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Without Merit: A Cautionary Tale About Boilerplate Litigation Disclosures in Public Company Filings

Minding Your Business on **August 29, 2023**

Counsel for public companies—it may be time to take another look at your litigation disclosures. A recent federal district court opinion held that one company's use of the phrase "without merit" to describe ongoing litigation in its public filings could give rise to federal securities fraud claims. The ruling serves as the latest admonition to exercise care in crafting litigation disclosures.

In *City of Fort Lauderdale Police and Firefighters' Retirement System v. Pegasystems Inc.*, plaintiff shareholders initiated a class action against Pegasystems Inc. ("Pegasystems") following a $2 billion verdict against it in a prior lawsuit. In that prior suit, a competitor sued Pegasystems for willful and malicious misappropriation of the competitor's trade secrets. Pegasystems did not initially opt to expressly disclose this lawsuit in its annual or quarterly public filings with the Securities and Exchange Commission ("SEC"), instead including a blanket disclosure that the company had received notices of claim for infringement of other parties' intellectual property. However, in February 2022, Pegasystems disclosed the existence of the trade secret lawsuit, stating that the claims in the suit were "without merit," that Pegasystems had "strong defenses to these claims," and that "any alleged damages claimed" were "not supported by the necessary legal standard." Pegasystems' stock fell 16% the day after its disclosure.

Then, in May 2022, the trade secret suit culminated in a $2 billion jury verdict against Pegasystems. Its stock dropped another 28% over the subsequent days. The federal securities lawsuit from plaintiff shareholders followed, claiming, among other things, that Pegasystems' litigation disclosures describing the trade secret suit as "without merit" were materially false and misleading to investors. Pegasystems moved to dismiss.

The United States District Court for the District of Massachusetts denied Pegasystems' motion. With respect to the "without merit" language from Pegasystems' litigation disclosures, the court held that a reasonable investor would expect not only that the issuer believed the opinion that the claims were "without merit," but also that it fairly aligned with the information in the issuer's possession at the time. The court further reasoned that, taken in context, Pegasystems' decision to separately state (i) that the claims were "without merit" and (ii) that Pegasystems had "strong defenses to these claims" which "weren't supported by the necessary legal standard," could have suggested to a reasonable investor that the "without merits" language meant that Pegasystems denied the facts underlying the trade secret claims.

The opinion was careful to state, however, that Pegasystems was under no obligation to "confess to wrongdoing" in its disclosure. According to the court, an issuer can state that it plans to vigorously oppose the disclosed lawsuit and that it has "substantial defenses" against it (provided the issuer believes the veracity of those statements) even where the issuer "possesses subject knowledge that the facts underlying the claims against it are true." But the issuer is not permitted to make statements about the "merits" of claims that an investor could reasonably interpret as denying the facts underlying them—especially where the issuer knows those facts to be true.

Given the success of the Pegasystems plaintiffs' attack on the "without merit" language—which is boilerplate litigation disclosure language—in surviving a motion to dismiss, this is likely not the last time we will see this and similar claims pertaining to litigation disclosure language. Such claims become especially likely where litigation against a company may end in an adverse judgment or verdict that negatively affects stock prices. Because the outcome of litigation is never certain, counsel for public companies would be wise to carefully evaluate future litigation disclosure language, and to consider sticking to express statements regarding the legal strength of the company's defenses and corresponding legal weakness of the claims, rather than anything that could be reasonably construed as a statement regarding the underlying facts. This admonition is true even for language that has been considered boilerplate for lawsuit disclosures in the past.

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