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Second Circuit Reverses S.D.N.Y. Decision Dismissing LIBOR Claims on Loss Causation Grounds, but Upholds Dismissal on Puffery and Clarifies Culpable Participation Requirement for Control Person Liability

In *Carpenters Pension Trust Fund of St. Louis, et al.* v. *Barclays PLC, et al.*, one of a recent spate of lawsuits arising out of matters concerning LIBOR, the Second Circuit addressed three pleading issues that frequently arise in securities class actions: loss causation, disclosures that amount to "puffery," and control person liability. Most significantly, it rejected efforts by the plaintiffs to base a misrepresentation claim on general statements about corporate internal controls that did not specify the particular area in which alleged misconduct later occurred.

Background

This decision, an appeal from dismissal in the United States District Court for the Southern District of New York, arose from the June 27, 2012 Barclays announcement that it had agreed to pay a total of $450 million in fines to the DOJ, CFTC and FSA in connection with its alleged submission between August 2007 and January 2009 of false LIBORs, which are rates that indicate the price at which a bank can borrow funds and are generally considered to be a marker of a bank's financial health. Barclays maintained that its submission rates were correct between January 2009 and the June 2012 announcement. Subsequently, plaintiffs, shareholders of Barclays, brought a putative class action against the company alleging that, between August 2007 and January 2009, Barclays had violated Section 10(b) and rules thereunder by knowingly misstating its LIBOR rates. Plaintiffs also brought control person claims against former Barclays officers under Section 20(a) of the '34 Act, premising liability on the company's primary 10(b) violations.

Defendants moved to dismiss all of plaintiffs' claims. On May 13, 2013, Judge Shira Scheindlin granted defendants' motion to dismiss, holding that plaintiffs failed to plead loss causation. The district court concluded that any market inflation caused by the inaccurate LIBOR submissions would have been resolved before the June 27, 2012 announcement, because an efficient market would have incorporated Barclays' accurate submission rates between 2009 and 2012 into Barclays' stock price. Further, Judge Scheindlin held that plaintiffs' allegations that Barclays had made material misrepresentations about its internal LIBOR controls in its 2006-2011 SEC filings by stating that "[m]inimum control requirements [had] been established for all key areas of identified risk" should be dismissed as generic "puffery."

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Finally, the district court dismissed plaintiffs' Section 20(a) control-person claims for failure to plead a primary violation under Section 10(b).

Second Circuit Opinion

On April 25, 2014, the Second Circuit upheld the district court's finding that the control requirement statements were mere puffery. Citing the requirement in the Private Securities Litigation Reform Act that alleged misstatements be pleaded with specificity, the court concluded that the language cited from Barclays' SEC filings about its internal controls was far too general to be actionable—principally because the allegedly false language just concerned controls generally, and not controls related to LIBOR. This decision is significant because a few decisions at the district court level in the past have made it relatively easy, in cases involving alleged misconduct, for plaintiffs to plead falsity under 10(b) by citing to fairly commonplace, general statements in public filings that a company is taking appropriate steps in terms of internal controls or risk management. *See, e.g., Freudenberg* v. *E*Trade Fin. Corp.*, 712 F. Supp. 2d 171, 189 (S.D.N.Y. 2010) ("[M]isstatements regarding risk management, discipline, monitoring and credit quality are not "puffery" where, as alleged here, they were "misrepresentations of existing facts."). This decision instead affirms dismissal because the references to controls didn't speak directly of the specific, narrow area where the problems occurred.

The Second Circuit reversed, however, the district court's finding that plaintiffs failed to properly plead loss causation. The Second Circuit confirmed the well-established rule that, for the purposes of establishing loss causation under Section 10(b), a plaintiff must allege that "available public information regarding the company's financial condition [was] corrected" and that the "market reacted negatively" to the disclosure. The court held plaintiffs' allegations that Barclays' stock price dropped 12% in response to the June 27 announcement correcting the 2007-2009 LIBOR rates were sufficient to meet this standard.

On the somewhat unique facts of this case, the court held that because plaintiffs sufficiently alleged that LIBOR rates are "non-cumulative" and are not "replaced" by later LIBOR submission rates, it could not conclude as a matter of law, as the district court had, that an efficient market "would fail to digest three years of non-fraudulent Submission Rates and other more detailed financial information, and would instead leave intact artificial inflation as a result of fraudulent Submission Rates in [2007-2009]." This decision is interesting in light of the Second Circuit's historical endorsement of the "efficient market." *See, e.g., ATSI Comms., Inc.* v. *Shaar Fund, Ltd.* 493 F.3d 87, 101 n. 4 (2d Cir. 2007). The efficient capital market hypothesis, as adopted by the Supreme Court, posits that "the market price of shares traded on well-developed markets reflects all publicly available information." Even so, the Second Circuit left open the possibility in *Carpenters Pension* that discovery would show that the alleged misrepresentations about LIBOR made in 2007-09 were "stale" by the time of the announcement of the 2012 regulatory settlement.

Finally, the court revived plaintiffs' Section 20(a) claims on the grounds that plaintiffs had sufficiently alleged a primary violation under Section 10(b), but clarified that, in order to state a control-person claim under Section 20(a), a plaintiff must establish that the "defendant was, in some meaningful sense, a culpable participant in the controlled person's fraud." In doing so, the court affirmed the district court's rejection of plaintiffs' argument below that "scienter is not an essential element of a Section 20(a) claim." *Gusinsky* v. *Barclays, et al.*, 12 Civ. 5329 (S.D.N.Y.) (SAS), Dkt. # 66 (citing *In re Initial Pub. Offering Secs. Litig.*, 241 F. Supp. 2d 281, 396 (S.D.N.Y. 2003)).

Analysis

Carpenters Pension may provide comfort to companies subject to SEC reporting requirements that general statements about the presence of internal controls are insufficiently specific as a matter of law to establish a material misstatement whenever a company admits a failure of controls. The Second Circuit reaffirmed the principle that alleged misstatements and omissions must specifically concern the alleged fraud. The impact of the loss causation ruling is less clear, as it appeared to turn on the relatively unusual circumstance that LIBOR rates are "non-cumulative," and as a consequence, the fact that the alleged corrective disclosure occurred years after the alleged misstatement was not a bar to pleading a claim. Lastly, the court's holding that culpable participation is required to establish liability under Section 20(a) clarifies that 20(a) is not a strict-liability statute under which liability can be established without showing that the controlling person participated in the fraud. This resolves some disagreement among the district courts, some of which had suggested otherwise.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Susanna M. Buergel
212-373-3553
sbuergel@paulweiss.com

Charles E. Davidow
202-223-7380
cdavidow@paulweiss.com

Andrew J. Ehrlich
212-373-3166
ehrlich@paulweiss.com

Brad S. Karp
212-373-3316
bkarp@paulweiss.com

Daniel J. Kramer
212-373-3020
dkramer@paulweiss.com

Richard A. Rosen
212-373-3305
rrosen@paulweiss.com

Audra J. Soloway
212-373-3289
asoloway@paulweiss.com

Katherine D. Kelly
212-373-3550
kkelly@paulweiss.com