November 6, 2014

Practice Groups:

Government Enforcement;

Securities Enforcement;

Securities and Transactional Litigation;

Class Action Litigation Defense;

Commercial Disputes;

Global Government Solutions

Successful Motions to Dismiss Securities Class Actions, A Review of What Worked in 2014

U.S. Securities and Transactional Litigation Alert

By: Jon Eisenberg

Motions to dismiss have been called "the main event" in securities class actions. They are filed in over 90% of securities class actions and they result in dismissal close to 50% of the time they are filed.[1] In contrast, out of 4,226 class actions filed between 1995 and 2013, only 14 were resolved through a trial, and of those, only five resulted in verdicts for the defendant.[2] In between a denial of a motion to dismiss and a trial are i) discovery, ii) opposition to class certification, iii) motion for summary judgment, iv) mediation, and iv) settlement. Unfortunately for defendants in securities class actions, class certification is granted in whole or in part 84% of the time,[3] and there is no summary judgment decision at all over 90% of the time.[4] Thus, for most defendants in securities class actions, a denial of a motion to dismiss usually results in writing a settlement check, often after years of costly discovery. Defendants that fail to give adequate attention to motions to dismiss are shortchanging the very best opportunity they have to avoid what may otherwise become multi-year, expensive litigation.

We previously addressed 75 defenses to securities class actions that are the building blocks for successful motions to dismiss.[5] In this alert, we look at recent cases—2014 decisions that relied on established precedents to dismiss securities class actions. Our purpose is not to be exhaustive, but rather to give examples of key defenses that worked well in 2014. All of the cases in the text were decided this year. We have focused on recurring issues of broad application rather than narrow issues unlikely to affect more than a handful of cases. For highly experienced securities practitioners, much of this will be common knowledge; but for those who face securities class actions only occasionally, it provides a primer and recent authorities on the defenses most likely to form a basis for successful motions to dismiss. We have also included in the endnotes the key Supreme Court cases addressing these issues.

Before turning to the 2014 cases, we provide a very brief overview of Section 10(b) of the Securities Exchange Act of 1934 and Sections 11 and 12(a)(2) of the Securities Act of 1933. Most securities class actions allege violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. Neither provides an express cause of action, but both the Supreme Court and lower courts implied private rights of action under these provisions long before the Supreme Court adopted a far more restrictive approach to implying private rights of action. Section 10(b)'s language is vague—it prohibits a "manipulative or deceptive device or contrivance"—but has been interpreted to require a plaintiff to allege and prove: i) a material misrepresentation or omission by the defendant,[6] ii) scienter,[7] iii) a connection between the misrepresentation or omission and the purchase or sale of a security,[8] iv) reliance on the misrepresentation or omission,[9] v) economic loss, and vi) loss causation.[10] [11]

Successful Motions to Dismiss Securities Class Actions, A Review of What Worked in 2014

In Section 10(b) class actions, alleging facts sufficient to support the scienter pleading requirement is particularly challenging. The Private Securities Litigation Reform Act of 1995 ("PSLRA")—described recently as "[t]he elephant-sized boulder blocking" a plaintiff's securities class action complaint[12]—requires that, with regard to any claim for damages requiring "proof that a defendant acted with a particular state of mind," i) the complaint must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind;"[13] ii) imposes a requirement that every complaint alleging securities fraud must "specify each statement alleged to have been misleading, the reasons or reasons why the statement is misleading, and if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed;" iii) created a safe harbor for forward-looking statements accompanied by meaningful cautionary language; iv) created a second safe harbor for forward-looking statements in which defendants lacked "actual knowledge" that the statements were false or misleading; and v) provided an automatic stay of discovery pending rulings on the motion to dismiss. Further, in addition to the PSLRA, Fed. R. Civ. P. 9(b) requires that in all averments of fraud, plaintiff must plead with particularity the circumstances constituting the fraud, which lower courts have held requires the plaintiff to plead the time, place, speaker, and content of the alleged misrepresentations.[14]

Plaintiffs also often file under Sections 11 and 12(a)(2) of the Securities Act of 1933, both of which provide express private rights of action. Sections 11 and 12(a)(2) are limited to misrepresentations or omissions in a registration statement or prospectus and, thus, often do not apply to the conduct at issue. On the other hand, when there is a securities offering to which they do apply, they do not require a plaintiff to prove scienter, reliance, or loss causation.[15] As a result, it is often more difficult to obtain complaints alleging misrepresentations or omissions related to a securities offering. In this alert, we consider successful motions to dismiss Section 10(b) class actions. We save for another day an alert covering successful motions to dismiss Sections 11 and 12(a)(2) class actions.

With that background in mind, we turn to 2014 decisions in which courts granted (or affirmed the grant of) motions to dismiss securities class action claims and the key principles on which they relied.

1. Consideration of Documents outside the Pleadings.

One of the developments that has greatly assisted defendants at the motion to dismiss stage has been the courts' willingness to consider documents outside the pleadings. This is critical because "[w]ere courts to refrain from considering such documents, complaints that quoted only selected and misleading portions of such documents could not be dismissed under Rule 12(b)(6) even though they would be doomed to failure."[16]

In *In Re Omnicare, Inc. Sec. Litig.*, 2014 U.S. App. LEXIS 19326 (Oct. 10, 2014), in which the Sixth Circuit affirmed the dismissal of a securities class action complaint, the court explained, "[I]f a plaintiff references or quotes certain documents, or if public records refute a plaintiff's claim, a defendant may attach those documents to its motion to dismiss, and a court can then consider them in resolving the Rule 12(b)(6) motion without converting the motion to dismiss into a Rule 56 motion for summary judgment." It further stated, "Fairness and efficiency require this practice." It cited Fed. R. Evid. 201(b), which states that a court may judicially notice a fact "that is not subject to reasonable dispute because it: i) is generally

known within the trial court's territorial jurisdiction, or ii) can be accurately and readily determined from sources whose accuracy cannot reasonably be questioned." On the other hand, it denied plaintiff's request to have the court take judicial notice of a number of documents (for example, the company's audit committee charter and the company's corporate integrity agreement) that the court stated plaintiffs had not referred to in their complaint and that plaintiffs were improperly seeking to introduce for the truth of the statements.

