

## Circuit Court Decisions Addressing Section 10(b) Claims

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### **Second Circuit: Plaintiffs Cannot Assert a Securities Fraud Claim Based on “Tentative and Generic” Compliance-Related Statements**

On March 5, 2019, the Second Circuit affirmed the dismissal of a securities fraud action alleging that a health services company made misstatements concerning its regulatory compliance. [Singh v. Cigna Corp.](#), 918 F.3d 57 (2d Cir. 2019) (Cabranes, C.J.). The court cautioned that plaintiffs cannot assert “a prima facie case of securities fraud” merely by “point[ing] to banal and vague corporate statements affirming the importance of regulatory compliance” coupled with “significant regulatory violations.” The court emphasized that “such generic statements do not invite reasonable reliance.”

The Second Circuit found that compliance-related statements in the company’s Code of Ethics were “textbook example[s] of puffery” because they were simply “general declarations about the importance of acting lawfully and with integrity.” The court further held that a reasonable investor would not rely upon the “tentative and generic” compliance-related statements in the company’s SEC filings, particularly because those statements were “framed by acknowledgements of the complexity and numerosity of applicable regulations.” The court observed that “[s]uch framing suggests caution (rather than confidence) regarding the extent of [the company’s] compliance.”

### **Third Circuit: Company’s Comprehensive Disclosures Defeated an Inference of Scienter**

On June 20, 2019, the Third Circuit affirmed the dismissal of a securities fraud action alleging that a company “fraudulently lauded its financial health and misrepresented that its distributions were funded from the performance of the business.” [Fan v. StoneMor Partners](#), 927 F.3d 710 (3d Cir. 2019) (Restrepo, C.J.). The Third Circuit found that “for each category of alleged misstatements, [the company] disclosed sufficient information to render them immaterial.” The court determined that these disclosures “alert[ed] reasonable investors” to the company’s downside potential.

The Third Circuit further held that the company’s comprehensive disclosures belied any inference of scienter. The court noted that the company’s disclosures “accurately show how [the company] leveraged its assets in order to maximize its distributions despite the state trust requirements” that limited its ability to recognize proceeds as revenue under GAAP. The court explained that although the company “may

have been caught by the risk inherent in its business strategy, . . . those risks were disclosed” to investors and thus “the pleadings do not demonstrate scienter as the [Private Securities Litigation Reform Act (“PSLRA”)] requires.”

### **Fifth Circuit: Plaintiffs Can Rely on Post-Statement Events to Demonstrate That a Statement Was False When Made**

On May 15, 2019, the Fifth Circuit found plaintiffs adequately pled that a company made misrepresentations concerning its algorithm for predicting and collecting insurance reimbursements, by alleging that the company “was ultimately unable to collect on the overwhelming majority of claims it billed.” *Masel v. Villareal*, 924 F.3d 734 (5th Cir. 2019) (King, C.J.). The court determined that “evidence of later events can provide useful circumstantial evidence that a given representation was false when made.”

The Fifth Circuit rejected defendants’ contention that plaintiffs were “attempting to prove fraud by hindsight by pointing to later events in order to shed light on the truth or falsehood of earlier statements.” The court noted that “fraud-by-hindsight issues arise in the context of the scienter factor, not the misrepresentation factor.” The court explained that “[w]here, as here, the representation in question concerned an asset or skill possessed by the defendant (here, an algorithm), the defendant’s failure to perform as promised casts doubt on whether he possessed that skill in the first place.”

### **Fifth Circuit: Plaintiffs Cannot Impute One Corporation’s Knowledge to Another Through Unsubstantiated Allegations of a Joint Venture**

On May 24, 2019, the Fifth Circuit affirmed the dismissal of an Enron-related securities fraud action brought against the independently-incorporated retail brokerage and investment banking arms of a major bank. *Lampkin v. UBS Fin. Servs.*, 925 F.3d 727 (5th Cir. 2019) (Higginbotham, C.J.). The Fifth Circuit rejected plaintiffs’ contention that “any material, nonpublic information known to [the investment bank] had to be disclosed by [the brokerage]” because the bank “operated as a single, fully integrated entity.” The court found that “vague corporate platitudes about integration as a firm’ are insufficient to support a finding of joint venture liability” (quoting *Giancarlo v. UBS Financial Services*, 725 F. App’x. 278 (5th Cir. 2018)). The court emphasized that plaintiffs did not allege “that defendants shared profits or losses” or “that defendants had joint control or right of control over the joint venture,” as required to establish the existence of a joint venture under governing Delaware law.

