

Second Circuit affirms dismissal of “event-driven” securities lawsuit

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A Second Circuit panel affirmed a decision dismissing securities fraud claims against Danske Bank and its officers and directors. The panel unanimously held that plaintiffs had not pled a false or misleading statement, reaffirming—among other things—that companies are not subject to securities liability for alleged failures to disclose uncharged wrongdoing or for generic statements about corporate ethics.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

Patrick W. Blakemore

+1 212 450 4452
patrick.blakemore@davispolk.com

Michael S. Flynn

+1 212 450 4766
michael.flynn@davispolk.com

Edmund Polubinski

+1 212 450 4695
edmund.polubinski@davispolk.com

Neal Potischman

+1 650 752 2021
neal.potischman@davispolk.com

Brian S. Weinstein

+1 212 450 4972
brian.weinstein@davispolk.com

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¹ As a matter of disclosure, one of the executives was the CEO, who was represented in the trial court and on appeal by Davis Polk.

The case

The Second Circuit decision

- **Companies do not generally have a duty to disclose uncharged, unadjudicated wrongdoing.** The court rejected plaintiffs' allegations that the company's financial statements were materially misleading because the company did not disclose the allegedly illegal profits from the Estonian branch. The plaintiffs did not allege, the court noted, that any of Danske Bank financials were manipulated or otherwise inaccurate. As the court explained, accurate historical data does not become misleading, as plaintiffs had argued, just because the company did not simultaneously disclose that some wrongdoing may have contributed to the company's performance. The court explained that plaintiffs' theory would impermissibly allow "every company whose quarterly financial reports include revenue from transactions that violated AML regulations [to] be sued for securities fraud." Op. at 14.
- **"Materiality can have a half-life."** The court also rejected plaintiffs' allegations that Danske Bank's 2014 announcement of a technical write-down of the goodwill on its assets, part of which concerned Estonia, was materially misleading. The court explained that "the further in time a purchase is removed from a misstatement and the more that updated related information reaches the market," the less likely a statement is to be material. Op. at 20. Here, over three years had passed between the 2014 announcement and the funds' 2018 purchases. In between those events, the court noted a number of intervening events and disclosures that amounted to an "outpouring of information" about the Estonian branch. Op. at 23. "In other words," the court reasoned, "materiality can have a half-life." Op. at 20.
- **Vague, generic statements about compliance do not create liability.** Plaintiffs argued that other statements about the company's efforts to comply with regulatory frameworks were actionable in light of the AML issues at the Estonian branch. For example, plaintiffs highlighted a nonspecific statement in which Danske Bank said it "strive[s] to conduct [its] business in accordance with internationally recognised principles in the area[] of ... anti-corruption." The court again rejected plaintiffs' arguments, reasoning that "bromides about being good and upright" are not actionable, and that no reasonable investor "would weigh these generic statements in its investment calculus." Op. at 27-29.
- **Plaintiffs that allege they purchased at an inflated price cannot rely only on statements made after that purchase.** The plaintiffs also pointed to a footnote contained in Danske Bank's 2018 second quarter financial results in which the company said it did not expect the outcomes of pending lawsuits regarding the AML issues to have a material effect on its financial condition. The court explained that because the funds failed to allege actionable misstatements or omissions prior to their purchase of Danske Bank's ADRs, the challenged footnote "could not have influenced the price of a purchase that had already been made." Op. at 31.

- **Scheme liability must be pled with particularity.** The court held that plaintiffs' Rule 10b-5(a) and 10b-5(c) claims failed to satisfy the heightened pleading requirements of Federal Rule of Civil Procedure 9(b) and that it was insufficient to refer generally to a lengthy complaint and allege that "Defendants carried out a common plan, scheme, and unlawful course of conduct" Op. at 33.

Conclusion