Clients&FriendsMemo

Securities Litigation Update

Courts of Appeal Address the Exchange Act's Exclusive-Jurisdiction and Non-Waiver Provisions, the Duty to Disclose, and Scienter

April 14, 2022

In the first quarter of 2022, federal appellate courts issued a number of thought-provoking (albeit not monumental) decisions addressing the reach of the federal securities laws and, in some cases, highlighting potentially powerful defenses for litigants. In this memorandum, we discuss the following developments:

The Exchange Act's exclusive-jurisdiction and non-waiver provisions. In *Seafarers Pension Plan v. Bradway*,[1] a divided panel of the U.S. Court of Appeals for the Seventh Circuit reinstated a claim brought in federal court under Section 14(a) of the Securities Exchange Act of 1934 (the "Exchange Act"), asserted derivatively by a stockholder of the Boeing Company, based on allegedly false and misleading statements in proxy solicitation materials. The Court declined to enforce a Boeing bylaw that, on its face, would have restricted all derivative claims (including those based on alleged violations of Section 14(a)) to the Delaware Court of Chancery. Because federal courts have exclusive jurisdiction over Exchange Act claims like those asserted under Section 14(a), the practical import of a contrary decision would have been to preclude the assertion of any Exchange Act claims via a derivative action. The majority based its ruling on interpretations of Delaware law and the Exchange Act, holding that the former did not permit a corporate bylaw that would "foreclose suit in a federal court based on federal jurisdiction," and that the latter disallowed "waiver" of federal exclusive jurisdiction so as to "close all courthouse doors" to a derivative Section 14(a) claim. The decision prompted a vigorous dissent from Judge Frank Easterbrook. Judge Easterbrook would have enforced the bylaw because (i) it did not prevent a plaintiff from bringing "direct" Section 14(a) claims (as to which the bylaw would not have applied), (ii) it did not preclude adjudication of procedural aspects of a Section 14(a) derivative claim in state court (that is, whether, under applicable state law, a pre-suit demand is required, and the plaintiff may properly

[1] 23 F.4th 714 (7th Cir. 2022).

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prosecute derivative claims on the corporation's behalf), and (iii) the bylaw should be viewed as an ordinary contractual forum-selection clause that permissibly waived exclusive federal jurisdiction.

Seafarers forecloses a particular application of an exclusive-forum bylaw, *i.e.*, one that, by limiting federal claims to state court, deprives the litigant of the right to assert the claim in any forum. The decision, however, leaves intact the holdings of the majority of courts that, otherwise, exclusive-forum bylaws are (at least under Delaware law) a permissible and effective way to limit multi-forum litigation and prevent inconsistent judgments. While the question is resolved for now in the Seventh Circuit, *Seafarers* rests on interpretations of state and federal law that could be upended by future Delaware and/or federal decisions, and leaves room for courts outside the Seventh Circuit to reach different conclusions.

Limits on issuers' disclosure obligations under Section 10(b). The U.S. Courts of Appeal for the Ninth and Second Circuits recently affirmed dismissal of putative class actions asserting claims under Section 10(b) of the Exchange Act and Rule 10b-5, in both cases invoking the principle that, under Section 10(b), issuers do not have a generalized duty to disclose any and all information concerning their business or prospects, even if the information could be deemed material to investors. Rather, absent an independent duty to disclose (such as by statute or regulation), an issuer typically is required to disclose information that is only "necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading."[2] Applying this concept, in *Weston Family Partnership LLLP v. Twitter, Inc.*,[3] the Ninth Circuit affirmed dismissal of Section 10(b) claims against Twitter, Inc. based on its alleged failure to disclose software bugs in public statements about an advertising program, reasoning that, by not specifically addressing the existence or non-existence of the software bugs in other statements, it had no independent duty to make such disclosure. Likewise, in *Arkansas Public Employees Retirement System v. Bristol-Myers Squibb Co.*,[4] the Second Circuit rejected claims against Bristol-Meyers Squibb Co., holding that it did not mislead investors by failing to publicly disclose a key metric used in a cancer drug trial, since it explicitly informed the public that it was withholding the information throughout the course of its trial.

Twitter and *Bristol-Myers* are apt illustrations of how issuers can minimize the risk of Section 10(b) liability through careful decision-making regarding subjects that the issuer chooses to address, and being upfront with investors about what they are—and are not—choosing to disclose. Nonetheless, issuers should exercise caution in reading too much into the decisions. Whether or not the omission of a fact renders other statements materially "misleading" is highly fact-dependent, and often a judgment call for the court at the motion stage. Still, the decisions may deter plaintiff

[2] 17 C.F.R. § 240.10b-5(b).

[3] -- F.4th --, No. 20-17465, 2022 WL 853252 (9th Cir. Mar. 23, 2022).

[4] 28 F.4th 343 (2d Cir. 2022).

overreach in borderline cases, and should serve as a valuable precedent for defendants in cases where the issuer has never affirmatively addressed the allegedly omitted information, and there is no independent duty to disclose.

Pleading a "strong inference" of scienter. The U.S. Court of Appeals for the Second Circuit issued two other decisions—*Malik v. Network 1 Financial Services, Inc.*[5] and *KBC Asset Management NV v. Metlife, Inc.*[6]—both affirming dismissal of putative class actions under Section 10(b) based on plaintiffs' failure to plead a "strong inference" of "scienter" (an intent to deceive or defraud). Any assessment of scienter is inherently fact-dependent and will vary on a case-by-case basis. These decisions, however, show that the Second Circuit continues to take the high bar set in the Private Securities Litigation Reform Act to plead scienter seriously, and will not hesitate to short-circuit a claim where the inference of fraudulent intent is not "cogent and at least as compelling" as a non-fraudulent inference.

I. *Seafarers Pension Plan v. Bradway*: Seventh Circuit Permits Derivative Section 14(a) Claim to Proceed in Federal Court, Declines to Enforce Delaware Exclusive-Forum Bylaw

A. Background

SEC Rule 14a-9, promulgated under Section 14(a),[7] prohibits solicitation of proxies by means of materially false or misleading statements.[8] Almost 60 years ago, in *J.I. Case Co. v. Borak*, the Supreme Court recognized an implied private right of action for violations of Rule 14a-9 (which the statutory text does not explicitly provide for), based on the "congressional belief that '(f)air corporate suffrage is an important right that should attach to every equity security bought on a public exchange."[9] The Court found a private right of action implicit because "among [the statute's] chief purposes is 'the protection of investors,' which certainly implies the availability of judicial relief where necessary to achieve that result."[10] *Borak* held that, under Section 14(a), a "right of action

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[5] No. 20-2948-CV, 2022 WL 453439 (2d Cir. Feb. 15, 2022).

