

INSIGHTS

A New Twist in M&A Litigation: Section 11 Cases in State Court

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Section 11 litigation may be picking up steam in state courts—and now it's not just for IPO companies. If you've seen the headlines, you know that in March 2018, the United States Supreme Court ruled that class action lawsuits under the Securities Act of 1933 could be brought in state court, not just federal court.



This opened the door for Section 11 claims under the Act to be brought in all 50 states, effectively expanding the opportunity for the plaintiffs' bar from just California to the entire country.

We've now seen something new in the data: Section 11 M&A claims in state court. If this becomes a trend, it will add significant cost and complexity to the world of M&A litigation.

In layman's terms, to have a solid Section 11 case, a plaintiff needs four things:

1. A registration statement with the Securities and Exchange Commission

2. Shares that can be traced back to that registration statement
3. A share price that drops below the offering price in the registration statement
4. A **material misstatement or omission** in the registration statement

Until now, we've considered Section 11 cases filed in state court to be mostly a problem for IPO companies. That's because IPO companies don't typically have a lot of shares trading other than the shares issued pursuant to the registration statement. For that reason, it's not hard for plaintiffs to be able to trace back IPO company shares (including shares issued in a follow-on offering pursuant to a registration statement shortly after the IPO) to a registration statement. However, it's much harder to do that for the more mature public companies since there are a lot of shares in the float, making the tracing requirement to a particular registration statement much harder to meet.

But we've now seen in the data Section 11 suits brought by plaintiffs in state court against three different mature public companies:

- Micro Focus International. *Ribeiro v. Micro Focus International*. (County of San Mateo, Calif.; filed March, 28, 2018.)
- Dentsply Sirona, Inc. (formerly Dentsply International, Inc.). *Castronovo v. Dentsply Sirona, Inc. et al* (County of New York; filed June 7, 2018.)

Colony Capital, Inc. Two suits in two separate states.

Bumgardner v. Colony Capital (County of Los Angeles; filed July 5, 2018) and *Houser v. CenturyLink, Inc.* (County of Boulder, Colo.; filed June 12, 2018.)

The reason is mergers and acquisitions. In each case, the buyer used its stock as currency and issued shares to the seller shareholders pursuant to a registration statement. Then the stock price declined below the registration statement price.

Given the proximity in time to the share issuance, the plaintiffs have a viable path to trace the shares back to the registration statement, and so it's perhaps inevitable that these cases are being brought in state courts. And, as mentioned earlier, after *Cyan Inc. v. Beaver County Employees Retirement Fund*, these types of cases can be brought in all 50 states.

These post-M&A lawsuits share the same problems as any Section 11 case brought in state court:

- The state court has lower pleading standards, so it's easier to survive the state court equivalent of a motion to dismiss.
- Discovery is not stayed, making the beneficial discovery postponement not an option for defendants.
- Some companies will face Section 11 litigation in both state and federal courts, as we've seen with Colony Capital.

As has been the case for state court IPO cases, these post-M&A Section 11 cases may settle for more than they otherwise would in federal court.

It remains to be seen how this new twist on M&A litigation will play out. For example, the state courts might take a tougher stance that ends up discouraging the plaintiffs from following this path.

Directors and officers involved in buying companies will want to be aware of this trend and factor it into their thinking as they decide whether to use their stock to buy other companies. We'll be watching this closely and reporting on any emerging trends.

All views expressed in this article are the author's own and do not necessarily represent the position of Woodruff-Sawyer & Co.



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