No. 13-

In the Supreme Court of the United States

JOHN J. MOORES, CHRISTOPHER A. COLE, RICHARD A. HOSLEY, CHARLES E. NOELL, III, NORRIS VAN DEN BERG, AND THOMAS G. WATROUS, SR.,

Petitioners,

v.

DAVID HILDES, INDIVIDUALLY AND AS TRUSTEE OF THE DAVID AND KATHLEEN HILDES 1999 CHARITABLE REMAINDER UNITRUST DATED JUNE 25, 1999,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

May a plaintiff state a claim under Section 11 of the Securities Act of 1933, which provides for strict liability "on account of" defective registration statements, where he made an irrevocable investment decision to acquire his securities before a registration statement covering the issuance of those securities existed?

PARTIES TO THE PROCEEDING

Petitioners John J. Moores, Christopher A. Cole, Richard A. Hosley, Charles E. Noell, III, and Norris van den Berg were limited intervenors in the district court and appellees in the court of appeals.

Petitioner Thomas G. Watrous, Sr. was a defendant in the district court and an appellee in the court of appeals.

Respondent David Hildes was the plaintiff in the district court and the appellant in the court of appeals.

In the district court, Arthur Andersen LLP, Douglas S. Powanda, and John Doe as the Executor of the Estate of David Farley were also defendants.

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PETITION FOR A WRIT OF CERTIORARI

Petitioners John J. Moores, Christopher A. Cole, Richard A. Hosley, Charles E. Noell, III, Norris van den Berg, and Thomas G. Watrous, Sr. petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

OPINIONS BELOW

The court of appeals' opinion (Pet. App. 1a-19a) is reported at 734 F.3d 854 (9th Cir. 2013). The court's order denying rehearing or rehearing *en banc* (Pet. App. 41a-42a) is unreported. The district court's opinion (Pet. App. 20a-40a) is unreported.

JURISDICTION

The court of appeals entered its judgment on August 19, 2013, and denied Petitioners' petition for rehearing or rehearing *en banc* on October 1, 2013. Pet. App. 1a, 41a. This Court's jurisdiction rests on 28 U.S.C. § 1254(1).

STATUTORY PROVISION INVOLVED

Section 11 of the Securities Act of 1933,15 U.S.C. § 77k, provides in relevant part:

> Civil liabilities on account of false registration statement
>
> (a) Persons possessing cause of action; persons liable
>
> In case any part of the registration statement, when such part became effective, contained an untrue statement

of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue–

(1) every person who signed the registration statement;

(2) every person who was a director of (or person performing similar functions) or partner in the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted;

(3) every person who, with his consent, is named in the registration statement as being or about to become a director, person performing similar functions, or partner;

(4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in

> such registration statement, report, or valuation, which purports to have been prepared or certified by him;
>
> (5) every underwriter with respect to such security.
>
> If such person acquired the security after the issuer has made generally available to its security holders an earning statement covering a period of at least twelve months beginning after the effective date of the registration statement, then the right of recovery under this subsection shall be conditioned on proof that such person acquired the security relying upon such untrue statement in the registration statement or relying upon the registration statement and not knowing of such omission, but such reliance may be established without proof of the reading of the registration statement by such person.

15 U.S.C. § 77k(a).

STATEMENT

In this case, the court of appeals held that a plaintiff who had made his sole investment decision *before* a false registration statement existed could nonetheless state a claim under Section 11 of the Securities Act of 1933, which provides for civil liability to investors "*on account of* [a] false registration statement." 15 U.S.C. § 77k (emphasis added). By so holding, the court of appeals eliminated an important limitation on Section 11's reach and created a conflict with the United States Court of Appeals for

the Eleventh Circuit's decision in *APA Excelsior III L.P. v. Premiere Technologies, Inc.*, 476 F.3d 1261 (11th Cir. 2007), and other lower courts' decisions. The court also created considerable uncertainty regarding the scope and application of this formerly limited investor remedy. For either or both of these reasons, this Court should grant review.

A. The Statutory Scheme

Section 11 was designed to ensure compliance with the disclosure provisions of the Securities Act by imposing strict liability, even for innocent misrepresentations, on issuers and on other defendants, subject to a due diligence defense. *See, e.g.*, *Herman & MacLean v. Huddleston*, 459 U.S. 375, 381-82 (1983). Placing a "relatively minimal burden on a plaintiff," *id.* at 382, Section 11 is strictly limited in its scope. Section 11 liability "must be based on mi-statements or omissions in a registration statement[.]" *Id.* "If there is a mixture of pre-registration stock and stock sold under the misleading registration statement, a plaintiff must either show that he purchased his stock in the [] offering or trace his later-purchased stock back to [that] offering." *Hertzberg v. Dignity Partners, Inc.*, 191 F.3d 1076, 1080 n.4 (9th Cir. 1999). Prior to the decision below, Section 11 claims were described as "notable both for the limitations on their scope as well as the *in terrorem* nature of the liability they create." *In re Morgan Stanley Info. Fund Sec. Litig.*, 592 F.3d 347, 359 (2d Cir. 2010).