[6] No. 21-29-CV, 2022 WL 480213 (2d Cir. Feb. 17, 2022).

[7] Section 14(a) provides: "It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 781 of this title." 15 U.S.C. § 78n(a).

[8] Rule 14a-9 provides: "No solicitation subject to this regulation shall be made by means of any proxy statement . . . containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading. . . ." 17 C.F.R. § 240.14a-9.

[9] 377 U.S. 426, 431 (1964) (quoting H.R. Rep. No. 1383, 73d Cong., 2d Sess., 13).

[10] *Id.* at 432 (quoting S. Rep. No. 792, 73d Cong., 2d Sess., 12).

exists as to both derivative and direct causes"—*i.e.*, on behalf of the corporation (for "damage done the corporation") and on behalf of the individual stockholder (for "damage inflicted directly upon the stockholder"), respectively.[11]

The distinction between a direct and derivative Section 14(a) claim was at the forefront of *Seafarers*. The case arose out of the tragic events surrounding the 2018 and 2019 fatal crashes of two Boeing 737 MAX airliners in Indonesia and Ethiopia. All 737 MAX airliners around the world were thereafter grounded until November 2020, when the Federal Aviation Administration approved the aircraft for flight. In December 2019, Seafarers Pension Plan, a Boeing stockholder, filed a complaint in the U.S. District Court for the Northern District of Illinois (where Boeing is headquartered), asserting violations of Section 14(a) and Rule 14a-9 thereunder, derivatively on behalf of Boeing, against Boeing officers and directors for allegedly false and misleading statements about the development and operation of the 737 MAX in Boeing's 2017, 2018, and 2019 proxy materials.

The defendants moved to dismiss on *forum non conveniens* grounds, arguing that the suit was precluded by a bylaw adopted by Boeing (which is incorporated in Delaware) providing that all derivative claims must be asserted in the Delaware Court of Chancery. In relevant part, the bylaw provided:

> [U]nless [Boeing] consents in writing to the selection of an alternative forum, the Court of Chancery of the State of Delaware shall be the sole and exclusive forum for . . . any derivative action or proceeding brought on behalf of the Corporation[.]

The district court (Hon. Harry D. Leinenweber) enforced the bylaw and dismissed the case. The district court was unmoved by the plaintiff's argument that, in light of federal courts' exclusive jurisdiction over Exchange Act claims, the bylaw effectively would preclude the plaintiff from bringing its derivative claim in any forum. The district court did not agree that there was a curtailment of plaintiff's rights because Delaware offers a claim that is "precisely" the same as a Section 14(a) claim, albeit under Delaware law, for failing "to disclose fully and fairly all material information within the board's control when it seeks shareholder action."[12] Given the availability of a state-law equivalent, the district court reasoned, it would not "thwart[]" public policy to compel plaintiff to bring its claim in state court.[13] There were "good reasons," the court believed, for a corporation to limit stockholder claims against its officers and directors to one forum, under a

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[11] *Id.* at 431-32.

[12] *Seafarers Pension Plan v. Bradway*, No. 19 C 8095, 2020 WL 3246326, at *2 (N.D. Ill. June 8, 2020).

[13] *Id.* at *3 (quoting *Bonny v. Society of Lloyd's*, 3 F.3d 156, 160 (7th Cir. 1993)).

"single law," including avoidance of multi-forum litigation and "inconsistent verdicts."[14] The plaintiff appealed to the Seventh Circuit.

B. The Decision

In a decision resting on interpretations of Delaware and federal statutory law, a divided panel of the Seventh Circuit reversed.[15] As for Delaware law, the basis for the majority's decision was Section 115 of the Delaware General Corporation Law, which permits Delaware corporations to adopt bylaws that "require, consistent with applicable jurisdictional requirements, that any or all internal corporate claims"—including "claims in the right of the corporation"—"be brought solely and exclusively in any or all of the courts in this State."[16] Relying on legislative history (and, specifically, a "synopsis" attached to the bill that enacted the statute), the Court explained that Section 115 was "not intended to authorize a provision that purports to foreclose suit in a federal court based on federal jurisdiction, nor . . . to limit or expand the jurisdiction of the Court of Chancery or the Superior Court."[17] Further, the Court found it significant that the Legislature chose to allow claims to be limited to "courts *in* this State" (*i.e.*, federal *and* state courts), as opposed to "courts *of* this State" (*i.e.*, solely state courts, as the Boeing bylaw purported to do). Based on these "signals," the Court construed Section 115 as prohibiting a bylaw that "close[s] all courthouse doors to [a] derivative action" over which federal courts have exclusive jurisdiction.[18]

Turning to the Exchange Act, the majority concluded that the Boeing bylaw impermissibly "close[d] all courthouse doors" in the present case. Section 27 of the Exchange Act "provides that only federal courts may exercise jurisdiction over claims that arise under the Act," including derivative claims under Section 14(a).[19] Moreover, the Exchange Act contains a "non-waiver" provision in Section 29(a) that "deems void contractual waivers of compliance with requirements of the Act."[20] In the majority's view, application of the Boeing bylaw in this case would amount to an illegal waiver of Section 14(a) "compliance" because it would "force plaintiff to raise its claims in Delaware state court, which is not authorized to exercise jurisdiction over Exchange Act claims."[21] "If that's correct,

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[14] *Id.*

[15] The panel consisted of Circuit Judges Diane P. Wood, David F. Hamilton, and Frank H. Easterbrook.

[16] *Seafarers*, 23 F.4th at 720 (quoting 8 Del. C. § 115).

[17] *Id.* (quoting S.B. 75, 148th Gen. Assemb., Reg. Sess. (Del. 2015) (synopsis)).

[18] *Id.* at 720.

[19] *Id.* at 719 (citing 15 U.S.C. § 78aa).

[20] *Id.* at 720 (citing 15 U.S.C. § 78cc(a)).

[21] *Id.*

checkmate for defendants."[22] Finding this result untenable, the Court reinstated plaintiff's derivative Section 14(a) claim and remanded to the district court for further proceedings.

C. Judge Easterbrook's Dissent

The majority's reversal prompted a vigorous dissent from Judge Frank Easterbrook—former Chief Judge and a prominent appellate jurist. In Judge Easterbrook's view, the majority fundamentally misunderstood the nature of (i) a Section 14(a) claim, (ii) a derivative action, and (iii) the exclusive-jurisdiction and non-waiver provisions of the Exchange Act.