2. Conclusory Allegations.

Although courts generally assume the truth of the facts that are pled in considering a motion to dismiss, they do not have to accept as true conclusory allegations or legal conclusions masquerading as fact.[17] In *In re Zagg Sec. Litig.,* 2014 U.S. Dist. LEXIS 15783 (D. Utah Feb. 4, 2014), the court granted a motion to dismiss a securities class action after stating that it would not be bound by a complaint's "legal conclusions, deductions and opinions couched as facts." In response to allegations that defendants began a secret succession plan to remove the CEO because of margin calls, the court stated, "Plaintiffs' general, conclusory assertions … are not sufficient to satisfy the heightened pleading requirements of Rule 9(b), much less the PSLRA's strong inference requirement." *See also, e.g., Potier v. JBS Liberty Securities, Inc.,* 2014 U.S. Dist. LEXIS 141271 (W.D. La. Sept. 29, 2014) (granting motion to dismiss and stating that "conclusory allegations and unwarranted deductions of fact" are not accepted as true on a motion to dismiss).

3. Strong Inference of Scienter.

The failure to plead facts creating a strong inference of scienter is by far the most common basis for granting motions to dismiss securities fraud claims under Section 10(b) of the Securities Exchange Act;[18] that continued to be the case in 2014. Among the 2014 appellate court decisions affirming the dismissal of securities fraud class action complaints for failure to plead facts creating a strong inference of scienter are *Wolfe v. Aspenbio Pharma, Inc.,* 2014 U.S. App. LEXIS 20222 (10th Cir. Oct. 17, 2014); *Gold v. Ford Motor Co.,* 2014 U.S. App. LEXIS 15700 (3d Cir. Aug. 15, 2014); *Weinstein v. McClendon,* 757 F.3d 1110 (10th Cir. 2014); *Philadelphia Financial Management of San Francisco, LLC v. DJSP Enterprises, Inc.,* 2014 U.S. App. LEXIS 13543 (11th Cir. July 16, 2014) (per curiam); *Police Retirement System of St. Louis v. Intuitive Surgical, Inc.,* 759 F.3d 1051 (9th Cir. 2014); *Shemian v. Research in Motion Limited,* 2014 U.S. App. LEXIS 11511 (2d Cir. June 19, 2014) (summary order); *In Re Genzyme Corp. Sec. Litig.*, 754 F.3d 31 (1st Cir. 2014); *In re Bank of America AIG Disclosure Sec. Litig.,* 2014 U.S. App. LEXIS 9197 (2d Cir. May 19, 2014) (summary order); *Kuyat v. BioMimetic Therapeutics, Inc.*, 747 F.3d 435 (6th Cir. 2014); *Applestein v. Medivation, Inc.*, 2014 U.S. App. LEXIS 4318 (9th Cir. Mar. 7, 2014); *Yates v. Municipal Mortgage & Equity, LLC,* 744 F.3d 874 (4th Cir. 2014); and *Sinay v. CNOOC Ltd.*, 2014 U.S. App. LEXIS 2010 (2d Cir. Feb. 3, 2014) (summary order). Suffice it to say that in most securities fraud cases, the best argument for dismissal will be the failure to plead with particularity concrete, non-conclusory facts creating a strong inference of scienter.

4. Corporate Scienter.

A recurring issue in securities class actions is the relationship between corporate scienter and individual scienter. May a corporation be accused of scienter without allegations that a

particular individual acted with scienter? Does scienter of a junior employee suffice to allege corporate scienter?

In *In Re Omnicare, Inc. Sec. Litig.,* 2014 U.S. App. LEXIS 19326 (Oct. 10, 2014), the Sixth Circuit affirmed the dismissal of a securities class action complaint after considering a number of alternative approaches to the relationship between corporate scienter and individual scienter. It concluded that, going forward within the Sixth Circuit, the state of mind of the following persons are probative of whether a misrepresentation made by a corporation was made by it with the requisite scienter:

1. The individual agent who uttered or issued the misrepresentation;
2. Any individual agent who authorized, requested, commanded, furnished information for, prepared (including suggesting or contributing language for inclusion therein or omission therefrom), reviewed, or approved the statement in which the misrepresentation was made before its utterance or issuance; and
3. Any high managerial agent or member of the board of directors who ratified, recklessly disregarded, or tolerated the misrepresentation after its utterance or issuance.…

The court stated that this formulation protects corporations from strike suits when "one individual unknowingly makes a false statement that another individual, unrelated to the preparation or issuance of the statement, knew to be false or misleading." On the other hand, it permits liability if lower-level employees "knowingly provide false information to their superiors with the intent to defraud the public." Applying this standard, the court of appeals affirmed the district court's holding that the allegations did not support a strong inference of corporate scienter.

5. Confidential Witness Statements.

Increasingly, plaintiffs seek to meet the demand requirements of pleading facts creating a strong inference of scienter by relying on confidential witness statements—often by disgruntled former company employees. Courts, however, often grant motions to dismiss complaints involving confidential witnesses. For example, in *Applestein v. Medivation, Inc.,* 2014 U.S. App. LEXIS 4318 (9th Cir. Mar. 7, 2014), the court of appeals affirmed the lower court's dismissal of claims purportedly supported by three confidential witness statements. The court stated that, "confidential witness statements may be relied on only 'where the confidential witnesses are described with sufficient particularity to support the probability that a person in the position occupied by the source would possess the information alleged' and the complaint 'provide[s] an adequate basis for determining that the witnesses in question have personal knowledge of the events they report.'"[19] It agreed with the district court that plaintiffs failed to plead factors supporting an inference that the confidential witnesses had personal knowledge of the relevant information. Other recent decisions affirming the dismissal of complaints with confidential witness statements include, for example, *In Re Omnicare, Inc. Sec. Litig.,* 2014 U.S. App. LEXIS 19326 (6th Cir. Oct. 10, 2014); *In Re NVIDIA Corp. Sec. Litig.,* 768 F.3d 1046 (9th Cir. 2014); *Yates v. Municipal Mortgage & Equity, LLC,* 744 F.3d 874 (4th Cir. 2014); and *City of Edinburgh Council v. Pfizer,* 754 F.3d 159 (3d Cir. 2014).

Successful Motions to Dismiss Securities Class Actions, A Review of What Worked in 2014

6. Insider Sales.

Plaintiffs frequently rely on sales by insiders to support an inference of scienter. In *Yates v. Municipal Mortgage & Equity, LLC,* 744 F.3d 874 (2014), the Fourth Circuit affirmed the dismissal of a securities class action complaint despite allegations of insider sales during the class period. The court stated that the sales occurred at regular intervals and amounts when compared to earlier periods, that the volume of the trading was not suspicious, that some of the trades occurred under nondiscretionary Rule 10b-5 plans, and that a lengthy class period makes it difficult to infer intent from a stock sale since insider selling is not unusual.