B. Factual Background

In early 2000, Peregrine Systems, Inc., a San Diego-based software company, negotiated a stock-for-

stock merger with Harbinger Corporation, a provider of business-to-business e-commerce software products. Pet. App. 4a-5a. Both companies were publicly traded. *Id.* Respondent David Hildes was a director of Harbinger and owned 1,384,217 shares of Harbinger's outstanding common stock at the time. *Id.* On April 5, 2000, Peregrine and Harbinger entered into a merger agreement. Pet. App. 5a. As a condition of that agreement, Hildes and certain other Harbinger shareholders executed "lock-up" agreements, agreeing to vote their shares in favor of the merger. Pet. App. 6a.

Lock-up agreements are a common deal protection device in public merger and acquisition practice. *See, e.g.*, *In re Answers Corp. S'holders Litig.*, C.A. No. 6170-VCN, 2011 WL 1366780, at *4 (Del. Ch. Apr. 11, 2011) (identifying voting agreements locking up shares as standard deal protection measure). Because the filing of the required registration statement makes public the terms of the merger agreement before the public shareholder vote, the acquiring company in a stock-for-stock merger (here, Peregrine) will often seek to protect the deal it negotiated, including by requiring irrevocable voting agreements from significant shareholders as a condition of the merger agreement. *See, e.g.*, *Orman v. Cullman*, No. Civ.A. 18039, 2004 WL 2348395, at *2 (Del. Ch. Oct. 20, 2004) ("central purpose" of voting agreement was to protect against risk of another party intervening in transaction). In these lock-up agreements, the shareholder gives his or her irrevocable proxy to the acquirer or otherwise commits to vote his or her shares in favor of the merger. Although buyers typically cannot lock up enough votes to make shareholder approval of a merger a *fait ac-*

compli, *see, e.g.*, *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 936 (Del. 2003), they can lock up enough shares to deter other potential bidders.

The "Voting Agreement and Irrevocable Proxy" executed by Hildes was such a lock-up agreement. In it, Hildes granted Peregrine an irrevocable proxy to vote his Harbinger shares in favor of the merger. Pet. App. 6a. Hildes's proxy was irrevocable "to the fullest extent permissible by law." *Id.* Hildes was permitted to sell his Harbinger shares prior to the merger, but only if the purchaser executed a counterpart to the Voting Agreement and Irrevocable Proxy maintaining its terms. *Id.* Hildes's irrevocable proxy was terminable only upon (1) the consummation of the Peregrine-Harbinger acquisition; or (2) the valid termination of the merger agreement. *Id.* The merger agreement was terminable only in the event of certain contingencies, all of which were beyond Hildes's personal control. Pet. App. 5a.

On May 22, 2000, nearly seven weeks after Hildes's April 5, 2000 execution of the Voting Agreement and Irrevocable Proxy, Peregrine filed a registration statement with the SEC. Pet. App. 6a. Petitioners—non-employee outside directors of Peregrine—each signed the registration statement. Pet. App. 6a. On June 16, 2000, a majority of Peregrine and Harbinger shareholders approved the proposed merger. *Id.* Peregrine acquired Harbinger and the shareholders' Harbinger shares were converted into Peregrine shares by operation of law. *Id.*

C. The District Court Proceedings

Two years later, in May 2002, Peregrine announced irregularities in its financial statements in-

corporated in the registration statement. Peregrine's shareholders filed multiple class actions alleging violations of the federal securities laws, and those actions were consolidated into a single federal class action in the United States District Court for the Southern District of California. Pet. App. 7a. When certain defendants settled with the class, Hildes opted out of the settlements and filed his own action against the defendants below, including Petitioner Watrous, and that action too was transferred to the Southern District of California. *Id.* In 2009, Hildes moved to amend his complaint to add Petitioners Moores, Cole, Hosley, Noell, and van den Berg as defendants. Pet. App. 7a-8a.

Petitioners opposed Hildes's motion,[1] arguing that leave to amend should be denied as futile because, among other things, Hildes could not state a claim under Section 11 given that he had made his sole investment decision before the Harbinger registration statement had issued. The district court agreed and denied as futile Hildes's motion for leave to amend to add Petitioners. Pet. App. 28a, 33a-34a. Following entry of final judgment as to the existing defendants, Hildes appealed the district court's decision with respect to his Section 11 claims only. Pet. App. 8a.

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[1] Petitioners Moores, Cole, Hosley, Noell, and van den Berg sought and obtained leave to intervene for the limited purpose of opposing Hildes's motion to amend. After leave to amend to add these individuals was denied, Hildes and Petitioner Watrous, already a defendant in the case, stipulated to entry of final judgment with the agreement that any rulings on appeal would also apply to Watrous. *See* Pet. App. 8a n.2.

D. The Court Of Appeals' Decision

In a published opinion, the Ninth Circuit reversed, holding that Hildes could state a claim under Section 11. Even though Hildes had irrevocably committed his shares to be voted in support of the merger weeks before the registration statement had issued, the court reasoned, that agreement "did not irrevocably commit him to exchange his Harbinger shares for Peregrine shares" because "[a]ny exchange of shares remained contingent on the consummation of the merger." Pet. App. 12a. The court of appeals listed potential reasons plaintiff alleged "the planned merger would have collapsed but for the misrepresentations in the Registration Statement"—none of which was within Hildes's control. Pet. App. 12a-13a.