First, Judge Easterbrook rejected the majority's assumption that limiting derivative claims to Delaware state court—as the Boeing bylaw purported to do—would prevent all private enforcement of Section 14(a). Under *Borak*, plaintiff may fashion a Section 14(a) claim as either "derivative" (on behalf of the corporation, as the plaintiff did in *Seafarers*) or "direct" (on behalf of the individual stockholder, which the plaintiff did not). "Nothing in Boeing's bylaw," Judge Easterbrook observed, "strips plaintiff, as a recipient of proxy materials, of the ability to file a direct § 14(a) action in federal court."[23] Therefore, "it is hard to see how it has been deprived of a right to enforce § 14(a)."[24]

Second, it would not contravene federal exclusive jurisdiction to require the plaintiff, at minimum, to litigate the *derivative* components of the Section 14(a) claim in state court. A derivative claim consists of three "steps": (1) a demand on the board; (2) if the board rejects the demand, a lawsuit seeking permission to bring a derivative action; and (3) only if the court grants permission, prosecution of the substantive claim. The first two steps, which address "[w]ho speaks for the corporation," are governed by state (not federal law) law. Even where the substantive claim arises under federal law, the Supreme Court has taught, "[i]t is state law . . . that determines both when demand is required and when investors can step into a corporation's shoes."[25] Thus, Judge Easterbrook thought it permissible to require a plaintiff to litigate the first two steps "in state court, under state law, and the third (if the state judiciary authorizes plaintiff to represent Boeing) in federal court."[26]

Finally, Judge Easterbrook disagreed with the majority's assessment that, in this context, exclusive federal jurisdiction is "non-waivable." To the contrary, the Supreme Court has "treat[ed] exclusivity under § 29(a) as a right that people may waive."[27] Thus, the Supreme Court has permitted

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[22] *Id.*

[23] *Id.* at 729 (Easterbrook, J., dissenting).

[24] *Id.*

[25] *Id.* at 729 (citing *Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90 (1991)).

[26] *Id.* at 730.

[27] *Id.*

arbitration of Exchange Act claims because "the anti-waiver clause in § 29(a) . . . is limited to the Act's substantive standards,"[28] and has suggested that a contractual forum-selection clause is "compatible with the Exchange Act."[29] These principles applied in *Seafarers*, in Judge Easterbrook's view, because, under Delaware law, bylaws are "contracts between corporations and investors." The Boeing bylaw, therefore, is "just another forum-selection clause" that permissibly "waives any right to exclusive federal jurisdiction."[30] Concluding that "there is no problem with litigating plaintiff's claim in the courts of Delaware," Judge Easterbrook would have affirmed dismissal of plaintiff's claim from Illinois federal court.[31]

D. Implications

Seafarers is significant for Delaware corporations that have adopted—or are considering whether to adopt—exclusive-forum bylaws that, like Boeing's, limit all derivative claims to Delaware state court. Since 2013, the Delaware Court of Chancery has held repeatedly that "forum selection bylaws are statutorily valid under Delaware law."[32] Since then, forum-selection bylaws have been seen widely as an effective means of limiting the exposure of directors and officers to overlapping, multi-forum litigation and inconsistent judgments (factors cited by the *Seafarers* district court in upholding the bylaw in this case). *Seafarers* does not question this precedent or the validity of exclusive-forum bylaws in general. Nor does it appear to disapprove of forum-selection bylaws that would limit a Section 14(a) claim to a particular federal district court, such as the U.S. District Court for the District of Delaware. Rather, the decision takes aim at a particular application of subset of bylaws—those that, like Boeing's, restrict claims over which federal courts exercise exclusive jurisdiction to state court, where such claims cannot be brought, so as to "close all courthouse doors to [a] derivative action."[33] Now, at least in the Seventh Circuit, a court will disregard such a bylaw and allow the Section 14(a) derivative claim to proceed in a federal district court where jurisdiction and venue are otherwise appropriate (in *Seafarers*, in Illinois, where Boeing's headquarters is located).

Nonetheless, as Judge Easterbrook's dissent shows, the majority's conclusions are open to debate. Delaware courts have not clearly delineated the scope of Section 115, and the majority's reliance

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[28] *Id.* (citing *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220 (1987)).

[29] *Id.* (citing *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974)).

[30] *Id.*

[31] *Id.* at 732.

[32] *Boilermakers Loc. 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934, 954 (Del. Ch. 2013); *see Sylebra Capital Partners Master Fund, Ltd. v. Perelman*, C.A. No. 2019-0843-JRS, 2020 WL 5989473, at *10 (Del. Ch. Oct. 9, 2020) ("[t]he ability of a board of directors of a Delaware corporation to adopt binding bylaws is an essential part of the contract stockholders assent to when they buy stock"); *City of Providence v. First Citizens BancShares, Inc.*, 99 A.3d 229, 242 (Del. Ch. 2014) ("[T]hat there is currently a controlling stockholder who may favor a board-adopted forum selection bylaw . . . does not make it per se unreasonable to enforce the bylaw.").

[33] *Seafarers*, 23 F.4th at 720.

on the statute's legislative history (which many jurists would disregard absent ambiguity in the statute) and a single statutory phrase ("courts *in* this State") appears less than conclusive. Solid counterarguments exist, including Judge Easterbrook's that the statutory language of Section 115 "does not prohibit bylaws that limit derivative claims to state court" but, on the contrary, "authorizes such bylaws and prohibits only those that *prevent* litigation in state court."[34] Moreover, Section 109(b) of the DGCL provides, more broadly, that a corporation's "bylaws may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees."[35] The majority refused to apply Section 109(b) based on the principle that the "more specific statutory provision" (Section 115) takes precedence over "more general provisions" (Section 109(b)). But even if Section 109(b) did apply, the question begs to be asked: is it "inconsistent" with federal law for a corporate bylaw—a construct of state law—to alter or abridge the mandate of a federal statute granting federal courts exclusive jurisdiction over federal claims? Considerations of federal supremacy would appear to weigh against that outcome.[36]

The answer, however, is not necessarily that simple. As Judge Easterbrook observed, the Supreme Court has treated "exclusivity under § 27(a) as a right that people may waive."[37] In *Shearson/American Express, Inc. v. McMahon*, moreover, the Supreme Court "reject[ed]" the argument that "§ 29(a) forbids waiver of § 27 of the Exchange Act."[38] Instead, the Court explained, Section 29(a) forbids only "enforcement of agreements to waive 'compliance' with the provisions of the statute."[39] Thus, the validity of a Boeing-style bylaw under Sections 27 and 29(a) should turn on whether closing the door on *derivative* Section 14(a) claims effectively waives "compliance" with the statute. On the one hand, even absent the risk of a Section 14(a) derivative suit, there are multiple avenues by which corporate directors could face Section 14(a) liability for false or misleading proxy solicitation materials. As multiple courts have recognized (including the Supreme Court in *Borak*), "shareholders may bring both direct and derivative claims under Section 14(a) because there is a possibility that both the shareholders and the corporation were separately injured by the alleged material misstatements and omissions."[40] The SEC also retains authority

[34] *Id.* at 731 (emphasis in original).

