase argued that by applying existing securities law to digital assets, the SEC has made a unilateral policy change that triggers an obligation to engage in formal rulemaking. Coinbase further argued that if the SEC plans to treat all transactions in digital assets as securities, notice and comment is also necessary since digital assets are largely incompatible with existing SEC rules, rendering compliance uncertain at best and potentially impossible.

While the Third Circuit declined to order the SEC to institute rulemaking proceedings, it agreed with Coinbase that the SEC's one-paragraph order was "conclusory and insufficiently reasoned" and instructed the commission to provide a more complete explanation. The court explained that while it generally affords great deference to an agency's decision not to start notice-and-comment rulemaking, the agency must still provide the court with the "assurance that [it] considered the relevant factors" and "a discernable path to which the court may defer." The court noted that an agency's explanation of its decision can be high-level, but it cannot be so bare that it fails to address issues squarely within the agency's regulatory purview.

Moreover, while the SEC may engage in incremental rulemaking to gain more information before taking final action, it must provide a clear path for the court and others to follow. The court ordered the SEC to "explain itself" in an amended order and cautioned the commission that "sporadically enforcing ill-fitting rules against crypto companies that are trying to follow the law goes way beyond fighting fraud."

SDNY Grants Appeal to Cryptoasset Trading Platform, Allowing Second Circuit To Determine Whether Platform Transactions Are Investment Contracts

SEC v. Coinbase, Inc. (S.D.N.Y. Jan. 7, 2025)

What to know: The Southern District of New York allowed a cryptoasset trading platform to appeal a court order, which partially granted and denied the defendant's motion for judgment on the pleadings. The appeal will enable the Second Circuit to determine whether cryptocurrency transactions on the defendant's platform qualify as investment contracts.

Judge Katherine P. Failla of the U.S. District Court for the Southern District of New York granted Coinbase Global, Inc. and Coinbase, Inc.'s motion to certify for interlocutory appeal the court's order granting in part and denying in part their motion for judgment on the pleadings. The SEC initially brought an enforcement action against Coinbase Global, Inc. and Coinbase, Inc. alleging they intermediated transactions in digital assets through Coinbase Inc.'s trading platform and thus violated federal securities laws by acting as an unregistered broker-dealer, exchange and clearing agency.

The defendants moved for judgment on the pleadings, in part, because the digital asset transactions at issue were not "investment contracts" under *SEC v. W.J. Howey Co.* and thus were not "securities" subject to SEC regulation. In a March 2024 order, the court held that certain of the cryptoassets were "investment contracts within the SEC's regulatory purview." The defendants moved the court to certify the order for interlocutory appeal, which the SEC opposed.

The court granted the defendants' motion by first addressing the statutory criteria for interlocutory appeal: whether the Order "[i] involves a controlling question of law [ii] as to which there is substantial ground for difference of opinion and [iii] that an immediate appeal from the order may materially advance the ultimate termination of the litigation." The order satisfied all three criteria.

First, the court noted that "the Order present[ed] a clear and controlling question of law: whether transactions involving crypto-assets of the kind [Coinbase, Inc.] intermediates are 'investment contracts,' and thus securities." The court further noted that question was a "pure" question of law because it was "a matter of statutory interpretation" and was "controlling" because "reversal on [it] would significantly affect the course" of both the immediate and other actions raising similar questions.

Second, the order presented a question as to which "there is substantial ground for difference of opinion." The court noted both conflicting authority on *Howey*'s application to digital assets within the Second Circuit and among other circuits, and that the question "raises a difficult issue of first impression for the Second Circuit."

Third, the court held that interlocutory appeal "would materially advance the ultimate termination of the litigation because it could result in dismissal of the bulk of the SEC's claims." The court further explained that judicial economy weighed in favor of interlocutory certification and no other factors weighed against certification. And, for the same reasons that interlocutory appeal was appropriate, the court stayed the action pending appellate resolution.

Northern District of Texas Holds SEC Exceeded Its Authority in Expanding Definition of 'Dealer'

Crypto Freedom All. of Tex. v. SEC (N.D. Tex. Nov. 21, 2024)

What to know: The Northern District of Texas granted summary judgment in favor of two nonprofits challenging the SEC's broadened definition of "dealer" to include those who trade in a decentralized finance model that relies on software instead of dealers.

Judge Reed O'Connor of the U.S. District Court for the Northern District of Texas granted summary judgment to two plaintiffs challenging the SEC's extension of the definition of "dealer" to include those who trade in a decentralized finance model (DeFi) that relies on software instead of dealers. The court concluded that the extension exceeded the SEC's statutory authority.

On February 28, 2024, the SEC broadened the definition of "dealer" under the Exchange Act via the Dealer Rule, 89 Federal Regulation 14938, 14945. The expanded definition included "certain market participants who act as dealers by 'providing liquidity' to other market participants." The digital assets industry operates under DeFi protocols where "liquidity pools" crowdsource assets and use software that automatically modifies prices as the assets in the pools change. Consequently, the software substitutes for the traditional role of a dealer.

The plaintiffs — two nonprofits that advocate for policies favorable to digital assets traders — argued that the rule's broad definition of "dealer" would apply to participants in DeFi protocols that do not need dealer intermediation. The plaintiffs further argued that trading activities for personal objectives do not constitute "dealing." They added that, by defining "dealer" as anyone engaged in trading activities that affect market liquidity, the rule does not distinguish between "trader" and "dealer." Therefore, the plaintiffs argued that the rule exceeded the SEC's authority. All parties filed cross-motions for summary judgment.

The court granted summary judgment in the plaintiffs' favor. Citing 15 U.S.C. § 78c(a)(5)(A), the court noted that Congress defined "dealer" as "any person engaged *in the business* of buying and selling securities for his own account." The court also noted that, "for nearly the last 100 years," anyone who buys and sells securities "*not* as a part of a regular business" is a trader rather than a dealer under the Exchange Act, and that "regular business" refers to activities that do more than just affect market liquidity. Accordingly, the court held that the rule exceeded the SEC's statutory authority by "de facto" removing the distinction between "trader" and "dealer" "as they have commonly been defined for nearly 100 years."

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