The court of appeals did not focus on the fact that Hildes's investment decision had preceded the registration statement. Instead, it relied upon a "negative causation" analysis in which petitioners carried the "heavy burden" of "prov[ing], as a matter of law, that the depreciation of the value of [the security] resulted from factors other than the alleged false and misleading statements." Pet. App. 13a (quoting *Provenz v. Miller*, 102 F.3d 1378, 1492 (9th Cir. 1996)) (internal quotations omitted). The court of appeals concluded that Petitioners had not met their "heavy burden" of establishing that misstatements in the registration statement did not "touch[] upon" the decline in value of Hildes's investments because the merger would have failed had the truth been disclosed. *Id.* (internal quotations omitted) (quoting *Miller v. Pezzani (In re Worlds of Wonder Sec. Litig.*), 35 F.3d 1407, 1422 (9th Cir. 1994)).

The decision below purported to distinguish (Pet. App. 13a-15a) the decision of the Eleventh Circuit in *APA Excelsior III L.P. v. Premiere Technologies, Inc.*, 476 F.3d 1261 (11th Cir. 2007), which held that a Section 11 claim failed as a matter of law where plaintiffs had granted irrevocable proxies in favor of a stock-for-stock merger agreement prior to the effective date of a registration statement. The court of appeals reasoned that Hildes "was not irrevocably bound to exchange his Harbinger shares for Peregrine stock at the time the Registration Statement was filed," concluding that "misrepresentations played a role in the causal chain that resulted in the exchange of stock." Pet. App. 14a-15a.

REASONS FOR GRANTING THE WRIT

I. THE COURT OF APPEALS' DECISION CONFLICTS WITH DECISIONS OF OTHER LOWER COURTS

Before the court of appeals issued its decision in this case, investors who had made their sole investment decision before a registration statement issued had no claim under Section 11 of the 1933 Securities Act. The Eleventh Circuit and other lower courts considering this question had uniformly held that, where an investor had made his sole investment decision in the absence of a registration statement, he could not claim the benefit of Section 11—a narrow statute designed to protect investors from false registration statements. The Ninth Circuit, in contrast, permitted a Section 11 claim concerning a pre-registration statement agreement on the ground that the exchange of shares was contingent on a registration statement subsequently

being issued and a merger eventually occurring. These decisions are in conflict and warrant this Court's review.

A. The Court Of Appeals' Decision Conflicts With The Eleventh Circuit's Decision In *APA Excelsior*

In *APA Excelsior*, 476 F.3d at 1267, recognizing that it was considering a matter of first impression at the time, the Eleventh Circuit framed the issue of investment decisions made before a registration statement existed as a question of reliance. The Eleventh Circuit held that, although Section 11 presumes reliance on a registration statement, that presumption is inapplicable to an investment decision to vote shares that is irrevocably made before any registration statement existed, *id.* at 1277, reasoning that, in such a case, "reliance is rendered impossible by virtue of a pre-registration commitment," *id.* at 1272.

First, the Eleventh Circuit found an implicit concern with reliance in Section 11's statutory language. As the court noted, Section 11 requires plaintiffs who purchased their securities more than a year after the registration statement issued to prove reliance on the registration statement, *see* 15 U.S.C. § 77k(a), while affording plaintiffs who purchased their securities within the twelve-month period after the registration statement issued a conclusive presumption of reliance. *APA Excelsior*, 476 F.3d at 1270-71; *accord Kirkwood v. Taylor*, 590 F. Supp. 1375, 1377-78 (D. Minn. 1984) ("[Section 11] in effect presumes that those who purchased stock in the public offering relied upon the allegedly misleading documents."), *aff'd*, 760 F.2d 272 (8th Cir. 1985); 2 T.L. Hazen, THE

LAW OF SEC. REG. § 7.3[4] (6th ed. 2009 & Supp. 2013) ("[T]here is a conclusive presumption of reliance for any person purchasing the security prior to the expiration of twelve months.").

Second, the Eleventh Circuit relied upon legislative history, finding support for its conclusion in Congress's "well-documented" legislative intent to create a presumption of reliance. *APA Excelsior*, 476 F.3d at 1271-72; *accord Barnes v. Osofsky*, 373 F.2d 269, 272 (2d Cir. 1967) ("Both the House and Senate versions of the present § 11, in identical language, established a conclusive presumption of reliance upon the registration statement by 'every person acquiring any securities specified in such statements and offered to the public.'") (citing S. Rep. No. 73-875 § 9 (1933); H.R. Rep. No. 73-4314 § 9 (1933)). The Eleventh Circuit observed that, "even though the purchaser may not read and rely on the registration statement, the misstatements and omissions contained therein are reasonably assumed to affect the market price and impel the purchase[.]" *APA Excelsior*, 476 F.3d at 1273-74 (citing H.R. Rep. No. 73-85, at 10 (1933)). By contrast, the court reasoned, plaintiffs must prove reliance on a false registration statement when they purchased a security after twelve months of earning statements because "in all likelihood the purchase and price of the security purchased after publication of such an earning statement will be predicated upon that statement rather than upon the information disclosed upon registration." *Id.* at 1275-76 (quoting *Hertzberg v. Dignity Partners, Inc.*, 191 F.3d 1076, 1081-82 (9th Cir. 1999) (quoting H.R. Rep. No. 73-1838, at 41 (1934))) (internal quotations omitted).