[35] 8 *Del. C.* § 109(b).

[36] U.S. CONST. art. VI, cl. 2 ("This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land. . . .").

[37] *Seafarers*, 23 F.4th at 730.

[38] *Shearson/Am. Express*, 482 U.S. at 227.

[39] *Id.* at 228.

[40] *In re Bank of Am. Corp. Sec., Derivative, & Emp. Ret. Income Sec. Act (ERISA) Litig.*, 757 F. Supp. 2d 260, 292 (S.D.N.Y. 2010); *see also Yamamoto v. Omiya*, 564 F.2d 1319, 1326 (9th Cir. 1977) ("[I]n light of . . . *Borak* . . . , a shareholder

under Section 21(d) of the Exchange Act to enforce its own rules, including Rule 14a-9.[41] And, as pointed out by the *Seafarers* district court, Delaware permits a claim "precisely" the same as a Section 14(a) derivative claim, *i.e.*, a "derivative claim"—under Delaware state law—"against their corporate directors for failing 'to disclose fully and fairly all material information within the board's control when it seeks shareholder action.'"[42]

On the other hand, the conclusion that precluding a derivative Section 14(a) claim does not waive "compliance" assumes that there is no fundamental right to bring such a claim, as well as that a "direct" action will always be available to stockholder-recipients of proxy materials. That is so, according to Judge Easterbrook: "[t]he federal right is for investors or the SEC to sue directly," and "[a] derivative suit adds only a procedural snarl."[43] But Judge Easterbrook's view is debatable. In *Borak*, the Supreme Court expressly recognized "that a right of action exists as to . . . derivative . . . causes" under Section 14(a).[44] Moreover, the Court suggested that a derivative form of action may be the preferred enforcement mechanism in most Section 14(a) cases. That is because "[t]he injury which a stockholder suffers from corporate action pursuant to a deceptive proxy solicitation ordinarily flows from the damage done the corporation, rather than from damage inflicted directly upon the stockholder. The damage suffered results not from the deceit practiced on him alone but rather from the deceit practiced on the stockholders as a group."[45] *Borak* did not squarely address whether, in such instances, a stockholder would be limited to bringing a derivative claim, or whether it could choose between two equally available alternatives (a derivative or direct claim). In Delaware, however, courts have held that, to assert a direct claim, a stockholder "must demonstrate that the duty breached was owed to the stockholder and that he or she can prevail *without showing an injury to the corporation*."[46] If federal courts were to adopt the same approach (an open question), an exclusive-forum bylaw like Boeing's effectively would wipe out a swath of potential Section 14(a) liability, strengthening the argument that "compliance" has been waived.

Regardless of how federal courts resolve the conundrum, it is unlikely that the solution is to split the difference, and divide procedural and substantive components of the derivative claim between state and federal court, respectively, as Judge Easterbrook suggests. As the majority noted, "the dissent does not cite any precedent adopting its solution for this case."[47] The division, moreover, would

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who alleges a deceptive or misleading proxy solicitation is entitled to bring both direct and derivative suits. The former action protects the shareholders' interest in 'fair corporate suffrage.'").

[41] *See* 15 U.S.C. § 78u(d).

[42] *Seafarers*, 2020 WL 3246326, at *2 (citing *Stroud v. Grace*, 606 A.2d 75, 84 (Del. 1992)).

[43] *Seafarers*, 23 F.4th at 729.

[44] *Borak*, 377 U.S. at 432.

[45] *Id.*

[46] *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1039 (Del. 2004) (emphasis added).

[47] *Seafarers*, 23 F.4th at 728.

undercut well established notions that judicial and party efficiency is promoted by litigating in one forum, and arguably run afoul of the rule against "claim splitting," which "prohibits a plaintiff from bringing a new case raising issues arising out of the same transaction or occurrence as an earlier case, when those issues could have been raised in the first litigation."[48] Under the rule, "multiple legal theories supporting relief on account of one transaction must be litigated at one go."[49]

In the end, *Seafarers* is a decision by two circuit judges, in one circuit. While binding on district courts in the Seventh Circuit for now, the decision hinges on interpretations of both Delaware law and the Exchange Act, either or both of which could be upended by future decisions of the Delaware and/or U.S. Supreme Court. In the meantime, courts outside the Seventh Circuit will be free to evaluate these issues afresh in future cases, and to reach their own conclusions. Thus, while *Seafarers* may temporarily encourage more plaintiffs to file duplicative Section 14(a) derivative actions in federal court, despite the presence of a Delaware state exclusive-forum bylaw, the final word on the question likely has not been written.

II. Ninth and Second Circuits Highlight Limits on Issuers' Disclosure Obligations in Affirming Dismissal of Section 10(b) Claims

A. *Weston Family Partnership LLLP v. Twitter, Inc.* (9th Cir.)

1. Background

Twitter, Inc., like other social-media companies, does not charge its users directly but rather earns money through advertising. To enhance the effectiveness of the advertising, and its value to advertisers, Twitter shares certain user data with advertisers, such as cell phone location data. Due to privacy concerns, however, Twitter has allowed its users to opt out of data-sharing since 2017. *Weston Family* concerned a particular advertising program, Twitter's Mobile App Promotion ("MAP") product, which allowed advertisers to prompt users to download the advertisers' apps onto their phones and tablets. As with other advertising programs, MAP was most effective when coupled with data-sharing, so, for example, the advertiser may know the user's operating system and what apps the user has already downloaded. Twitter had touted its MAP program as an important driver of future growth, and invested in an improved next-generation MAP product.