Similarly, in *City of Bristol Pension Fund v. Vertex Pharmaceuticals Inc.,* 2014 U.S. Dist. LEXIS 43400 (D. Mass. Mar. 31, 2014), the court rejected plaintiffs' contention that insiders' sales during the class period supported the plaintiffs' scienter allegations. With regard to one group of insiders, the court said plaintiffs had failed to set forth the amount of trading before and after the class period to determine how unusual the trading was. With regard to another, the court held that while the sales were "unusual on their face," they were not unusual in the context of an individual leaving the company.

7. GAAP Violations.

Plaintiffs often support their allegations of fraudulent misconduct by claiming that defendants violated generally accepted accounting principles ("GAAP"). In *Athale v. Sinotech Energy Limited*, 2014 U.S. Dist. LEXIS 22996 (S.D.N.Y. Feb. 21, 2014), the court granted a motion to dismiss despite allegations of GAAP violations. Consistent with dozens of other cases, it stated, "[A]llegations of GAAP violations or accounting irregularities, standing alone[,] are insufficient [to support a strong inference of scienter] and must be coupled with evidence of corresponding fraudulent intent in order to state a securities fraud claim."[20]

8. Fraud by Hindsight.

Plaintiffs in securities class actions also often argue that scienter is demonstrated by the proximity between positive statements made by the company and subsequently revealed problems. Courts routinely reject such claims as impermissibly pleading "fraud by hindsight." *E.g., City of Pontiac Policemen's and Firemen's Retirement System v. UBS AG, et al.,* 752 F.3d 173 (2d Cir. 2014) ("We do not recognize allegations of fraud by hindsight"); *Special Situations Fund III QP, LP v. Deloitte Touche Tohmatsu CPA, Ltd.,* 2014 U.S. Dist. LEXIS 99861 (S.D.N.Y. July 21, 2014) ("To the extent that Plaintiffs argue that new management quickly unearthed the fraud, and thus it was easily discoverable, this argument suffers from hindsight bias"); *In re PUDA Coal Securities Inc. Litigation,* 2014 U.S. Dist. LEXIS 83138 (S.D.N.Y. June 25, 2014) ("Facts merely supporting an inference that an audit could have been done better constitute 'fraud by hindsight' and do not support the requisite scienter").

9. No False Statement.

After the absence of scienter, the second most successful basis for motions to dismiss complaints in securities class actions is the failure to plead facts showing that a statement or omission was "false."[21] For example, in *Louisiana Pacific Corp. v. Merrill Lynch & Co., Inc.,* 2014 U.S. App. LEXIS 11909 (June 24, 2014) (summary order), the Second Circuit rejected claims that defendants created a false appearance of liquidity and artificially inflated prices

paid for auction-rate securities after concluding that the defendants sufficiently disclosed that auction managers could and did intervene in the auctions for auction rate securities. In *In re Keryx Biopharmaceuticals, Inc. Sec. Litig.,* 2014 U.S. Dist. LEXIS 19138 (S.D.N.Y. Feb. 14, 2014), the court held that assertions that the methodology of a drug trial had not been sufficiently disclosed did not support allegations that the statements regarding the results of the drug test were false. *See also, e.g., United Food and Commercial Workers Union Local 880 Pension Fund v. Chesapeake Energy Corp.,* 762 F.3d 1158 (10th Cir. 2014) (defendant adequately disclosed hedging strategy in light of other disclosures forming part of the "total mix" of information known or reasonable available to shareholders); *Scott v. General Motors,* 2014 U.S. Dist. LEXIS 124370 (S.D.N.Y. Sept. 4, 2014) (motion to dismiss granted with respect to claim that defendant engaged in channel-stuffing and failed to disclose excess dealer inventory because "[t]he allegation of misstatements and omissions as to GM's inventory practices are supported neither by plausible factual allegations nor by the quoted passages from the Registration Statement"); *Ironworkers Local 580 Joint Funds v. Linn Energy, LLC,* 2014 U.S. Dist. LEXIS 93344 (S.D.N.Y. July 8, 2014) ("The detailed factual recital set forth above makes it perfectly clear that, at all times, LINN and LinnCo told the whole truth and nothing but about how they were calculating adjusted EBITA, DCF, the distribution coverage ratio, and maintenance capex—all non-GAAP metrics for which there is no 'right' formula);…." *In re TVIX Sec. Litig.,* 2014 U.S. Dist. LEXIS 78298 (S.D.N.Y. June 9, 2014) (motion to dismiss granted where "[t]he Pricing Supplement underscored repeatedly that the TVIX ETNs were intended to be used 'as short-term trading vehicles for investors managing their portfolios on a daily basis'").

Courts also use the falsity requirement to reject so-called "puzzle pleadings"—pleadings in which defendants provide lengthy block quotes from various public reports and, instead of specifically stating why each statement is false, summarize the numerous reasons why all of the statements allegedly are false. *E.g., Mauss v. NuVasive, Inc.,* 2014 U.S. Dist. LEXIS (S.D. Cal. Aug. 19, 2014) (collecting cases)

10. Duty to Disclose.

Most securities class actions are based in part on alleged omissions of material fact rather than allegations of specific misrepresentations. In omission cases, it is critical to recognize the difference between the mere possession of material information and a duty to disclose it.[22] In *City of Edinburgh Council v. Pfizer, Inc.,* 754 F.3d 159 (2014), the Third Circuit affirmed the dismissal of a securities class action alleging that defendants concealed material information about poor Phase 2 interim results related to the efficacy of its drug compared to a placebo. The court stated, "A duty to disclose under the federal securities laws may arise when a statute requires disclosure, insider trading occurs, or there is an inaccurate, incomplete, or misleading prior disclosure." The court stated that because the company's release made no affirmative statement about the strength of the Phase 2 interim results, it was under no duty to provide additional details about those results.

In *In Re NVIDIA Corp. Sec. Litig.,* 768 F.3d 1046 (2014), the Ninth Circuit considered whether Item 303 of Regulation S-K, 17 C.F.R. § 229.303, which requires disclosure of known trends or uncertainties that an issuer expects will have a material favorable or unfavorable effect, creates a Section 10(b) duty to disclose. In affirming the lower court's dismissal of the action, the Ninth Circuit held "Item 303 does not create a duty to disclose for

purposes of Section 10(b) and Rule 10b-5. Such a duty to disclose must be separately shown ….”

