Cos. Must Show Discretion In Public Statements When Sued

By **Brian Kearney and Stephen Kastenberg** (October 6, 2023)

Brian Kearney

Stephen Kastenberg

A recent U.S. District Court for the District Court of Massachusetts ruling in City of Fort Lauderdale Police and Firefighters' Retirement System v. Pegasystems should give legal leaders and communications management pause about making routine public statements disdaining the merits of pending claims.

In an opinion and order denying a motion to dismiss on July 24, the court held that a defendant public company's boilerplate public denial of the merits of a lawsuit against it could form the basis for a claim that the statement was false or misleading, in violation of the federal securities laws.

The district court ruling came in a shareholder putative class action brought by an investor against software company Pegasystems Inc., or Pega, asserting federal securities violations. As recounted by the district court in its opinion denying a motion to dismiss on the pleadings, employees of Pega — including senior executives — had allegedly engaged in a conspiracy over the better part of a decade to misappropriate trade secrets of one of its primary competitors.

Upon receiving evidence of this scheme from two former Pega employees, the competitor filed a lawsuit in Virginia state court in May 2020, alleging theft of trade secrets. The suit sought actual damages in the amount of $90 million, plus punitive and treble damages.

Two years later, in February 2022, the competitor amended its complaint to revise its damages calculation drastically upward — to $3 billion. Five days later, Pega filed its fiscal 2021 Form 10-K filing. In that filing, Pega "made express and detailed mention of the Virginia action," and, in an apparent attempt to reassure investors, stated that the claims in that case were "without merit."

The next day, Pega's stock price suffered a 15.62% drop. Following a seven-week trial, the jury in the Virginia action returned a unanimous verdict against Pega, awarding its competitor over $2 billion in compensatory damages. As a result, Pega's stock value declined 28% in the 48 hours following the verdict.

The putative class action was brought in Massachusetts 10 days after the Virginia jury returned its verdict. Relying on the findings in the Virginia action, the plaintiff alleged that Pega's CEO and other senior executives had taken part in the misconduct at issue in the Virginia action, and that the reassurance in Pega's February 2022 10-K filing that the Virginia action was "without merit" was therefore false and misleading.

The district court rejected Pega's motion to dismiss the securities case, finding that the plaintiff had adequately alleged that Pega and its CEO had misled investors when stating that the claims in the Virginia action were "without merit," and that the misstatement was "causally connected to the significant decline in the value of Pega's stock."[1]

In its opinion, the Massachusetts court made a number of statements relevant to companies

crafting a 10-K filing, or indeed any public statement, about pending litigation involving their company. In particular, the court held that "reassur[ing] investors" that claims are "without merit ... is an actionable opinion statement."[2]

The court noted that "a reasonable investor 'expects not just that the issuer believes the opinion (however irrationally), but that it fairly aligns with the information in the issuer's possession at the time.'"[3]

The Massachusetts district judge highlighted that the choice to single out claims as being "without merit" — despite its current status as a phrase that has arguably become public relations boilerplate in response to incipient litigation — is a choice that will almost inevitably lead to "reasonable investors ... underst[anding the company]'s message that [the] claims were 'without merit' as a denial of the facts underlying [those] claims — as opposed to a mere statement that [the company] had legal defenses against those claims."[4]

This ruling comes in the midst of — and offers cautionary guidance regarding participation in — a recent trend toward companies offering more robust, detailed commentary on pending litigation in 10-K filings and public statements. This trend is likely both responsive to and reinforcing market pressures; increasingly, investors may expect a company to proactively advocate for itself in public filings, and may thus interpret a muted response as a warning sign of trouble ahead.

With some implicit awareness of this reality of the market, the court went on to emphasize that its ruling doesn't require that a company bestow credibility on pending claims — even if it has knowledge that the underlying facts are true.

If the company chooses to address pending claims, "however, it must do so with exceptional care, so as not to mislead investors."[5] The safe ground, in the court's estimation, is the stoic approach: Focus on what the company can control — namely, how it plans to approach the litigation.

For instance, a company "may validly assert its intention to oppose the lawsuit." Or it may "state that it has 'substantial defenses' against [the lawsuit], if it reasonably believes that to be true." According to at least one federal judge, avoiding an assessment or value judgment of the validity of pending claims — and, by implication, of the veracity of the factual basis for those claims — is what's crucial.

As a postscript, it's worth noting that this ruling may have implications for private companies as well. Executives would do well to evaluate the nature of their communications with their investors regarding pending litigation in light of the detailed holding in Pegasystems.

Brian N. Kearney is an associate and Stephen J. Kastenberg is a partner at Ballard Spahr LLP.

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[1] Opinion at 3.

[2] Opinion at 27, citing Omnicare Inc. v. Laborers Dist. CouncilConst. Indus. Pension Fund, 575 U.S. 175, 189 (2015).

[3] Id.

[4] Opinion at 28.

[5] Opinion at 29.