In May 2019, Twitter announced in a blog post that it had discovered software bugs that caused inadvertent sharing of cell phone location data. Twitter, however, assured its users that it had resolved the problem. Then, on August 6, 2019, Twitter announced that it again had accidentally

[48] *Rexing Quality Eggs v. Rembrandt Enters., Inc.*, 953 F.3d 998, 1002 (7th Cir. 2020).

[49] *Id.* (citation omitted); *see also Maldonado v. Flynn*, 417 A.2d 378, 382 (Del. Ch. 1980) ("The rule against claim splitting is an aspect of the doctrine of res judicata and is based on the belief that it is fairer to require a plaintiff to present in one action all of his theories of recovery relating to a transaction, and all of the evidence relating to those theories, than to permit him to prosecute overlapping or repetitive actions in different courts or at different times.").

shared data with advertisers from users who had opted out of data-sharing. In an accompanying post, Twitter stated, "[w]e fixed these issues on August 5, 2019." What Twitter did not reveal, however, was that the "fix" was not to eliminate the software bugs, but to shut down data-sharing for its MAP advertising program altogether. In so doing, Twitter not only stopped unauthorized data-sharing, but blocked transmission of data that would bolster the value of MAP to advertisers and Twitter. Almost three months later, Twitter announced a $25 million revenue shortfall resulting from the effect of software bugs on its MAP program, leading to a downgrade of Twitter's stock and 20% drop in its stock price.

Following the announcement, a Twitter investor filed a putative class action in the Northern District of California on behalf of all purchasers of Twitter's stock between July 26, 2019, and October 23, 2019, alleging violations of Section 10(b) and Rule 10b-5. In essence, plaintiffs' theory was that various public statements by Twitter concerning its products and MAP—for example, that it was "continuing [its] work to increase the stability, performance, and flexibility of [its] ad platform and [MAP]" but was "not there yet"—were false or materially misleading due to non-disclosure of the software-bug issue. The district court (Gonzalez Rogers, J.) dismissed plaintiffs' claims for failure to allege material misstatements or omissions, or to plead facts establishing a strong inference of scienter. Plaintiff appealed to the Ninth Circuit.

2. The Decision

A unanimous Ninth Circuit panel affirmed.[50] The premise of plaintiff's fraud theory was that Twitter was obligated to identify the risk presented by the software bugs affecting the prospects of its MAP program in public statements over the class period. The Court, however, rejected that premise, explaining that "companies do not have an obligation to offer an instantaneous update of every internal development, especially when it involves the oft-tortuous path of product development."[51] Rather, companies are required to disclose a development only if "its omission would make other statements materially misleading."[52] In this instance, and contrary to plaintiff's contention, Twitter's failure to specifically identify software bug issues did not leave a "misimpression" that work to improve MAP was "on track." Rather, Twitter's statements about MAP progress were qualified and non-definitive, *e.g.*, that it was "continuing [its] work to increase the stability, performance, and flexibility of . . . [MAP] . . . but we're not there yet" and "MAP work is ongoing." At most, the

[50] The panel consisted of Circuit Judges Daniel P. Collins and Kenneth K. Lee and District Judge Jill A. Otake of the District of Hawaii, sitting by designation.

[51] *Twitter*, 2022 WL 853252, at *6.

[52] *Id.* (citing *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 45 (2011)).

company's vaguely optimistic statements about MAP were "so imprecise and noncommittal that they [were] incapable of objective verification" and, therefore, not actionable.[53]

Likewise, the Court rejected the argument that the risk warning in Twitter's July 2019 Form 10-Q—that "products and services may contain undetected software errors, which could harm our business and operating results"—was materially misleading because the risk had already materialized by then. First, the Court held that plaintiff had not adequately alleged that defendants knew of the software bugs at the time: the fact that Twitter referred to a non-specific "fix" in August and two months later had acknowledged the existence of software-bug issues as hampering MAP was not a sufficient basis from which to infer knowledge in July.[54] Second, plaintiff alleged no facts to suggest that, at the time of the 10-Q, Twitter was aware of or expected any material impact on the MAP program—or its bottom line—from software bugs.[55] Finally, the Court held that Twitter's July statements were subject to the protections of the Exchange Act's safe-harbor provisions: Twitter identified the statements as forward-looking at the time and added "very detailed meaningful cautionary language that 'identif[ied] important factors that could cause actual results to differ materially from those in the forward-looking statement[s].'"[56]

B. *Arkansas Public Employees Ret. System v. Bristol-Myers Squibb Co.* (2d Cir.)

1. Background

This case arose from a clinical trial to determine whether a drug in development would be more effective than chemotherapy in treating a common form of lung cancer. In 2009, Bristol-Myers acquired a company developing a drug called "nivolumab," later marketed as "Opdivo." Opdivo was a type of drug called a PD-1 checkpoint inhibitor. The aim of a PD-1 checkpoint inhibitor is to prevent the interaction in cancer cells between a protein called PD-L1 and another protein called PD-1 found on immune system T-cells. In healthy cells the interaction is salutary, preventing T-cells from attacking the healthy cells. But in cancer cells the presence of PD-L1 is counterproductive, blocking the immune system from attacking the tumor. A PD-1 checkpoint inhibitor, therefore, may serve as a cancer treatment by preventing PD-1/PD-L1 interaction and allowing T-cells to act on the cancer cells. Additionally, research has revealed that the efficacy of a PD-1 checkpoint inhibitor is positively correlated with the percentage level of PD-L1 present in the patient's cancer cells, referred to as "expression." In other words, the more PD-L1 there is to inhibit (*i.e.*, the greater

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[53] *Id.*

[54] *Id.* at *7-8.

[55] *Id.* at *8.

[56] *Id.* (quoting 15 U.S.C. § 78u-5(c)(1)).

"expression" percentage), the more likely it is that the checkpoint inhibitor will make a difference in treating the cancer.

On January 19, 2014, Bristol-Myers announced a clinical trial to test Opdivo's efficacy as a treatment of non-small cell lung cancer, the most common form of lung cancer in the United States. Bristol-Myers publicly stated that the trial would involve patients "strongly" expressing PD-L1. Over the course of the study, however, Bristol-Myers never quantified as a percentage what it meant by a "strong" expression. At the time of the study there was little consensus in the industry or among researchers as to what level of PD-L1 constitutes "strong" expression. For example, a 2015 survey of various studies noted that many used 5% expression, while others used 1% or 10%. In June 2016, moreover, Merck & Co. announced a successful clinical trial for its PD-1 checkpoint inhibitor that it was developing, called "Ketruda." Merck further disclosed that, for the purpose of its trial, it defined "strong" expression as PD-L1 expression greater than 50%.