11. Duty to Update.

Just as there is no general duty to disclose material information, so too there is no duty to update a prior statement of historical fact. In *Finnerty v. Stiefel Laboratories, Inc.,* 756 F.3d 1310 (2014), the Eleventh Circuit explained:

> There is, of course, no obligation to update a prior statement about a historical fact. The duty attaches only to forward-looking statements—statements that contain “an implicit factual representation that remain[s] ‘alive’ in the minds of investors as a continue representation.” Determining if such an implicit representation was present and whether the representation subsequently became misleading involves an assessment of “the meaning of the statement to the reasonable investor and its relationship to truth.” (Internal citations omitted).[23]

In *City of Edinburgh Council v. Pfizer, Inc.,* 754 F.3d 159 (2014), the Third Circuit explained that “a duty to update applies only in ‘narrow circumstances’ involving more fundamental corporate changes such as mergers, takeovers, or liquidations, as well as when subsequent events produce an ‘extreme’ or ‘radical change’ in the continuing validity of the original statement.” In *Seaman v. California Business Bank*, 2014 U.S. Dist. LEXIS (N.D. Cal. Apr. 2, 2014), holding that there was no duty to update projections or the status of loan reserves, the court stated that “even the circuits that have applied the duty to update have done so ‘only to statements that are clear, factual, and forward-looking.’”

12. Mismanagement.

Section 10(b) applies only to disclosure violations, not to claims of corporate mismanagement.[24] Courts occasionally dismiss complaints on the ground that even though they are pled as misrepresentation claims, they are, in reality, complaints about mismanagement. In *In re Lululemon Sec. Litig.*, 2014 U.S. Dist. LEXIS 54128 (S.D.N.Y. Apr. 18, 2014), plaintiffs alleged that defendants’ statements about the high quality of Lululemon’s products and the steps the company took to fix quality issues were materially misleading. In dismissing, the court stated, “This narrative requires the Court to stretch allegations of, at most, corporate mismanagement into actionable federal securities fraud. This is not the law.” In *In re Magnum Hunter Resources Corp. Sec. Litig.,* 2014 U.S. Dist. LEXIS 85781 (S.D.N.Y. June 23, 2014), the court stated that, absent a showing that defendants knew of the accounting problems identified by confidential witnesses, the inference was one of non-actionable oversight failure of management rather than a securities law violation. In *In re BP p.l.c. Sec. Litig.,* 2014 U.S. Dist. LEXIS 69900 (S.D. Tex. May 20, 2014), in which defendants survived a motion to dismiss, the court nevertheless explained:

Successful Motions to Dismiss Securities Class Actions, A Review of What Worked in 2014

> A distinction must be drawn between the alleged misrepresentation and the subject matter allegedly misrepresented—in this case, between Defendants' public misstatements of their process safety reforms, and the underlying failure to institute process safety reforms. The Exchange Act provides compensation for losses caused by the former; losses caused by the latter are beyond the scope of the Act.

13. Forward-Looking Statements.

One of the PSLRA's most important contributions is the safe harbor for forward-looking statements.[25] The safe harbor applies if *either* the forward-looking statements are accompanied by meaningful cautionary language *or* the defendant made the statements without actual knowledge that they were false or misleading. State of mind is irrelevant if there is adequate cautionary language; whereas cautionary language is irrelevant if the defendant acts without actual knowledge of deception. Defendants frequently rely on the safe harbor in motions to dismiss. In 2014, appellate and district courts issued dozens of securities applying the safe harbor. We consider only a handful of illustrative cases below.

On the issue of whether a statement was "forward looking," courts held that statements vaguely referencing potential expansion and future revenue, statements that total revenue growth is expected to be in the 20%-30% range, and statements concerning the company's backlog where "backlog" was defined as outstanding orders that management "believes will result in recognition of revenue" were forward looking. *Somerset Communications Group, LLC v. Wall to Wall Advertising, Inc.,* 2014 U.S. Dist. LEXIS 62690 (W.D. Wash. May 6, 2014) and *Pound v. Stereotaxis, Inc.,* 8 F. Supp. 3d 1157 (E.D. Mo. 2014). A court also held that the following statements and related assumptions were forward looking:

1. We are on target to open 33 new stores in 2011.
2. We have operational initiatives underway that we believe will enhance our ability to achieve our long-term growth objectives.
3. We believe we can continue to drive long-term profit growth of 20% or more.
4. Our direct business is ahead of plan.
5. We have taken corrective action and expect this category to improve as we head into the second quarter.

Mogensen v. Body Central Corp., 2014 U.S. Dist. LEXIS 56747 (M.D. Fla. Mar. 19, 2014).

For two particularly good examples of decisions in which the courts parsed through dozens of statements and ultimately concluded that they were all subject to the safe harbor or immaterial and granted defendants' motion to dismiss, *see Norfolk County Retirement System v. Tempur-Pedic International, Inc.,* 2014 U.S. Dist. LEXIS 70859 (E.D. Ky. May 23, 2014) and *In re Harman International Industries, Inc., Sec. Litig.,* 2014 U.S. LEXIS 6175 (D.D.C. Jan. 17, 2014).

With respect to whether particular cautionary language was adequate to satisfy the cautionary language safe harbor, courts held that the following cautionary language was adequate:

Successful Motions to Dismiss Securities Class Actions, A Review of What Worked in 2014

1. Actual results may differ materially from those expressed or implied, as a result of certain risks and uncertainties. These risks and uncertainties are described in detail in the company's SEC filings. Prospective investors are cautioned not to place undue reliance on such forward-looking statements. *Police Retirement System of St. Louis v. Intuitive Surgical, Inc.* 759 F.3d 1051 (9th Cir. 2014).
2. The company warned that during the past several years a number of its competitors offered mattress and pillow products, and that competition by established manufacturers or new entrants could have a material adverse effect on its business, financial condition, and operating results. *Norfolk County Retirement System v. Tempur-Pedic International, Inc.,* 2014 U.S. Dist. LEXIS 70859 (E.D. Ky. May 23, 2014)
3. The company warned that with respect to its backlog that purchase orders and other commitments are subject to contingencies that are outside the company's control and may be revised, modified, delayed, or canceled, and warned that there could be no assurance that the company would recognize revenue related to its purchase orders and other commitments. *Pound v. Stereotaxis, Inc.,* 2014 U.S. Dist. LEXIS 3921 (E.D. Mo. Mar. 18, 2014).
4. The company's 10-K listed as risks that any product launch may not be successful. *In re K-V Pharmaceutical Company Sec. Litig.,* 2014 U.S. Dist. LEXIS 40828 (E.D. Mo. Mar. 27, 2014).
5. The company's 10-K warned that two car manufacturers were not obligated to any long-term purchases of the company's products and that if the company failed to introduce new products or misinterpreted consumer preferences or failed to respond to changes in the market place, then demand for its products could decrease. *In re Harman International Industries, Inc. Sec. Litig.,* 2014 U.S. Dist. LEXIS 6175 (D.D.C. Jan. 17, 2014).