Relying on this language and legislative history, the Eleventh Circuit explained why the presumption of reliance could not apply to the plaintiffs in *APA Excelsior*:[2]

> First, as a matter of common sense, Plaintiffs are not entitled to the presumption [of reliance] in light of the timing of their investment decision and commitment. To hold otherwise would mean that an impossible fact will be presumed in Plaintiffs' favor.
>
> * * *

[2] The plaintiffs in *APA Excelsior* were a group of individual and institutional shareholders of Xpedite Systems, Inc. 476 F.3d at 1263. Xpedite's board entered into a stock-for-stock merger agreement with Premiere Technologies, Inc. *Id.* at 1263-64. Premiere required as a condition of entering into the merger agreement that plaintiffs execute voting agreements granting irrevocable proxies to Premiere to vote their Xpedite stock for the merger. *Id.* at 1264-65. Premiere locked up approximately 32.8 percent of Xpedite's stock in favor of the merger before the general stockholder vote. *See* Premiere Technologies, Inc. Amendment No. 1 to Form S-4 Registration Statement Under the Securities Act of 1933, at 34 (Jan. 28, 1998), *available at* http://www.sec.gov/Archives/edgar/data/880804/0000931763-98-000128.txt (last accessed Dec. 29, 2013). Months after those lock-up agreements were executed, Premiere issued a registration statement for the offering and Xpedite's shareholders voted to approve the merger. *APA Excelsior*, 476 F.3d at 1265. Later that year, Premiere announced revenue shortfalls not disclosed in the registration statement. *Id.* Premiere's stock price dropped, and the Xpedite shareholders who had entered into voting agreements before the registration statement issued attempted to assert Section 11 claims. *Id.*

> Plaintiffs made their investment decision and were legally committed to the transaction (and thus could not possibly have relied on the registration statement) months before the registration statement was in existence.
>
> Furthermore, and more significantly, our review of the legislative history of Section 11 strongly suggests that Congress did not intend for the presumption to apply in a situation such as the one presented here. This is because when there is a binding pre-registration commitment, the entire purpose of, and justification for, the presumption in the first place is non-existent.

Id. at 1273-74. The court also observed that, if reliance cannot be presumed a year *after* a registration statement issued, it certainly cannot be presumed to exist *before* the registration statement issued. *Id.* at 1275-76 ("It would be absurd to conclude that Congress intended to limit the Section 11 presumption when 'in all likelihood' the stock purchase was motivated by other factors, and yet allow the presumption when it is an absolute *certainty*.") (emphasis in original).

Finally, the Eleventh Circuit noted that Section 11's requirement that plaintiffs trace their purchases to a defective registration statement further reinforced its conclusion that Section 11 relief is unavailable to locked-up plaintiffs. Plaintiffs who make their investment decision *before* the issuance of a misleading registration statement cannot "trace" their purchases to the registration statement. *Id.* at

1276. Thus, the court concluded that a Section 11 claim cannot be stated where "reliance is rendered impossible by virtue of a pre-registration commitment." *Id.* at 1272; *see also id.* at 1277 (presumption of reliance does not apply "where sophisticated investors participating in an arms-length corporate merger make a legally binding investment commitment months before the filing of a defective registration statement").

In sharp contrast to the Eleventh Circuit's decision in *APA Excelsior*, the Ninth Circuit held in the decision below that Hildes, who undisputedly had made his sole investment decision before a registration statement existed, *could* state a claim under Section 11. The court of appeals purported to distinguish *APA Excelsior* by reasoning that Hildes was not actually a locked-up investor because the merger might still have failed, but that reasoning fails to dispel the conflict. The court conceded that Hildes had irrevocably bound his shares to be voted in favor of the merger before the registration statement issued, but proceeded to reach the opposite conclusion from that in *APA Excelsior*:

> According to the district court, Hildes' losses could not have been caused by the misleading Registration Statement because Hildes made a binding commitment to exchange his Harbinger shares for Peregrine stock when he signed his Voting Agreement and Irrevocable Proxy on April 5, 2000, prior to the date misrepresentations were made in the Registration Statement. We disagree. *Although the Voting Agreement and Ir-*

> *revocable Proxy irrevocably committed Hildes to have his shares voted in favor of the merger, it did not irrevocably commit him to exchange his Harbinger shares for Peregrine shares.* Any exchange of shares remained contingent on the consummation of the merger.

Pet. App. 12a (emphasis added).

The court of appeals' emphasis on whether the ultimate exchange of Hildes's shares was inevitable conflicts with the analysis of the Eleventh Circuit. Here, as in *APA Excelsior*, the plaintiff's own investment decision was complete before a false registration statement issued. Here, as in *APA Excelsior*, the merger could have been stymied by a "causal chain" of other parties' actions apart from the individual plaintiff's investment decision. The fact that the "exchange of [Hildes's] shares remained contingent on the consummation of the merger," Pet. App. 12a, does not distinguish *APA Excelsior*, because an exchange of shares is *always* contingent on the merger's consummation, and there might *always* be events that could prevent that from occurring.[3] Under the court of appeals' reasoning (in conflict with the holding of the Eleventh Circuit), there can be no such thing as a locked-up investor.

