

Ninth Circuit Applies Lower Standard for Pleading Scienter Under § 14(e) of Securities Exchange Act Even as to Opinions

Corporate Defense and Disputes on **January 23, 2023**

The U.S. Court of Appeals for the Ninth Circuit ruled last week that the securities-law requirement to plead a “strong inference” of scienter does not apply to claims under § 14(e) of the Securities Exchange Act even where the challenged statement is a statement of opinion. The decision in *Grier v. Finjan Holdings, Inc. (In re Finjan Holdings, Inc. Securities Litigation)* (9th Cir. Jan. 20, 2023) held that, because § 14(e) claims – which arise in connection with tender offers – can be based on mere negligence instead of knowing or reckless misconduct, a plaintiff needs to plead only a “reasonable inference,” rather than a “strong inference,” of an opinion’s subjective falsity.

The *Finjan Holdings* decision appears to lower the pleading bar for allegations about state of mind and expressions of opinion in cases that do not require proof of scienter. But the decision does not apply where proof of scienter is required, and it does not dilute the separate pleading-particularity requirements under the securities laws and Federal Rule of Civil Procedure 9(b).

Background

The Ninth Circuit’s decision involves the interplay among (i) Rule 9(b)’s general pleading-particularity requirements for all claims sounding in fraud, (ii) the provision of the Private Securities Litigation Reform Act (the “PSLRA”) requiring a securities plaintiff to plead particularized allegations of falsity, (iii) the separate PSLRA provision requiring a securities plaintiff to plead a “strong inference” of scienter for claims requiring proof of fraud, and (iv) the special considerations that apply to challenged statements of opinion.

The case arose from a tender offer for Finjan’s shares. Finjan had been engaged in a “strategic review process,” including an exploration of opportunities to sell the company. As the process progressed, only two potential acquirors remained interested. One of them eventually withdrew from consideration, and the other made a tender offer for Finjan’s shares.

A shareholder sued, alleging that Finjan had made false or misleading statements to get shareholders to accept the tender offer. The challenged statements were (i) revenue projections that Finjan had provided to its investment banker, (ii) the banker's estimate of the value of Finjan's shares, and (iii) Finjan management's statements endorsing the revenue projections and the estimated share value as "reasonable."

The parties agreed that the challenged statements were statements of opinion, which, under controlling Supreme Court precedent, can be actionable only if the speaker did not actually believe the opinion expressed and the opinion was objectively false, the opinion contained embedded factual assertions that were false, or the opinion was misleadingly incomplete. The parties also agreed that the statements challenged here could be false only under a theory of subjective falsity: the speaker did not hold the belief professed, and the belief was objectively untrue.

The District Court dismissed the case under Rule 9(b) and the PSLRA's heightened pleading standards. The court held that the claims sounded in fraud, so the pleading-particularity requirements of Rule 9(b) and PSLRA § 4(b)(1) applied and were not satisfied. The court also held that the plaintiff had failed to plead a "strong inference" of subjective falsity under PSLRA § 4(b)(2)(A), which mandates that, in any private action under the Exchange Act "in which the plaintiff may recover money damages *only on proof* that the defendant acted with a particular state of mind, the complaint shall . . . state with particularity facts giving rise to a *strong inference* that the defendant acted with the required state of mind" (emphasis added).

The District Court recognized that, unlike § 10(b) of the Exchange Act, § 14(e) does not require proof of scienter and that mere negligence can suffice. But the court nevertheless applied the PSLRA's strong-inference requirement because (i) the plaintiff had pled that the defendants had known the opinions were false, and (ii) the plaintiff could not establish his § 14(e) claim without pleading and proving subjective falsity, "which is essentially a state-of-mind requirement."

The Ninth Circuit affirmed the dismissal, but it disagreed with the District Court's analysis of the strong-inference requirement in a § 14(e) case.

Ninth Circuit's Decision

The Ninth Circuit analyzed each of the three steps that the District Court had taken: application of Rule 9(b), application of the PSLRA's pleading-particularity requirement, and application of the PSLRA's strong-inference requirement for scienter.

The Ninth Circuit agreed with the District Court on the first two steps as to the particularity requirements.

- “Rule 9(b) applies where a claim is ‘grounded in fraud’ or ‘sound[s] in fraud,’ even if fraud is not an essential element of the cause of action.” Because the plaintiff had alleged that the defendants had known the revenue projections and other opinions were false, the claim sounded in fraud even though fraud is not an essential element of a § 14(e) claim.
- PSLRA § 4(b)(1)'s pleading-particularity requirements – under which a complaint must “specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is based” – also apply to all allegations of untrue material facts, even in § 14(e) cases.

But the Ninth Circuit disagreed with the District Court's application of PSLRA § 4(b)(2)(A)'s requirement to plead a “strong inference” of scienter. Mere negligence can establish a § 14(e) claim, so the claim does not depend “on *proof* that the defendant acted with a particular state of mind” – the predicate for the statute's applicability. Scienter allegations in § 14(e) cases thus are governed by the lower “plausibility” pleading standard applicable in most federal cases, rather than by the PSLRA's heightened “strong inference” standard, which applies only to claims requiring *proof* of fraud (such as claims under § 10(b)). As the court explained: “It is not enough that the complaint ‘sounded in fraud’ or that the allegations tend to expound a theory of fraud. The question [under PSLRA § 4(b)(2)(A)] is instead whether the cause of action itself has scienter as a required element.” Section 14(e) does not have such a requirement.

The Ninth Circuit rejected the argument that the analysis should differ in a case involving opinions and the need to prove subjective falsity. The court observed that, although such circumstances might be rare, a speaker could “negligently state an opinion in which he does not subjectively believe.” Accordingly, § 14(e) “can be satisfied without scienter, even when the statements at issue are statements of opinion.”

However, even though the Ninth Circuit held that the District Court had erroneously required a “strong inference” rather than a “reasonable inference” of subjective falsity, it affirmed the dismissal of the case because the plaintiff had not pled even a reasonable inference that the defendants had not believed the challenged statements of opinion.

Implications

The Ninth Circuit’s rejection of a “strong inference” standard for § 14(e) cases challenging opinions that allegedly were subjectively false could enable some complaints to survive motions to dismiss even if they would have failed under the PSLRA’s heightened pleading standard for cases requiring proof of scienter. But the *Finjan* decision applies only to claims that do not require proof of scienter, such as claims under § 14(e). It does not apply under the more frequently litigated § 10(b), which requires such proof.

Moreover, as the *Finjan* holding itself illustrates, the lower “reasonable inference” standard is not toothless. The plaintiff’s claim here failed to meet even that lower standard.

The *Finjan* decision also is a lesson in distinguishing between, on the one hand, the *particularity* requirements in Rule 9(b) and PSLRA § 4(b)(1) and, on the other hand, the *plausibility* requirement in PSLRA § 4(b)(2)(A) for state-of-mind allegations. Claims that sound in fraud are subject to the pleading-particularity requirements regardless of the underlying elements of those claims. But only those claims requiring proof of fraud as an essential element are subject to the PSLRA’s heightened plausibility standard.

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