14. Loss Causation.

Under the PSLRA (and pre-PSLRA decisions as well), plaintiffs are required to plead and prove "loss causation" in actions alleging violations of Section 10(b) of the Securities Exchange Act. In contrast to transaction causation, which requires a plaintiff to prove that but for the fraud he or she would not have entered into a purchase or sale transaction, loss causation requires the plaintiff to prove that the decline in the price of the stock (after the purchase and before the sale) was caused by the fraud as well.[26]

A number of recent decisions have granted motions to dismiss based on inadequate allegations of non-conclusory facts demonstrating loss causation. For example, in *Loos v. Immersion Corp.,* 2014 U.S. App. LEXIS 17813 (9th Cir. Sept. 11, 2014), plaintiffs alleged that the company suffered a precipitous decline in its stock price after it announced an internal investigation into the company's accounting practices. In affirming the dismissal of the complaint, the court of appeals held that the announcement of an investigation, standing alone, is insufficient to establish loss causation because an investigation does not reveal fraudulent practices to the market, but only puts investors on notice of a potential future disclosure of fraudulent conduct. The court said, "[A]ny decline in a corporation's share price following the announcement of an investigation can only be attributed to market speculation

about whether fraud has occurred. This type of speculation cannot form the basis of a viable loss causation theory."

In *In re KBC Asset Management N.V. v. Eaton Corp.,* 2014 U.S. App. LEXIS (6th Cir. 2014), plaintiffs alleged that defendant had falsely represented that the company had not improperly attempted to influence a judge in a trademarks lawsuit even though a special master later concluded that the company's lawyer, with the company's knowledge, had engaged in improper ex parte communications with the judge. The court of appeals affirmed the dismissal of the complaint because plaintiff failed to adequately plead loss causation. The court found that the so-called "corrective disclosure" on which plaintiffs relied disclosed information that was already known to the market, and that "[b]ecause the complaint does not identify sufficiently new evidence that was revealed to the market, [the plaintiff] has not plausibly pled loss causation."

In *Financial Guaranty Insurance Co. v. The Putnam Advisory Co.,* No. 12 Civ. 7372 (S.D.N.Y. Apr. 28, 2014), plaintiffs alleged that contrary to representations by the defendant that it alone would select the collateral for a collateralized debt obligation ("CDO"), it allowed the process to be controlled by a hedge fund manager with a short position in the CDO. The court found that the complaint did not sufficiently plead that the hedge fund manager's alleged control of the collateral, as opposed to the global financial crisis, caused the CDO losses. "To plead loss causation in the backdrop of a marketwide downturn," the court stated, "the complaint must allege facts that support 'an inference that . . . plaintiffs would have been spared all or an ascertainable portion of the loss absent the fraud.'"[27]

In *In re New Energy Systems Sec. Litig.,* 2014 U.S. App. LEXIS 140124 (S.D.N.Y. Sept. 30, 2014), the plaintiffs alleged that the defendants kept two sets of books and that its Chinese filings reflected the true state of the company's finances while the SEC filings were false and misleading. The court dismissed the complaint for failure to adequately allege loss causation because the price of the stock fell not when the company revealed it had two sets of books, but rather when it disclosed a precipitous drop in earnings.

15. Puffery.

Under the federal securities laws, only misrepresentations or omissions of "material" facts are actionable. A fact is material for securities law purposes if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[28] One category of alleged misrepresentations that courts have held are immaterial as a matter of law are representations that courts characterize as "puffery."

For example, in *Police Retirement System of St. Louis v. Intuitive Surgical, Inc.,* 759 F.3d 1051 (2014), the Ninth Circuit, in affirming the dismissal of a securities class action complaint, stated, "Statements of mere corporate puffery, 'vague statements of optimism like "good," "well-regarded," or other feel good monikers,' are not actionable because 'professional investors, and most amateur investors as well, know how to devalue the optimism of corporate executives.'"[29] It held that defendant's expressed optimism about the following was non-actionable puffery: i) that the opportunity for system placement at hospitals "is still very, very large"; ii) that there is potential for growth in the relevant market; iii) that the company is 'reservedly optimistic' about sales; and iv) wishing it had a 'crystal ball' that defendant 'will come out stronger' and 'in a pretty good position' despite the

economic crisis." They represent, the court stated, "feel good speak that characterizes non-actionable puffing."

In *Reese v. Bahash, et al.,* 2014 U.S. App. LEXIS 17290 (Sept. 8, 2014), the Second Circuit stated that statements regarding the "independence" and "integrity" of a rating agency's ratings constitute "mere commercial puffery" and, thus, were not actionable.

In *Philadephia Financial Management of San Francisco, LLC v. DJSP Enterprises,* 2014 U.S. App. LEXIS 13543 (July 16, 2014), the Eleventh Circuit, in affirming the dismissal of a securities class action complaint, held that statements regarding the company's technological prowess were non-actionable puffery.

In *City of Pontiac Policemen's and Firemen's Retirement system v. UBS AG,* 752 F.3d 173 (2014), the Second Circuit, in affirming the dismissal of a securities class action complaint, held that general statements about reputation, integrity, and compliance with ethical norms are non-actionable puffery. The court said, "This is particularly true where, as here, the statements are explicitly aspirational with qualifiers such as 'aims to,' 'wants to,' and 'should' and that plaintiffs' claims that these statements were knowingly and verifiably false 'does not cure their generality, which is what prevents them from rising to the level of materiality required to form the basis for assessing a potential investment.'"

16. Pejorative Characterizations.

Plaintiffs' allegations sometimes amount to a claim that defendants should have disclosed facts in a more pejorative manner than they did. Courts frequently dismiss these claims on the ground that, having disclosed the facts, defendants are not under a duty to characterize them negatively.

For example, in *Wu v. Stomber,* 750 F.3d 944 (2014), the D.C. Circuit affirmed the dismissal of claims involving an investment fund whose assets consisted of residential mortgage-backed securities. The fund had disclosed that the market value of the securities was "highly volatile" and "difficult to predict" and plaintiff conceded that it was widely known that the value of residential mortgage securities nationwide was in extreme flux. The court stated that defendants did not have to go further and put "a skull and crossbones" on its disclosures.