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[3] Notably, the Eleventh Circuit considered and rejected this same tautological argument in *APA Excelsior*. *See* 476 F.3d at 1276 n.6 ("It is true that Plaintiffs in one sense 'acquired' their stock only after consummation of the merger and after the registration statement was filed. Regardless of when they may have physically acquired the stock, however, Plaintiffs made their investment decision, and were committed thereto, months before that time.").

The court of appeals' decision thus created a conflict with that of the Eleventh Circuit on virtually identical facts, and thus broadened the scope of Section 11 to plaintiffs who cannot have relied upon a registration statement given the timing of their investment decisions, and who cannot trace their decisions to such a statement. Because plaintiffs now have a Section 11 remedy in the Ninth Circuit that is unavailable in the Eleventh Circuit, review by this Court is warranted to restore uniformity.

B. The Court Of Appeals' Decision Conflicts With The Decisions Of Other Lower Courts

The decision below also conflicts with decisions of other lower courts, both before and after *APA Excelsior*, that have reached conclusions similar to the Eleventh Circuit's. Whether framing the issue as one of reliance, standing, materiality, tracing, or logic, other courts have routinely concluded that plaintiffs who have made their sole investment decisions before a false registration statement was filed cannot state a claim under Section 11. *See, e.g.*, *In re HealthSouth Corp. Sec. Litig.*, 261 F.R.D. 616, 657 (N.D. Ala. 2009) ("Every court that has addressed this issue after *APA Excelsior* has agreed that plaintiffs who acquired registered bonds [after acquiring unregistered bonds to be exchanged for them] through a voluntary 144A/*Exxon Capital* exchange are precluded from asserting claims under Section 11. . . . These courts recognize the obvious: a registration statement cannot be the basis for an investment decision where an investor made its investment decision *before* the registration statement had been filed.").

For example, in *In re Refco, Inc. Securities Litigation*, 503 F. Supp. 2d 611 (S.D.N.Y. 2007), the United States District Court for the Southern District of New York noted that the defendants in that case had "frame[d] the argument in several different ways, all of which are based on the idea that the Bond Registration Statement had nothing to do with the unregistered bondholders' decision to exchange their unregistered bonds for registered bonds." *Id.* at 633. The court concluded that, "[w]hether framed as a question of materiality or reliance, it seems clear as a matter of law and logic that plaintiffs should be entitled to no recovery when it can be established with certainty that they were not harmed in any way by the relevant misrepresentations." *Id.* Another district court also expressed the issue as one of materiality: "[T]he court concludes that the alleged misstatements and omissions would not have been material to the unregistered bondholders' decision whether to exchange unregistered shares they had already chosen to purchase pursuant to the Rule 144A offering documents. Because the unregistered bondholders had already invested in Levi bonds through the Rule 144A offerings, they were not presented with the decision of whether or not to purchase Levi bonds pursuant to the registration statement." *In re Levi Strauss & Co. Sec. Litig.*, 527 F. Supp. 2d 965, 978 (N.D. Cal. 2007).

Other courts have concluded that locked-up or otherwise committed plaintiffs cannot meet Section 11's tracing requirements. *See, e.g.*, *HealthSouth*, 261 F.R.D. at 648 ("If simple logic shows that the plaintiff's investment decision occurred *before* the registration statement, then the decision is not

traceable to a registration statement and no basis arises for a Section 11 claim.") (emphasis in original); *accord Abbey v. Computer Memories, Inc.*, 634 F. Supp. 870, 876 (N.D. Cal. 1986) ("The purpose of [S]ection 11's tracing requirement is to limit standing to sue to those individuals who actually purchased shares issued pursuant to a defective registration statement.").

Still other courts have suggested that standing requirements may preclude locked-up plaintiffs' claims. *See, e.g.*, *Guenther v. Cooper Life Sciences*, 759 F. Supp. 1437, 1440 (N.D. Cal. 1990) (dismissing certain plaintiffs' claims for lack of standing because reading Section 11 to allow plaintiffs "to bring a [S]ection 11 action even though at the time they purchased their shares they could not possibly have relied on misleading registration statements, since none had been filed" would "clearly contravene the purpose of [S]ection 11").

As with *APA Excelsior*, the court of appeals failed to address the conflict it was creating with these other decisions because, in concluding that Hildes was not a locked-up investor, it focused on the timing of the exchange of Hildes's Harbinger shares for Peregrine shares rather than on the pre-registration statement timing of his investment decision. The outcome below, however, is irreconcilable with the outcome in these other lower courts' decisions. Review by this Court is additionally warranted to resolve the conflict created by the court of appeals' decision below with the decisions of these other lower courts.

II. WHETHER A SECTION 11 REMEDY EXTENDS TO PRE-REGISTRATION INVESTMENT DECISIONS PRESENTS AN IMPORTANT QUESTION OF FEDERAL LAW

A. The Court Of Appeals' Decision Creates Confusion About Longstanding SEC Rules For Stock-For-Stock Mergers

In addition to creating conflict with the decisions of the Eleventh Circuit and other lower courts, the court of appeals' decision below also has created confusion and uncertainty regarding stock-for-stock mergers that this Court should dispel. Specifically, by focusing on the inevitability of the *exchange* of Hildes's shares rather than the finality of his investment decision, the court of appeals' decision calls into question whether Section 11 can apply to stock-for-stock mergers at all.