### **Fifth Circuit: Defendants’ Alleged Awareness of Excess Inventory Levels Was Insufficient to Raise a Strong Inference of Scienter Concerning a Significant Markdown Risk**

On August 19, 2019, the Fifth Circuit affirmed the dismissal of a securities fraud action alleging that a home furnishings company and its executives failed to disclose “the risk that [the company] had so much inventory that it could get rid of it only by lowering prices dramatically.” *Municipal Emps. Ret. Sys. of Mich. v. Pier 1 Imports*, 935 F.3d 424 (5th Cir. 2019) (Elrod, C.J.). Plaintiffs did not claim that defendants “misrepresented [the company’s] inventory” but instead asserted that defendants “misled the public about [the company’s] ability to offload that excessive inventory without significant markdown risk.” The court held plaintiffs failed to allege scienter because “[k]nowledge of high inventory does not necessarily equate to knowledge of significant markdown risk.”

The court rejected plaintiffs’ contention that the company’s “products are particularly subject to markdown risk” because the company “is a trend-based [home] fashion retailer that is subject to the whims of consumer trends.” The court found the company “operates largely in the sturdier business of style” rather than the ever-changing business of fashion. The court also noted that plaintiffs offered no explanation for why defendants “kept ordering more inventory when they supposedly knew deep down that they would not be able to sell it.” Rather than raising a strong inference of scienter as to a significant markdown risk, the court found it “equally plausible . . . that [defendants] reasonably believed they could fix the excessive inventory problem without resorting to markdowns.”

### **Eleventh Circuit: (1) The Puffery Defense Applies in the Securities Fraud Context, and (2) Statements Conveying Future Plans Are Entitled to Safe Harbor Protection Even If They “Implicitly Communicate Information About the Present”**

On August 15, 2019, the Eleventh Circuit issued its first published decision applying the puffery defense in the securities fraud context. *Carvelli v. Ocwen Fin. Corp.*, 934 F.3d 1307 (11th Cir. 2019) (Newsom, C.J.). The court found that “the defense seems a particularly good fit in

the securities context” because Rule 10b-5 prohibits only “untrue statements of a *material* fact, with ‘material’ defined to mean something that a reasonable investor would view as having significantly altered the total mix of information made available.” The court explained that “[e]xcessively vague, generalized, and optimistic comments—the sorts of statements that constitute puffery—aren’t those that a ‘reasonable investor,’ exercising due care, would view as moving the investment decision needle—that is, they’re not material.”

The Eleventh Circuit cautioned that “[a] conclusion that a statement constitutes puffery doesn’t absolve the reviewing court of the duty to consider the possibility—however remote— that in context and in light of the ‘total mix’ of available information, a reasonable investor might nonetheless attach importance to the statement.” The court found that many of the compliance-related statements at issue in the case before it—such as assertions that the company “was taking a ‘leading role’ and making ‘progress’ toward compliance”—were “quintessential puffery” and “immaterial as a matter of law.” The court rejected plaintiffs’ contention that the statements “can’t be nonactionable puffery because [the company] did not genuinely or reasonably believe them.” The court explained that “[w]hether a statement was made in bad faith or without a reasonable basis is irrelevant to the question [of] whether the statement is nonetheless so airy as to be insignificant.”

The Eleventh Circuit also held that the company’s forward-looking statements were entitled to safe harbor protection even though they included “statements about the [c]ompany’s present condition and intentions.” The court held that “when a forward-looking statement is of the sort that, by its nature, rolls in present circumstances—that is, when a statement forecasts in a tentative way a future state of affairs in which a present commitment unfolds into action— the statement isn’t barred from safe harbor protection solely on that ground.”

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