17. Absence of Aiding and Abetting Liability.

One of the most significant developments in class action litigation under federal securities laws has been the Supreme Court's rejection of aiding and abetting liability under Section 10(b). Prior to 1994, class actions against aiders and abettors were standard and virtually unquestioned. The Supreme Court, however, rejected 30 years of lower court precedent and held that only primary violators, not aiders and abettors, are liable in private actions brought under Section 10(b).[30] The Court then rejected efforts to circumvent its holding through what some courts had referred to as "scheme liability"— liability based on alleged conduct the purpose and effect of which allegedly is to facilitate misrepresentations by the principal wrongdoer (for example, by entering into questionable transactions with knowledge that the defendant will use the transaction to misrepresent its financial condition).[31] More recently, the Court created a bright-line distinction between primary violators and aiders and abettors. It held that even though an investment adviser to a mutual fund exercised significant influence over the fund and prepared and allegedly misleading prospectus on behalf of the

fund, the adviser could not be liable as a primary violator because the mutual fund, not the adviser, "made" the statements.[32] It stated that for purposes of Section 10(b) liability, "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. … One who prepares or publishes a statement on behalf of another is not its maker."

The Supreme Court's "made the statement" standard has been used effectively by defendants in a variety of circumstances. For example, in *In re UBS AG Sec. Litig.,* 2012 U.S. Dist. LEXIS 141449 (S.D.N.Y. Sept. 28, 2012, *aff'd on other grounds,* 762 F.3d 173 (2d Cir. 2014), the district court considered the effect of the Supreme Court's decision in *Janus* on class action claims against corporate officers. The court held that "a theory of liability premised on treating corporate insiders as a group cannot survive a plain reading of the *Janus* decision" and that while *Janus* does not necessarily mean that there can be only one maker of a statement, "the individual defendants still must have actually 'made' the statements under the new *Janus* standard to be liable under Section 10(b)." The court also held that *Janus* is inconsistent with liability for a "nonspeaking defendant."

In *Starr Investment Cayman II, Inc. v. China MediaExpress Holdings, Inc.,* 2014 U.S. Dist. LEXIS 116475 (D. Del. Aug. 21, 2014), the court relied on *Janus* to hold that an engagement partner for an audit firm is not liable for a false opinion issued by the audit firm because he was not the "maker" of the statements in the audit opinion.

In *Town North Bank, N.A. v. Shay Financial Services, Inc.,* 2014 U.S. Dist. LEXIS 137551 (N.D. Tex. Sept. 30, 2014), the court dismissed a complaint alleging that offering documents prepared by defendants' affiliated contained false information or information that was no longer accurate by the time it purchased the securities at issue, and that defendants misled it by failing to disclose that the securities were subject to greater risk at the time of the sale than indicated in the stock offering documents prepared by defendants' affiliates. In dismissing, the court stated that *Janus* foreclosed liability because plaintiff "attributes the allegedly misleading statements in the offering documents to Defendants' affiliates, the issuers of the offering documents, and the credit rating agencies" and failed to alleged any facts that would establish that Defendants made the misleading statements.

In *In re Miller Energy Resources Sec. Litig.,* 2014 U.S. Dist. LEXIS 15810 (E.D. Tenn. Feb. 4, 2014), the court held that claims that the president of a company was responsible for false and misleading statements made by others was foreclosed by *Janus* because none of the statements released during his tenure were issued by him, signed by him, presented by him, or quote him. The court stated, "Simply asserting that he was a 'maker' of the statements with 'authority to control' them, without more, is not enough; these are conclusions, not allegations of facts stated with particularity."

18. Controlling Person Liability.

The Securities Exchange Act expressly provides for liability of "controlling persons," i.e., persons who control the person who commits the violation.[33] The most common basis for dismissing controlling person allegations is that the complaint fails to state a claim against the controlled person because there can be no controlling person liability absent a violation by the controlled person.

Some courts also take the position that for there to be controlling person liability a plaintiff must allege some level of culpable participation by the controlling person at least

approximating recklessness and that the PSLRA's heightened pleading requirements require the plaintiff to plead with particularity facts giving rise to a strong inference of the requisite state of mind.

For example, in *Special Situations Fund III QP, L.P. v. Deloitte Touche Tohmatsu CPA, Ltd.,* 2014 U.S. Dist. LEXIS 99861 (S.D.N.Y. July 21, 2014), the court acknowledged that both the circuit courts of appeal are divided and district courts within the Second Circuit are divided on whether plaintiffs must plead the element of "culpable participation" to state a claim for controlling person liability. The court stated, however, that a majority of the district courts within the Second Circuit require plaintiffs to allege "that the [controlling person] was, in some meaningful sense, a culpable participant in the controlled person's fraud." In dismissing controlling person claims against Deloitte U.S., it held that "culpable participation is an element of a [controlling person] claim that must be pleaded with the same particularity as scienter," and that "it stands to reason that an allegation of 'culpable participation' requires 'particularized facts of the controlling person's conscious misbehavior or recklessness.'"

In *Universal American Corp. v. Partners Healthcare Solutions Holdings, L.P.,* 2014 U.S. Dist. LEXIS 100654 (D. Del. July 24, 2014), plaintiffs alleged that one of the individual defendants was aware of a misleading presentation given to senior management and played a role in reviewing and approving other incorrect presentations. In dismissing with leave to re-plead, the court stated that the allegations of control were insufficient because the individual defendant was not alleged to have had primary responsibility for the company's operations or to have been a "major player" in the sales efforts. The court stated that plaintiffs had to allege facts showing that the individual defendant i) had primary responsibility for the company's overall management and day-to-day operations or was a "major player" in those operations and ii) was a culpable participant in the alleged fraud.

In *In re Long Wei Petroleum Investment Holding Limited Sec. Litig.,* 2014 U.S. Dist. LEXIS (S.D.N.Y. Jan. 27, 2014), the court dismissed controlling person allegations against an individual defendant because the complaint contained "only boilerplate allegations that the 'Individual Defendants … knew or recklessly disregarded the fact that … representations were materially false and misleading and/or omitted material facts when made.'"

19. SLUSA and State Law Class Actions.

In 1998, Congress enacted the Securities Litigation Uniform Standards Act ("SLUSA") because plaintiffs were trying to avoid the requirements of the PSLRA by filing claims under state law or in state court. SLUSA provides that subject to certain limitations,

> No covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging—
>
> (A) a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security; or
>
> (B) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security.[34]

SLUSA defines "covered class action" to include, among other things, a lawsuit in which damages are sought on behalf of more than 50 persons, and it defines "covered security" to

include, among other securities, securities listed or authorized for listing on a national securities exchange.

