# Ninth Circuit Affirms Dismissal of Securities Class Action Against H.C. Wainwright & Co., LLC

April 19, 2021

**On April 8, 2021, the Ninth Circuit issued a decision in Panthera Investment Fund L.P v. H.C. Wainwright & Co., LLC, No. 19-56048, affirming the dismissal of a putative securities fraud class action. The lawsuit accused H.C. Wainwright ("HCW"), a specialty investment bank, along with two of its officers and an analyst, of fraudulently attempting to inflate the stock price of MannKind Corporation ("MannKind"), a small publicly traded biopharmaceutical company. The court held that the plaintiffs had failed to plead a "strong inference" of scienter under the Private Securities Litigation Reform Act, and underscored that "even head-scratching mistakes" do "not amount to fraud." The decision confirms that plaintiffs face a difficult task in alleging scienter when they cannot adequately plead a plausible motive.**

In 2017, an HCW investment analyst published a report on MannKind with a buy rating and a $7/share target. The report disclosed that HCW "will seek compensation from the companies mentioned in this report for investment banking services within three months" of publication. Op. at 20. The stock moved up substantially. *Id.* at 5. The same day, HCW signed an exclusive agent agreement with MannKind for a registered direct offering. *Id.* MannKind announced the offering that night with a $6/share price, and revealed that HCW was the exclusive placement agent and would be paid 5% of the total gross offering proceeds. *Id.* at 5-6. MannKind's stock fell the next day. The Plaintiffs alleged that the drop was because investors were blindsided by the discrepancy between the $7/share analyst target and the $6/share offering price. *Id.* at 6. They alleged that HCW and the individual defendants fraudulently sought to inflate MannKind's stock price. *Id.* The Plaintiffs filed suit under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, and brought claims against individual defendants for control person liability under Section 20 of the Exchange Act. *Id.*

In affirming the district court's dismissal of the complaint, the Ninth Circuit held that the plaintiffs' allegations failed to support a strong inference of scienter. *Id.* at 10-11. The court first rejected the plaintiffs' theory of motive. The plaintiffs alleged that: (1) HCW had an incentive to boost the stock price, arguing that a higher share price would result in a higher fee from its work on the offering; and (2) HCW had an incentive to increase trading volume. *Id.* The court held that neither theory was "persuasive or plausible, as both are divorced from common experience." *Id.* at 12 (citing *Nguyen v. Endologix, Inc.*, 962 F.3d 405, 415 (9th Cir. 2020)).

The court explained that the first theory failed for two reasons. First, the plaintiffs failed to connect the share price to the offering proceeds, and thus to the size of HCW's compensation. In other words, the plaintiffs failed to explain how the difference in share price would result in a higher fee. The court concluded that HCW would receive the same compensation from the $61 million offering "no matter if the share price was $6 or $7." *Id.*

Second, the court found that HCW stood to lose more than it would have gained from these actions, because issuing the $7/share report prior to leading a $6/share offering "likely strained its longstanding relationship with MannKind." *Id.* at 12-13. The court concluded that the risk of losing the client, in conjunction with the reputational risk, "far outweigh[ed] the benefit of a slightly higher return on one transaction." *Id.* at 13.

The court characterized the conduct as "more like an embarrassing Red Sox error than an elaborate Black Sox fraud." *Id.* The court stressed that "a company's apparent error — even an embarrassing or inexplicable one — does not establish fraudulent intent, especially if the plaintiff cannot offer a plausible motive for the company's conduct." *Id.* And the court found that the plaintiffs' second theory was "even more speculative," because the plaintiffs pleaded no facts showing the offering would not have succeeded but for the allegedly inflated share price and trading volume. *Id*.

The court then turned to the remaining factual allegations, while underscoring that without a plausible motive, the plaintiffs need to "assert[] compelling and particularized facts showing fraudulent intent or deliberate recklessness." *Id.* The court held that the complaint failed to plead any particularized facts showing that the individual defendants acted with scienter. *Id.* at 14-17. The court also found unpersuasive allegations that HCW had scienter because its compliance department must have approved the report and must have known about the offering. The court held that the allegations only showed that HCW "generally adhered to industry standards," not that the HCW compliance department necessarily knew of the conflict and recklessly or intentionally disregarded it. *Id.* While the plaintiffs had offered a confidential witness to try "to remedy this problem," the court rejected the effort because that witness had left the company prior to the publication of the report or the offering. *Id.* at 18-19.

Finally, the court rejected the plaintiffs' attempted reliance on the "core operations" and "duty to correct" theories to show scienter. *Id*. at 21-23. On the latter topic, the court explained that neither Ninth Circuit nor Supreme Court precedent supported allowing the plaintiffs to create an inference of scienter simply by pleading that the defendant failed to correct a false statement promptly. *Id.* at 22-23.

The panel included Circuit Judge Ronald M. Gould, Circuit Judge Kenneth K. Lee, and Circuit Judge Lawrence VanDyke.

---

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


| | | |
|---|---|---|
| **Edmund Polubinski III** | +1 212 450 4695 | edmund.polubinski@davispolk.com |
| **Neal A. Potischman** | +1 650 752 2021 | neal.potischman@davispolk.com |
| **Andrew Yaphe** | +1 650 752 2088 | andrew.yaphe@davispolk.com |
| **Andrei Gribakov Jaffe** | +1 650 762 2097 | andrei.jaffe@davispolk.com |