Until 1972, public offerings relating to stock-for-stock mergers did not have to be registered. Under former SEC Rule 133, 17 C.F.R. § 230.133, stock-for-stock mergers were deemed the result of a corporate act authorized by majority shareholder approval rather than actual "sales" to individual investors. Notice of Adoption of Rule 145 and 153A, Prospective Rescission of Rule 133, Securities Act Release No. 5316, 1972 WL 121530, at *2 (Oct. 6, 1972). In 1972, the SEC replaced the prior "no-sale rule" with the modern SEC Rule 145, which provides that "[a] statutory merger or consolidation or similar plan or acquisition in which securities of such corporation or other person held by such security holders will become or be exchanged for securities of any person"

involves an "offer, offer to sell, offer for sale, or sale" requiring registration under the Securities Act. 17 C.F.R. § 230.145(a)(2).

The SEC explained the rule change as follows:

> A stockholder faced with a [stock-for-stock merger] proposal must decide on his own volition whether or not the proposal is one in his own best interest. The basis on which the "no-sale" theory is predicated, namely, that the exchange or alteration of the shareholder's security occurs not because he consents thereto but because the corporation by authorized corporate action converts his securities, in the Commission's opinion, is at best only correct in a formalistic sense and overlooks the reality of the transaction. The corporate action, on which such great emphasis is placed, is derived from the individual consent given by each stockholder in voting on a proposal to merge or consolidate a business or reclassify a security.

Notice, 1972 WL 121530, at *2.

Thus, since 1972, the "sale" of a security arising from a stock-for-stock merger has been tied to the individual shareholder's voting decision, not the ultimate corporate action that results from the majority shareholder vote. *Id.* As the SEC noted, "[i]n voting, each consenting stockholder is expressing his voluntary and individual acceptance of the new security." *Id.* For the last 40 years, in the SEC's view, it has been the voting decision of the individual plain-

tiff, not the ultimate corporate action of the merger, that constitutes the "sale" that may support Section 11 claims in the stock-for-stock merger context.

Recent SEC guidance regarding lock-up agreements like the one executed by Hildes confirms this. The SEC has recognized that "[t]he execution of a lock-up agreement (or agreement to tender) may constitute a contract of sale under the Securities Act." SEC Division of Corporation Finance, Compliance and Disclosure Interpretations, Securities Act Sections, Question 139.30 (Aug. 11, 2010), *available at* http://www.sec.gov/divisions/corpfin/guidance/sasinterp.htm (last accessed Dec. 29, 2013). "Recognizing the legitimate business reasons for seeking lock-up agreements in the course of negotiated third-party exchange offers," the SEC has stated that it will not object to the registration of public offerings subsequent to the execution of private lock-up agreements so long as the agreements do not extend beyond certain enumerated parameters. *Id.*[4] This exception underscores that the SEC views the execution of the pre-registration statement lock-up agreement itself, and not the post-registration statement exchange of

[4] This guidance is necessary because otherwise, if viewed as a pre-registration statement contract of sale for a publicly-offered security, a lock-up agreement could constitute illegal "gun-jumping" in violation of 15 U.S.C. § 77e(a). Alternatively, if the contract of sale embodied in a lock-up agreement were viewed as a private offering exempt from the 1933 Securities Act's registration requirements, that would bar the post-registration-statement public offering because "a transaction that has commenced privately must be completed privately." SEC Division of Corporation Finance, Compliance and Disclosure Interpretations, Securities Act Sections, Question 139.30 (Aug. 11, 2010).

shares, as the event defining the relevant transaction.

The court of appeals departed from the SEC's approach by disregarding the fact that "the Voting Agreement and Irrevocable Proxy irrevocably committed Hildes to have his shares voted in favor of the merger" because the ultimate "exchange of shares remained contingent on the consummation of the merger." Pet. App. 12a. The SEC rules, since 1972, have emphasized that an individual's investment decision, rather than the corporate act of the exchange of shares, is the relevant "sale" event in a stock-for stock merger.

If the timing of the investment decision (represented by the individual shareholder's surrender of his vote) is irrelevant, as the court of appeals held here, the SEC's replacement of the "no-sale" rule and application of Section 11 to stock-for-stock mergers is called into question. At minimum, the court of appeals' decision has created serious confusion as to when (if at all) a "sale" occurs for purposes of the 1933 Securities Act. This Court should grant review to dispel this confusion.

B. The Court Of Appeals' Decision Impairs The Fair Operation Of The Federal Securities Laws

This Court has repeatedly observed that the fair and effective operation of the federal securities laws is of critical national importance. *See, e.g., Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.,* 552 U.S. 148, 161 (2008) ("[A] dynamic, free economy presupposes a high degree of integrity in all of its parts, an integrity that must be underwritten

by rules enforceable in fair, independent, accessible courts."); *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 78 (2006) ("The magnitude of the federal interest in protecting the integrity and efficient operation of the market for nationally traded securities cannot be overstated.").