The Supreme Court held that SLUSA preempts state law class actions alleging that a defendant's alleged fraud induced plaintiffs to hold onto overvalued securities (as opposed to purchasing or selling such securities) even though such "holder" claims are not actionable in private damage actions brought under the federal securities laws.[35] The Court held that the "in connection with" language in SLUSA is broad and is not limited to claims brought by a plaintiff claiming to have been induced to purchase or sell a security; that SLUSA is not limited to claims that could otherwise be brought under federal law; and that, in enacting SLUSA, Congress was highly focused on the dangers of abusive class actions and the risks of allowing such class actions to be brought under state law.

More recently, the Supreme Court revisited SLUSA and held that a class action alleging misrepresentations regarding the safety of certificates of deposit that were not "covered securities" could be brought in state court even though defendants allegedly told plaintiffs that the uncovered securities were backed by covered securities.[36] The Court nevertheless recognized the broad reach of SLUSA. It stated that it precludes state law class actions "where the misrepresentation makes a significant difference to someone's decision to purchase or sell a covered security" and reached cases involving "victims who took, who tried to take, who divested themselves of, who tried to divest themselves of, or who maintained an ownership interest in financial instruments that fall within the relevant statutory definition."

Lower courts routinely reject efforts to bring class actions in state court or under state law that involve misrepresentations or omissions related to covered securities regardless of how plaintiffs characterize their claims.

For example, in *In re Herald,* 753 F.3d 110 (2014) (per curiam), the Second Circuit held that state law class action claims that Madoff Securities fraudulently induced investments in covered securities through feeder funds and fraudulently failed to follow through on its promise to place the investments in covered securities were precluded by SLUSA.

Similarly, in *Goodman v. Assetmark, Inc.,* 2014 U.S. Dist. LEXIS 148198 (E.D.N.Y. Oct. 17, 2014), plaintiffs alleged that defendants breached their fiduciary duties by failing to purchase Funds selected by a particular individual and, instead, purchasing Funds that paid defendants higher fees. Even though plaintiffs framed their claims as breach of fiduciary duty rather than fraud claims, the court dismissed under SLUSA because plaintiffs' breach of fiduciary duty claim "alleges misrepresentations and omissions of material facts in connection with the purchase of mutual funds.…"

20. Foreign Securities Transactions.

In 2010, the Supreme Court overturned four decades of lower court precedent and held that Section 10(b) reaches "only transactions in securities listed on domestic exchanges, and domestic transactions in other securities to which Section 10(b) applies."[37] It based its decision primarily on the "longstanding principle of American law 'that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.'" It held that the fact that some allegedly fraudulent activity happened in the United States was not enough to avoid dismissal because "the focus of the

Exchange Act is not upon the place where the deception originated, but upon purchases and sales of securities in the United States."

One issue left open by *Morrison* is whether the requirement of a "domestic" transaction is not only necessary for Section 10(b) to apply, but sufficient as well. In *Parkcentral Global Hub Ltd. v. Porsche Automobile Holdings SE*, 763 F.3d 198 (2014), involving swaps executed in the United States but dependent on the price of securities traded exclusively outside the United States, the Second Circuit held that a domestic securities transaction is necessary but not always sufficient for US securities laws to apply. It held that because the complaint concerned statements made primarily in Germany with respect to stock in a German company traded only on exchanges in Europe, "the relevant actions in this case are so predominantly German as to compel the conclusion that the complaints fail to invoke § 10(b) in a manner consistent with the presumption against extraterritoriality."

In *City of Pontiac Policemen's and Firemen's Retirement System v. UBS AG,* 752 F.3d 173 (2014), the Second Circuit held that where a foreign plaintiff purchased shares on a foreign exchange, *Morrison* precludes application of Section 10(b) even if those shares are also listed on a US exchange. The court also held that the mere placement of a buy order in the United States for the purchase of foreign securities on a foreign exchange is not sufficient to allege that a purchaser incurred irrevocable liability in the United States such that US securities laws govern the purchase of those securities.

Conclusion

As we mentioned at the outset, motions to dismiss are now successful in close to half of all securities fraud class actions. Even complaints that go on for hundreds of pages, cite dozens of confidential witnesses, and allege insider sales or GAAP violations have been dismissed. Courts may ignore conclusory allegations and may consider documents outside the pleadings. Courts often rule that, as a matter of law, the facts pled by plaintiffs do not create a strong inference of scienter, do not demonstrate that the statements were false when made, and do not show loss causation, especially if the losses coincide with market-wide events or changed economic circumstances. Beyond this, private claims against alleged aiders and abettors are no longer viable under federal securities laws. Under the PSLRA safe harbors, forward-looking statements accompanied by meaningful cautionary language are not actionable; and, even when they are not accompanied by meaningful cautionary language, such forward-looking statements are not actionable in the absence of well-pled facts showing that the defendant actually knew that the statements were false. Fraud by hindsight is dead. The absence of a "duty to disclose" and a "duty to update" even material information have often led to dismissals. "Puffery" and other vague generalities have been declared by courts to be non-actionable. Under SLUSA, securities class actions based on claims in connection with the purchase or sale of securities cannot be brought under state law or in state court even if they also cannot be brought in federal court. Transactions outside the United States are far more frequently deemed to be beyond the purview of the federal securities laws. If the motion to dismiss is the "main event" in securities class action litigation, the defenses discussed above are among the key ingredients for defendants to obtain a successful outcome.

Successful Motions to Dismiss Securities Class Actions, A Review of What Worked in 2014

Authors:

Jonathan N. Eisenberg
Jon.eisenberg@klgates.com
+1.202.778.9348

K&L GATES

Anchorage Austin Beijing Berlin Boston Brisbane Brussels Charleston Charlotte Chicago Dallas Doha Dubai Fort Worth Frankfurt Harrisburg Hong Kong Houston London Los Angeles Melbourne Miami Milan Moscow Newark New York Orange County Palo Alto Paris Perth Pittsburgh Portland Raleigh Research Triangle Park San Francisco São Paulo Seattle Seoul Shanghai Singapore Spokane Sydney Taipei Tokyo Warsaw Washington, D.C. Wilmington

K&L Gates comprises more than 2,000 lawyers globally who practice in fully integrated offices located on five continents. The firm represents leading multinational corporations, growth and middle-market companies, capital markets participants and entrepreneurs in every major industry group as well as public sector entities, educational institutions, philanthropic organizations and individuals. For more information about K&L Gates or its locations, practices and registrations, visit www.klgates.com.

