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Second Circuit Affirms Dismissal of Securities Fraud Class Action Alleging Undisclosed Projections

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In *Maso Cap. Invs. Ltd. v. E-House (China) Holdings Ltd.*, No. 22-355 (2d Cir. June 10, 2024), the United States Court of Appeals for the Second Circuit affirmed the district court's dismissal of a putative securities-fraud class action brought against a company and several of its directors based on, among other things, the alleged failure to disclose newer projections before a go-private merger in violation of Section 10(b) of the Securities Exchange Act of 1934 and its implementing rule, Rule 10b-5.

In June of 2015, E-House (China) Holdings Limited (the Company) received a buyout offer from a group (the Buyer Group) that included several members of the Company's board of directors (the Board). On the date of the offer, the Company formed a transaction committee composed of the Board members who were not part of the Buyer Group in order to evaluate the buyout offer. The transaction committee retained separate counsel and advisors, and engaged in negotiations with the Buyer Group. In April of 2016, the transaction committee and the Board approved the proposed buyout. The Company filed a proxy statement that set forth, among other things, management's projections for the Company (the "Management Projections"), and the reasons for the merger. In August of 2016, the shareholders approved the merger, and the closing occurred shortly thereafter.

Following the closing, during an appraisal hearing initiated by a dissenting shareholder, it was asserted that another set of projections (the Parallel Projections) – purportedly approved by the co-chair of the Board before the date of the final proxy statement but not disclosed in such proxy statement – showed higher profit figures, sales figures, earnings before interest and taxes, and consolidated annual growth rates than those included in tho Management Projections. While the parties to the appraisal action settled, certain Company investors (the Investors) subsequently brought a putative class action alleging that the proxy contained false and misleading statements because, among other things, the Management Projections contained in the proxy had been supplanted by the Parallel Projections. The United States District Court for the Southern District of New York, holding that the Investors failed to plead any actionable misstatement or omission, granted the defendants' motion to dismiss, and the Investors appealed.

The Court noted that to state a claim under Section 10(b) and Rule 10b-5, a plaintiff must, among other things, plead a material misrepresentation or omission by the defendant. Addressing this element of a claim, the Court stated that, to establish liability under Rule 10b–5(b), there must be (1) a false statement (an actual statement that is untrue outright), or (2) a half-truth (a representation that omits critical qualifying information). Notably, the Court underscored that Section 10(b) and Rule 10b-5 "do not create an affirmative duty to disclose any and all material information", instead requiring disclosure only when necessary to make "statements made, in the light of the circumstances under which they were made, not misleading".

The Court then examined the Investors' contention that the Management Projections contained in the proxy did not reflect management's "best currently available estimates and judgments" because they had been superseded by the

Parallel Projections. In disagreeing with this contention, the Court noted that the projection would be misleading only if the speaker "(1) did not hold the belief [that was] professed, (2) supplied" "supporting fact[s]" that "were untrue," or (3) "omit[ted] information whose omission ma[de] the statement misleading to a reasonable investor." According to the Court, the Investors failed to explain who created the Parallel Projections, for what purpose they were prepared, and to whom they were made available – in other words, the complaint did not contain the requisite detail as to the "who, what, when, where, and how" of the Parallel Projections. While the Investors alleged that the Parallel Projections were prepared by the Company's management, the Court found that the Investors provided no particularized facts suggesting that the Parallel Projections were even created by or shared with the Company, the Board, or the transaction committee prior to the date of the final proxy. Applying the standard for a misleading projection finding described above, the Court concluded that the Investors failed to adequately plead that the defendants "did not believe that the Management Projections were accurate at the time they were published, that they disclosed any untrue facts, or that they concealed information that made such projections misleading".

Moreover, the Court stated that the "bespeaks caution" doctrine required it to credit cautionary language contained in the proxy and to consider the context of the alleged misstatements or omissions "to determine whether a reasonable investor would have been misled". Because the proxy contained express cautionary language (including a statement in bold print and capital letters warning investors that the Company undertook no obligation to update the Management Projections for circumstances or events occurring after their preparation) that did not only "bespeak caution" but "shout[ed] it from the rooftops…", the Court found that it would be difficult to conceive how a reasonable investor could have been misled about the risks presented by the Management Projections. As for the Investors' "pure-omission" theory claim that the defendants had an independent duty to disclose the Parallel Projections, it was rejected by the Court because such claims are no longer actionable under Rule 10b-5 following the Supreme Court ruling in *Macquarie Infrastructure Corp. v. Moab Partners, L. P.*, 601 U.S. 257 (2024).

Additionally, the Investors claimed that, while the proxy statement disclaimed any Buyer Group plans to materially change the Company's business, the Buyer Group had at that time already had plans to relist the Company on the Hong Kong Stock Exchange. The Court rejected this claim because "virtually all" of the evidence presented by the Investors related to post-merger periods, and because the proxy explicitly stated that the Buyer Group may in the future "propose or develop plans and proposals", "including the possibility of relisting the Company…on another stock exchange".

The *Maso* case provides some helpful guidance regarding 10b-5 claims based on projections included in a merger proxy statement. The dismissal of the case, in part, because the plaintiffs failed to establish the details of the origin and use of the Parallel Projections should guide issuers to consider and analyze all available projections when preparing a proxy statement. Later dated projections that are provided to a board, a financial advisor or bidders could potentially render earlier dated projections misleading and their omission could form the basis of a 10b-5 claim. While the court cited to the clear cautionary language included in the proxy statement around projections, whether the "bespeaks caution" doctrine alone is sufficient to protect defendants in a case involving a different set of parallel projections will likely depend on the actual facts in issue.