On August 5, 2016, Bristol-Meyers announced that its trial for Opdivo had failed: the drug did not show better results than chemotherapy in patients "strongly" expressing PD-L1. In addition, with its announcement, Bristol-Myers revealed for the first time that it had defined "strong" expression for the purpose of the trial as 5% or greater. Following the announcement, Bristol-Myers' stock price fell, and, thereafter, Bristol-Myers investors brought a putative class action in the Southern District of New York, asserting violations of Section 10(b) of the Exchange Act and Rule 10b-5. According to plaintiffs, Bristol-Myers intentionally misled investors about the design and likelihood of success of its clinical trial by stating that it involved patients "strongly" expressing PD-L1, despite allegedly knowing of an industry consensus that 5% expression was not "strong." To bolster its allegations, plaintiffs alleged that a medical-oncologist expert would testify that there was an industrywide consensus that 5% meant "low or minimal expression" and 50% was "strong" expression. The district court (Vyskocil, J.), however, dismissed plaintiffs' claims, holding that plaintiffs failed to allege material misrepresentations or omissions or facts giving rise to a strong inference of scienter. Plaintiffs appealed.

2. The Decision

A unanimous panel of the Second Circuit affirmed.[57] Section 10(b), the Court explained, does not create an affirmative duty to disclose "any and all material information."[58] Disclosure is required only when there is an independent duty to disclose or "when [it is] necessary to make statements made, in the light of the circumstances under which they were made, not misleading."[59] In this case, Bristol-Myers had no obligation to disclose the precise percentage it used, and considered "strong"

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[57] The panel consisted of Circuit Judges Debra Ann Livingston, Dennis Jacobs, and Steven J. Menashi.

[58] *Bristol-Myers*, 28 F.4th at 352-53 (quoting *Matrixx*, 563 U.S. at 44).

[59] *Id.* (quoting *Kleinman v. Elan Corp., plc*, 706 F.3d 145, 153 (2d Cir. 2013)).

expression, and in fact made clear that it was not disclosing that information. Despite plaintiffs' contention that there was an industrywide consensus as to what constituted "strong" expression, moreover, the allegations of the complaint suggested otherwise. The complaint itself pointed to a wide range of thresholds used in other studies, from 1% to 49%, reflecting a lack of consensus. And plaintiff's contention that an expert would testify to a 50% consensus was unavailing, because the only facts on which the expert based his opinion were the same varying thresholds alleged in the complaint, which the Court had found insufficient.

Nor did Bristol-Myers mislead investors with vaguely optimistic statements about the trial's prospects, such as that the study was designed with "great care" or that the company had "great confidence" in it. Plaintiffs alleged no facts indicating that these statements of opinion were false, or not genuinely held at the time they were made. What is more, each statement was accompanied by language cautioning that the trial could fail, thereby invoking the protections of the Exchange Act's safe harbor for forward-looking statements.[60] Accordingly, none of the statements was actionable.

Finally, the Court held that plaintiffs failed to allege facts giving rise to a strong inference of scienter. The Court rejected plaintiffs' theory that defendants had motive to commit fraud in order to keep the company's stock price while insiders sold shares at a profit: the complaint did not allege any unusual or disproportionate trading patterns among Bristol-Myers insiders during the class period, and the majority of sales were conducted pursuant to a Rule 10b5-1 trading plan, or for procedural reasons.[61] Further, there was no evidence of conscious misbehavior or recklessness, given the lack of industry consensus over the threshold constituting "strong" expression. The departure of high-level employees following the failed trial reflected not fraudulent intent but, rather, the importance the company placed on the trial's success.[62]

C. Implications

Twitter and *Bristol-Myers* reaffirm the principle that, at least when it comes to liability under Section 10(b) and Rule 10b-5, there is no generalized duty for issuers to disclose any and all material information to the public concerning their business or prospects. Rather, disclosure is required only when there is an independent duty to disclose (*e.g.*, under a statute or regulation) or "when necessary 'to make . . . statements made, in the light of the circumstances under which they were made, not misleading.'"[63] Thus, as the Supreme Court has noted, even with respect to material

[60] *Id.* at 354-55 (citing 15 U.S.C§ 78u-5(c)).

[61] *Id.* at 355-56; *see* 17 C.F.R. § 240.10b5-1(c) (identifying adoption of a "written plan for trading securities" as an affirmative defense in insider trading cases).

[62] *Id.* at 356.

[63] *Matrixx*, 563 U.S. at 45 (quoting 17 C.F.R. § 240.10b-5(b)).

information, "companies can control what they have to disclose under these provisions by controlling what they say to the market."[64] In *Twitter*, that meant not making any specific representations about the existence or non-existence of software bugs hampering the company's MAP program, or about the likelihood of whether the program would be successful, prior to the announcement of a revenue shortfall. Similarly, in *Bristol Myers*, the company was explicit in *not* defining what it meant by a "strong" expression of PD-L1, and at all times noting in public statements that its trial could fail.

Both *Twitter* and *Bristol-Myers* also highlight the continued viability of the Exchange Act's safe harbor for "forward-looking statements" identified as such and accompanied by "meaningful cautionary language."[65] Under that provision, a defendant is not liable if (1) "the forward-looking statement is identified and accompanied by meaningful cautionary language," (2) the forward-looking statement "is immaterial," or (3) "the plaintiff fails to prove that [the forward-looking statement] was made with actual knowledge that it was false or misleading."[66] To take advantage of the "meaningful cautionary language" prong, the defendant must show not only that the challenged statement was "forward-looking"—*i.e.*, a statement concerning revenue projections, plans or objectives for future operations, or future economic performance[67]—but that the cautionary language accompanying it "was not boilerplate and conveyed substantive information."[68] In *Twitter*, the Ninth Circuit found the statement that the company was "continuing [its] work to increase the stability, performance and scale of [its] ads platform and [MAP]" forward-looking, and the risk warning that the company's "product and services may contain undetected software errors" sufficiently meaningful, to qualify for safe-harbor protection.[69] So too in *Bristol-Myers*, with respect to vaguely optimistic statements about the Opdivo trial, accompanied by cautionary language that identified "the relevant risk—that the trial may fail to reach its primary endpoint."[70]

While defenses based on absence of a duty to disclose and the safe harbor are powerful in theory, it is important to keep in mind that both are context-dependent, and courts may reach differing conclusions based on subtle gradations of the facts. For example, just last year, the Second Circuit reversed lower court decisions dismissing Section 10(b) claims in two cases where it found corporate disclaimers inadequate to negate the existence of the alleged material misrepresentation. In *In re Synchrony Financial Securities Litigation*, the Court held that a credit card company CEO's

[64] *Id.*

[65] *See* 15 U.S.C. § 78u-5(c).