Such national uniformity and fairness are impaired if identically situated plaintiffs have a Section 11 remedy in the courts of one circuit but not in those of another. Because the 1933 Securities Act provides for nationwide service of process, this disparity creates pernicious potential for forum shopping. And the question whether locked-up investors may pursue a Section 11 remedy is certain to resurface, as lock-up agreements are and will remain an essential tool in modern merger and acquisition practice. *See, e.g.*, S. Davidoff, "Ways to Muscle Out Competing Deal Offers," N.Y. TIMES DEALBOOK, 2013 WLNR 17640443 (July 19, 2013) (discussing AT&T's lock up of 30% of the target's outstanding shares in its pending $1.19 billion acquisition of Leap Wireless International); M. Landau & D. Do, "Locking Up the Public Deal: Seeking Certainty in Uncertain Times," METRO. CORP. COUNSEL, 2010 WLNR 5079975 (Mar. 1, 2010).

For example, before announcing a recently-completed $1.2 billion merger, Parkway Properties, Inc. locked up at least 33 percent of the shares in Thomas Properties Group, Inc. with irrevocable voting agreements.[5] In the $3.6 billion merger between

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[5] *See*, *e.g.*, Parkway Properties, Inc., Form S-4/A, at 6 (Nov. 5, 2013), *available at* http://www.sec.gov/Archives/edgar/data/729237/000119312513426280/d606512ds4a.htm (last accessed Dec. 29, 2013); Parkway Properties, Inc., "Parkway Properties

Leucadia National Corporation and Jefferies Group, Inc. that closed in early 2013, the lock-up agreements to vote in favor of the merger ran both ways: Leucadia National locked up approximately 31.5 percent of the Jefferies Group's outstanding shares and the Jefferies Group locked up approximately 18.3 percent of Leucadia National's outstanding shares.[6] Markel Corporation's $3.3 billion acquisition of Alterra Capital Holdings Ltd., closed on May 1, 2013, also involved bilateral lock-up agreements; Markel locked up approximately 19.6 percent of Alterra's outstanding shares and Alterra locked up approximately 5.2 percent of Markel's outstanding shares to vote in favor of the merger.[7]

These are but a few of the recently-closed or ongoing stock-for-stock mergers that have used lock-up agreements as a deal-protection device. Locked-up investors typically represent (by design) a significant

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Agrees To Merger With Thomas Properties Group In Stock-For-Stock Transaction Valued At $1.2 Billion," *available at* http://corporate.pky.com/file.aspx?IID=108213&FID=19572664 (last accessed Dec. 29, 2013).

[6] *See, e.g.*, "Leucadia National Corporation and Jefferies Group, Inc. to Merge," MERGERS & ACQUISITIONS WEEK, 2012 WLNR 26621042 (Nov. 12, 2013); Jefferies Group, Inc., "Leucadia National Corporation and Jefferies Group, Inc. Merger to be Effective March 1, 2013," *available at* http://www.jefferies.com/News/PressReleases/201/304 (last accessed Dec. 29, 2013).

[7] *See, e.g.*, Markel Corp., Form 8-K, at 4 (Dec. 19, 2012), *available at* http://www.sec.gov/Archives/edgar/data/1096343/000119312512507418/d455911d8k.htm (last accessed Dec. 29, 2013); Markel Corp., Form 10-K, at 7 (Aug. 7, 2013), http://www.sec.gov/Archives/edgar/data/1096343/000109634313000017/mkl0630201310-q.htm (last accessed Dec. 29, 2013).

number of the shares at issue in any given merger. Whether such investors can have a remedy under Section 11, notwithstanding the lack of any registration statement when their investment decisions are made, has divided the lower courts. This Court should grant the Petition to resolve this important federal question and restore uniformity, certainty and fairness to the federal securities laws.

CONCLUSION

The petition for writ of certiorari should be granted.

Respectfully submitted,

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December 30, 2013

APPENDIX

APPENDIX A

FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 11-56592
D.C. No. 3:08-cv-00008-BEN-RBB

DAVID HILDES, individually and as Trustee of The David and Kathleen Hildes 1999 Charitable Remainder Unitrust dated June 25, 1999,

Plaintiff-Appellant,

v.

ARTHUR ANDERSEN LLP; THOMAS G. WATROUS, SR.; DOUGLAS S. POWANDA; JOHN DOE, as the Executor of the Estate of David A. Farley,

Defendants-Appellees,

and

JOHN J. MOORES; CHRISTOPHER A. COLE; RICHARD A. HOSELY; CHARLES A. NOELL, III; NORRIS VAN DEN BERG, Outside Directors,

Intervenors-Appellees.

Appeal From the United States District Court
for the Southern District of California

Roger T. Benitez, District Judge, Presiding

Argued and Submitted
June 7, 2013—Pasadena, California

Filed August 19, 2013

OPINION

Before: Stephen S. Trott, Carlos F. Lucero[*], and William A. Fletcher, Circuit Judges.

Opinion by Judge Lucero

SUMMARY[**]

Securities

Reversing the dismissal of a securities fraud action, the panel held that the district court erred by denying the plaintiff leave to amend his complaint to add claims under § 11 of the Securities Act of 1933 against former outside directors of Peregrine Systems, Inc.

