

Second Circuit Rejects Securities Claims Based on Generic Statements About Ethics and Compliance

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The Court of Appeals for the Second Circuit yesterday affirmed the dismissal of a securities class action alleging misrepresentations arising from generalized statements about an issuer's compliance efforts and Code of Ethics. The decision in [Singh v. Cigna Corporation](#) held that such generic statements are not material because a reasonable investor could not have relied on them as representations of regulatory compliance.

The decision is welcome news for issuers in light of the many recent lawsuits alleging securities-law violations based on generalized statements about the importance of ethical standards and regulatory compliance. Such cases should be more difficult to maintain unless the issuer has touted its compliance efforts in detail.

Background

The *Singh* case arose from Cigna's purchase of a regional Medicare insurer. After the acquisition, Cigna began receiving notices of noncompliance from the Centers for Medicare and Medicaid Services ("CMS"). CMS conducted an audit and concluded that Cigna had failed to comply with CMS requirements. Cigna eventually announced that it had already spent nearly \$30 million to remedy the alleged violations, but that it might "not be able to address matters arising from the [CMS Sanctions] Notice in a timely and satisfactory manner."

Cigna shareholders filed a securities class action alleging that Cigna had made false or misleading statements by:

- claiming that it had "established policies and procedures to comply with applicable requirements" and that it "expect[ed] to continue to allocate significant resources" to compliance efforts,

- publishing a Code of Ethics that affirmed the importance of compliance and integrity, and
- stating in its annual report that it “‘expect[ed] to continue to allocate significant resources’” to compliance, and discussing the difficulty of compliance in light of regulatory uncertainty in the healthcare arena.

These statements allegedly were false or misleading in light of the regulatory issues that Cigna was facing.

The District Court dismissed the case, holding that the plaintiffs had failed to sufficiently allege both materially false statements and scienter. The Second Circuit affirmed on the first ground, without reaching the scienter issue.

Second Circuit’s Decision

The court framed its decision as presenting “a creative attempt to recast corporate mismanagement as securities fraud.” “[F]irst, point to banal and vague corporate statements affirming the importance of regulatory compliance; next, point to significant regulatory violations; and *voilà*, you have alleged a prima facie case of securities fraud!” But the court held that “such generic statements do not invite reasonable reliance” and therefore are not materially misleading.

The court ruled that Code of Ethics statements that “amount to general declarations about the importance of acting lawfully and with integrity” constitute inactionable puffery. Similarly, the statements about Cigna’s compliance efforts were too generic to be material. The court distinguished the statements in this case from those in a prior case, in which the company had “described its compliance mechanisms in confident detail, including references to 24-hour monitoring teams, specific compliance equipment, and its clean compliance record.” “Such detailed descriptions stand in sharp contrast to Cigna’s simple and generic assertions about having ‘policies and procedures’ and allocating ‘significant resources’” to compliance.

The court also noted that Cigna's statements were "framed by acknowledgments of the complexity and numerosity of applicable regulations," thereby suggesting "caution (rather than confidence) regarding the extent of Cigna's compliance." Because Cigna's challenged statements were "tentative and generic, and because they emphasize the complex, evolving regulatory environment that Cigna faced," a reasonable investor would not view them as material.

Implications

Securities cases traditionally were about accounting or financial matters, but so many securities actions these days are actually about something else: alleged foreign bribery, sexual harassment, antitrust violations, money laundering, environmental disasters, apartment fires, etc. Companies involved in those situations have been sued under the securities laws based on the theory that they made broad statements about the importance of and their efforts to comply with legal and ethical standards – and that those statements must have been false or misleading because of what ultimately happened.

Many (although not all) courts have dismissed such claims where the challenged statements were only generic. Some courts, however, appear to have applied a looser standard, at least at the pleading stage. The *Singh* decision should cause courts to look harder at the challenged statements to determine whether they are specific enough to be material – or whether, as in so many cases, they are merely generic, almost boilerplate recitations that most companies make to state their aspirational goals and show that they hope to be considered good corporate citizens.

The *Singh* decision does not specifically address a situation where a company has made *generic* statements about compliance and ethics in *direct response* to questions about or allegations of misconduct. Nor, however, does the Second Circuit's ruling create an exception for those statements. The decision focuses more on the generic nature of the statements than on the specific context in which they were made. We shall see how courts construe *Singh* if merely generic statements are made to rebut allegations of misconduct.

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