[66] *Slayton v. Am. Express Co.*, 604 F.3d 758, 766 (2d Cir. 2010); *see Wochos v. Tesla, Inc.*, 985 F.3d 1180, 1191-92 (9th Cir. 2021).

[67] *See* 15 U.S.C. § 78u-5(i)(1).

[68] *Slayton*, 604 F.3d at 772.

[69] *Twitter*, 2022 WL 853252, at *7-8.

[70] *Bristol-Myers*, 28 F.4th at 355.

statement that it did not receive "any pushback on credit" from retail partners was materially misleading based on allegations that the company's principal retail partner (Walmart) had objected to changes in underwriting standards, despite the company's contemporaneous warnings about increased competition for renewals.[71] And in *Altimeo Asset Management v. Qihoo 360 Technology Co. Ltd.*, the Court reinstated Section 10(b) claims premised on the defendants' alleged failure to disclose in proxy materials a plan to relist the post-merger company on a foreign exchange. In so ruling, the Court parted ways with the district court, which concluded that the proxy materials adequately disclosed the "possibility" of a relisting, and the plaintiffs failed to allege a "concrete" pre-merger relisting plan so as to render the disclosure misleading.[72] In reversing carefully reasoned district court decisions finding disclaimers to be sufficient, these cases show what a close call the assessment can be.

Moreover, issuers cannot evade Section 10(b) liability with a blanket policy of not revealing risks to the company's business or prospects. As courts uniformly recognize, a duty to disclose may be based on "an affirmative obligation set by regulation or statute, *or* it may derive from a necessity to avoid misleading statements."[73] And Items 105 and 303 of Regulation S-K, in fact, do impose on issuers an affirmative obligation to disclose "risk factors" in certain public filings.[74] Item 105 (formerly Item 503) requires "discussion of the most significant factors that make the offering speculative or risky," and "only applies to the 'most significant' risk factors."[75] Item 303, in turn, requires a prospectus to explain "[i]f there has been an important change in [the] company's business or environment that significantly or materially decreases the predictive value of [the] reported results' so as to prevent 'the latest reported results from misleading potential investors.'"[76] Consequently, the question is not whether issuers have any obligation to disclose risks in the first place—they do. Rather, the task for issuers both to comply with affirmative disclosure obligations *and* say enough (including by way of substantive disclaimers) to ensure that the statements made are not materially misleading.

The flip side of the coin is that plaintiffs, too, must make an assessment before seeking to impose Section 10(b) liability based on the issuance of news negatively affecting a company's prospects.

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[71] *See In re Synchrony Fin. Sec. Litig.*, 988 F.3d 157, 168-70 (2d Cir. 2021).

[72] *See Altimeo Asset Mgmt. v. Qihoo 360 Tech. Co.*, 19 F.4th 145, 150-52 (2d Cir. 2021).

[73] *In re SunEdison, Inc. Sec. Litig.*, 300 F. Supp. 3d 444, 472 (S.D.N.Y. 2018) (emphasis added).

[74] *See* 17 C.F.R. § 229.105(a) (Item 105) ("Where appropriate, provide under the caption 'Risk Factors' a discussion of the material factors that make an investment in the registrant or offering speculative or risky."); 17 C.F.R. § 229.303(b)(2)(ii) (Item 303) ("Describe any known trends or uncertainties that have had or that are reasonably likely to have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations.").

[75] *In re Lions Gate Entmt. Corp. Sec. Litig.*, 165 F. Supp. 3d 1, 21 (S.D.N.Y. 2016) (citations omitted).

[76] *Willard v. UP Fintech Holding Ltd.*, 527 F. Supp. 3d 609, 619 (S.D.N.Y. 2021) (quoting *Lowinger v. Pzena Inv. Mgmt., Inc.*, 341 F. App'x 717, 720 (2d Cir. 2009)).

In particular, plaintiffs have to meet the heightened pleading requirements attendant to a Section 10(b) claim, including "[s]pecify[ing] each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and . . . stat[ing] with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind."[77] In borderline cases, then, *Twitter* and *Bristol-Meyers* may deter litigation. And where plaintiffs do file suit, the decisions should prove valuable in defending against plaintiff overreach where the issuers carefully controlled the information flow, complied with all affirmative disclosure requirements, and included substantive cautionary language in public filings covering the allegedly undisclosed information.

III. Second Circuit Affirms Dismissal of Section 10(b) Claims for Failure to Plead "Strong Inference" of Scienter

One of the threshold hurdles a plaintiff must overcome to plead a private securities fraud claim under Section 10(b) of the Exchange Act and Rule 10b-5 is pleading with the requisite specificity the element of scienter, *i.e.*, "a mental state embracing intent to deceive, manipulate, or defraud."[78] Enacted by Congress as "a check against abusive litigation by private parties," the Private Securities Litigation Reform Act of 1995 imposes heightened pleading requirements for scienter.[79] Section 21D(b)(2) requires a complaint, with respect to each alleged act or omission, to "state with particularity facts giving rise to a *strong inference* that the defendant acted with the required state of mind."[80] To establish the requisite "strong inference," it is not sufficient to allege "facts from which, if true, a reasonable person could infer that the defendant acted with the required intent"; that measure "does not capture the stricter demand Congress sought to convey in § 21D(b)(2)."[81] Rather, "an inference of scienter must be more than merely plausible or reasonable—it must be *cogent and at least as compelling* as any opposing inferences of nonfraudulent intent."[82]

The Supreme Court has left it to the circuit courts to implement this framework. Thus, the Second Circuit has articulated its own test, holding that a "strong inference" is pled where the complaint alleges facts showing either (1) "motive and opportunity to commit the fraud" or (2) "strong circumstantial evidence of conscious misbehavior or recklessness."[83] "Recklessness," in turn, is established only if a defendant's conduct is "an extreme departure from the standards of ordinary

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[77] 15 U.S.C. § 78u-4(b)(1), (b)(2).

[78] *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194 n.12 (1976).

[79] *Tellabs, Inc. v. Makor Issues & Rts., Ltd.*, 551 U.S. 308, 313 (2007).