This publication is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer.

© 2014 K&L Gates LLP. All Rights Reserved.

---

[1] "Recent Trends in Securities Class Action Litigation: 2013 Full-Year Review," at 18 (NERA Economic Consulting, Jan. 21, 2014)
[2] Id. at 36.
[3] Id. at 19.
[4] "Securities Class Action Filings: 2013 Mid-Year Assessment," at 16-17 (Cornerstone Research 2013).
[5] Jonathan Eisenberg, "Beyond the Basics: Seventy-Five Defenses Securities Litigators Need to Know," Vol. 62 *The Business Lawyer* No. 4 (August 2007). *See also* Jonathan Eisenberg, Chapter 2, "Motions to Dismiss Securities Class Actions," in Eisenberg (Editor) ***Litigating Securities Class Actions*** (Matthew Bender 2012–2014). Portions of this alert are based on these two sources.
[6] A fact is material "if there is a substantial likelihood that a reasonable shareholder would consider it important" to making an investment decision. *Basic, Inc. v. Levinson*, 485 U.S. 224, 232 (1988).
[7] In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), the Supreme Court held that to recover under Section 10(b), a plaintiff must prove that the defendant acted not merely negligently but with a "mental state embracing intent to deceive, manipulate, or defraud." The Supreme Court has not decided whether recklessness satisfies the scienter requirement, but lower courts have held that it does.
[8] In *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71 (2006), the Supreme Court, in rejecting a plaintiff's effort to file a state law "holder" class action, broadly construed the "in connection with" requirement. On the other hand, in *Chadbourne & Parke LLP v. Troice*, 134 S.Ct. 1058, 1066 (2014), the Supreme Court held that "[a] fraudulent misrepresentation or omission is not made 'in connection with… a 'purchase or sale of a covered security' unless it is

material to a decision by one or more individuals (other than the fraudster) to buy or to sell a 'covered security.'"

[9] In *Halliburton v. Erica P. John Fund, Inc.*, 134 S.Ct. 2398 (2014), the Supreme Court re-affirmed its holding in *Basic Inc. v. Levinson, 485 U.S. 224 (1988),* that investors can satisfy the reliance requirement by invoking the presumption that that price of stock traded in an efficient market reflects all public material information, and that anyone who buys or sells the stock at the market price may be considered to have relied on material misrepresentations or omissions with respect to such securities.

[10] In *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005), the Supreme Court held that purchase price inflation alone is not enough to show loss causation; rather, plaintiff must show that that the decline in the value of the stock was related to the fraud as well.

[11] *Matrixx Initiatives, Inc. v. Siracusano*, 131 S.Ct. 1309, 1317 (2011).

[12] *In Re Omnicare, Inc. Sec. Litig.*, 2014 U.S. App. LEXIS 19236 (6th Cir. Oct. 10, 2014).

[13] For the strong inference of scienter requirement to be satisfied, the facts pled must create an inference of scienter "that must be cogent and at least as compelling as any opposing inference of non-fraudulent intent." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 324 (2007).

[14] *E.g., Denny v. Barber*, 576 F.2d 465, 469 (2d Cir. 1978).

[15] *See, e.g., Herman & MacLean v. Huddleston*, 459 U.S. 375, 381 (1983) ("If a plaintiff purchased a security issued pursuant to a registration statement, he need only show a material misstatement or omission to establish his prima facie case. Liability against the issuer of a security is virtually absolute, even for innocent misstatements."). *See also Gustafson v. Alloyd Co.*, 513 U.S. 561, 584-87 (1995) (even if a Section 12(a)(2) claim is based on an oral statement, the oral statement must relate to a prospectus).

[16] *Kramer v. Time Warner, Inc.*, 939 F.2d 767, 774 (2d Cir. 1991).

[17] *E.g., Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555 (2007).

[18] In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), the Supreme Court held that to recover under Section 10(b), a plaintiff must prove that the defendant acted not merely negligently but with a "mental state embracing intent to deceive, manipulate, or defraud." The Supreme Court has not decided whether recklessness satisfies the scienter requirement, but lower courts have held that it does.

[19] Quoting *Zucco Partners, LLC v. Digimarc Corp.*, 552 F.3d 981, 995 (9th Cir. 2009).

[20] Quoting *Novak v. Kasaks*, 216 F.3d 300, 309 (2d Cir. 2000).

[21] The PSLRA requires that to allege falsity a complaint must "specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement is made on information and belief, the complaint shall state with particularity all facts on which the belief is formed." 15 U.S.C. § 78u-4(b)(1).

[22] The Supreme Court has held that "[w]hen an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak" and "a duty to disclose under § 10(b) does not arise from mere possession of nonpublic market information." *Chiarella v. United States*, 445 U.S. 222, 235 (1980).

[23] In *Finnerty*, the Eleventh Circuit refused to disturb a jury verdict for the plaintiff, who alleged that a company that represented it "will continue to be private held" had a duty to update at some point after it entered into preliminary merger negotiations.

[24] *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 477 (1977).

[25] 15 U.S.C. § 78u-5, 15 U.S.C. § 77z-2.

[26] In *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005), the Supreme Court emphasized the centrality of loss causation in securities fraud cases. The Court held that at least in fraud-on-the-market cases, "an inflated purchase price will not itself constitute or proximately cause the relevant economic loss." Rather, loss causation focuses on the losses sustained "when the facts . . . become generally known." The Supreme Court held that the complaint in *Dura* should have

been dismissed because it "fail[ed] to claim that Dura['s] shares fell significantly after the truth became known."

[27] Quoting *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 175 (2d Cir. 2005).

[28] *TSC Indus. v. Northway, Inc.*, 426 U.S. 439, 448 (1976); *Matrixx Initiatives, Inc. v. Siracusano*, 131 S.Ct. 1309, 1318 (2011); *Basic, Inc. v. Levinson*, 485 U.S. 224, 232 (1988).

[29] Quoting *In re Cutera Sec. Litig.*, 610 F.3d 1103, 1110 (9th Cir. 2010).

[30] *Central Bank of Denver, N.A. v. First interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994).

[31] S*toneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148 (2006).

[32] *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S.Ct. 2296 (2011).

[33] 15 U.S.C. § 78t.

[34] 15 U.S.C. § 78bb(f)(1).

[35] *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 84 (2006).

[36] *Chadbourne & Parke LLP v. Troice*, 134 S.Ct. 1058 (2014).

[37] *Morrison v. National Australia Bank Ltd.*, 130 S.Ct. 2869 (2010).