[80] 15 U.S.C. § 78u-4(b)(2)(a) (emphasis added).

[81] *Tellabs*, 551 U.S. at 314.

[82] *Id.* (emphasis added).

[83] *Emps.' Ret. Sys. of Gov't of the Virgin Islands v. Blanford*, 794 F.3d 297, 306 (2d Cir. 2015) (citation omitted).

care to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it."[84]

A. *Malik v. Network 1 Financial Services, Inc.*

In *Malik v. Network 1 Financial Services, Inc.*, the plaintiff asserted a Section 10(b) claim on behalf of a putative investor class based on allegations that Network 1 Financial Services, an investment bank, facilitated the unlawful issuance of unregistered securities, at inflated prices, by Longfin Corp., a now-defunct technology and finance company. The crux of plaintiff's allegations was that Network 1, as lead underwriter for Longfin's offering of securities under Regulation A (an exemption from registration requirements under the Securities Act of 1933), was aware that a significant number of the securities to be issued were not actually exempt from registration requirements because they had previously been transferred to Longfin insiders for no consideration. As a result, plaintiff alleged, Longfin invalidly reached the one million-share minimum for its shares to be listed on the NASDAQ and, thus, there was no basis for Longfin's shares to be traded at all, let alone at the prices at which they were purchased by investors.

The district court (Hon. Denise Cote, S.D.N.Y.) dismissed the Section 10(b) claim against Network 1, and a Second Circuit panel affirmed, holding that scienter was insufficiently pled.[85] Applying the Second Circuit's two-prong test, the Court declined to infer that Network 1 had "motive and opportunity" to participate in Longfin's alleged scheme to circumvent the NASDAQ listing requirements, which plaintiff attempted to show based on the allegation that Network 1 would "receive larger commission on the funds [Longfin] unlawfully raised in the Offering." Although "financial gain" often "weigh[s] heavily in favor of a scienter inference," motive and opportunity cannot be shown simply by alleging, as here, "common goals" such as a desire to increase compensation or maximize profit.[86] Nor, in the Court's view, did plaintiffs recite facts showing conscious misbehavior or recklessness. The evidence cited by plaintiffs (including a Longfin control log and bank statements) did not clearly evince that Longfin had transferred securities to insiders with no consideration, or else was not evidently shared with Network 1 in advance of Longfin's offering. Thus, the Court could not infer an inference of fraudulent intent on the part of Network 1 that was "cogent and at least as compelling" as the explanation that Network 1 was innocently unaware of the alleged basis for non-exemption.[87]

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[84] *In re Carter-Wallace, Inc., Sec. Litig.*, 220 F.3d 36, 39 (2d Cir. 2000) (citation omitted).

[85] The Court observed that Network 1—as an underwriter—had no duty under the NASDAQ rules to guarantee Longfin's compliance NASDAQ listing criteria; NASDAQ Rule 5205 requires the "Company" (*i.e.*, Longfin) to satisfy those rules, not the underwriter. *Network 1*, 2022 WL 453439, at *2.

[86] *Id.* at *3.

[87] *Id.* at *4.

B. *KBC Asset Management NV v. MetLife, Inc.*

KBC Asset Management NV v. Metlife, Inc. involved an alleged scheme in connection with MetLife's pension risk management business to offload liabilities and maximize profit by releasing pension funds earmarked for future retirees. MetLife allegedly accomplished this through a practice of sending letters to annuitants (at ages 65 and 70½) and presuming that individuals were deceased if they did not respond, giving it a basis to release the funds as "reserves" for future liabilities. Plaintiffs alleged, on behalf of a putative class of MetLife investors, that MetLife and its executives, in failing to disclose this practice, made materially false statements concerning MetLife's financial condition and internal controls, artificially boosting MetLife's stock price in violation of Section 10(b).

The district court (Hon. Sterling Johnson, Jr., E.D.N.Y.) dismissed the Section 10(b) claims and, again, the Second Circuit affirmed based on insufficient allegations of scienter. Plaintiffs attempted to demonstrate "conscious misbehavior" by way of a 2012 settlement agreement between MetLife and state regulators concerning its failure to use the Social Security Administration's Death Master File to identify deceased individuals who had life insurance policies or annuity contracts. The Court rejected the allegation, however, because (although superficially similar in relating to the identification of deceased individuals) it had nothing to do with the specific practice at issue in the complaint, and plaintiffs did not allege that MetLife had violated the settlement agreement in any respect. Nor was the Court persuaded by the fact that three MetLife executives resigned in 2018 and 2019. Although suspiciously timed resignations may be suggestive of scienter, that is so only "in the context of other compelling circumstantial allegations supporting scienter" not present in this case.[88] Finally, a 2016 internal audit report discussing "control weaknesses" concerning "retirement letter mailings" suggested only that recipients had been "alerted to possible issues" concerning MetLife's method of locating pension annuitants; it did not support an inference of "fraudulent intent or recklessness."[89] In short, plaintiffs failed to allege "any specific facts" showing that MetLife and its executives intended to defraud shareholders; "poor business judgment," by itself, "is not actionable under section 10(b) and Rule 10b-5.[90]"

C. Implications

Evaluation of scienter is fact-dependent, and no hard-and-fast rule can be drawn from any particular decision. Courts invariably will determine whether the requisite "strong inference" is pled on a case-by-case basis, determining, based on the specific allegations, the parties' respective arguments, and the court's own judgment and experience, whether an inference of fraudulent intent

[88] *Metlife*, 2022 WL 480213, at *3.

[89] *Id.*

[90] *Id.* (quoting *Rothman v. Gregor*, 220 F.3d 81, 90 (2d Cir. 2000).

is "cogent and at least compelling" as an alternative, innocent explanation for defendants' conduct. Nonetheless, *Malik* and *KBC* should be of interest to securities litigants because they show that the Second Circuit—still the most fertile ground nationwide for securities class-action filings[91]—will closely scrutinize a plaintiff's factual allegations, and not hesitate to cut off claims absent a "strong inference" of fraudulent intent. Defendants, in the Second Circuit and elsewhere, should leave no stone unturned in challenging Section 10(b) claims on scienter grounds.

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[91] *See* JANEEN MCINTOSH & SVETLANA STARYKH, NERA ECONOMIC CONSULTING, RECENT TRENDS IN SECURITIES CLASS ACTION LITIGATION: 2021 FULL-YEAR REVIEW 1, 5 (2022) (noting that in 2021 40% of all class-action filings were in the Second Circuit, the most nationwide).