The panel held that the district court erred in concluding that amendment would be futile because the "negative causation" defense barred the proposed claims. The panel held that the plaintiff sufficiently alleged that material misstatements in a registration statement caused his losses even though prior to the filing of the registration statement he had entered into an agreement that his shares in Harbinger Corp. be voted in favor of a merger between Peregrine and Harbinger. The panel reasoned that the plaintiff did not irrevocably commit to exchange his Harbinger shares for Peregrine shares prior to the filing of the registration statement. In addition, he alleged that if Peregrine's registration statement had contained accurate information, then the merger would not have

[*] The Honorable Carlos F. Lucero, Circuit Judge for the U.S. Court of Appeals for the Tenth Circuit, sitting by designation.

[**] This summary constitutes no part of the opinion of the court. It has been prepared by court staff for the convenience of the reader.

taken place, and his voting agreement and proxy would have terminated.

COUNSEL

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Harry A. Olivar, Jr. (argued), John B. Quinn, Valerie Roddy, and Molly Stephens, Quinn Emanuel Urquhart & Sullivan, LLP, Los Angeles, California, for Intervenors-Appellees.

Anne H. Hartman and Wayne T. Lamprey, Goodin MacBride Squeri Ritchie & Day LLP, San Francisco, California; Robert H. Logan, Keesal, Young & Logan, Long Beach, California, for Defendants-Appellees.

OPINION

LUCERO, Circuit Judge:

David Hildes appeals from a district court order denying leave to amend his complaint. Hildes sought to add a claim under Section 11 of the Securities Act of 1933, 15 U.S.C. § 77k, against former outside directors of Peregrine Systems, Inc. ("Peregrine"). The district court concluded that amendment would be futile because the "negative causation" defense barred Hildes' proposed claim. It noted that Hildes entered into a Voting Agreement and Irrevocable Proxy with Peregrine, which required that Hildes' shares in Harbinger Corporation ("Harbinger") be voted in favor of a merger between the two companies. Because that agreement was executed before Peregrine filed an S-4/A registration statement ("Registration Statement") with the SEC that is alleged to contain various omissions and misstatements, the district court

concluded that any misrepresentations in the Registration Statement could not have caused Hildes' losses.

We reject this reasoning. Section 11 imposes broad liability without regard to reliance or fraudulent intent for any material misstatements or omissions contained in a registration statement for the first year that the registration statement is available. 15 U.S.C. § 77k(a). Although Hildes agreed to have his Harbinger shares voted in favor of the merger with Peregrine, he did not irrevocably commit to exchange those shares for Peregrine shares prior to the filing of the Registration Statement. Moreover, Hildes alleges that if Peregrine's Registration Statement had contained accurate information, the merger would not have taken place, and Hildes' Voting Agreement and Irrevocable Proxy would have terminated. Accordingly, Hildes sufficiently alleged that the material misstatements caused his losses, and thus amending the complaint would not be futile. Exercising jurisdiction under 28 U.S.C. § 1291, we reverse and remand.

I

In early 2000, Peregrine, a publicly traded software company, began merger discussions with Harbinger, an Atlanta-based provider of business-to-business e-commerce software products.[1] Hildes was a director

[1] We accept as true all well-pleaded, non-conclusory allegations contained in a proposed complaint. *See Sw. Ctr. for Biological Diversity v. Berg*, 268 F.3d 810, 819–20 (9th Cir. 2001). Accordingly, the foregoing facts are drawn from Hildes' proposed second amended complaint and the documents upon which it necessarily relies. *See Marder v. Lopez*, 450 F.3d 445, 448 (9th Cir. 2006) (court may look to documents upon which complaint relies if "(1) the complaint refers to the document; (2) the

of Harbinger and beneficially owned 1,384,217 shares of Harbinger common stock.

On April 5, 2000, the two companies entered into an Agreement and Plan of Merger and Reorganization ("Merger Agreement"). Under the terms of the Merger Agreement, Harbinger's board would recommend the merger to its shareholders. Harbinger would become a wholly-owned subsidiary of Peregrine, and each outstanding share of Harbinger common stock would be exchanged for 0.75 shares of Peregrine common stock. Harbinger's obligations to effect the merger were subject to certain conditions, including: (1) approval of the merger by each company's shareholders; (2) acceptance by the SEC of the then to-be-filed S-4 Registration Statement, with no pending or threatened action; (3) satisfaction that each Peregrine representation and warranty contained in the Merger Agreement was true and correct as of both the date of the Merger Agreement and the date of closing of the merger; and (4) performance by Peregrine of all agreements and covenants in the Merger Agreement.

Article VII of the Merger Agreement provided for termination under certain circumstances, including: (1) by either company if the merger was not consummated by October 31, 2000; (2) by either company if the required approval of shareholders was not obtained; or (3) by Harbinger "upon a breach of any representation, warranty, covenant or agreement" by Peregrine, "or if any representation or warranty of [Peregrine] shall have become untrue." Peregrine warranted that "[n]one of the information supplied or to be supplied by [Peregrine] for inclusion or

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document is central to the plaintiff's claim; and (3) no party questions the authenticity of the" document).

incorporation by reference in . . . the S-4 will, at the time the S-4 becomes effective under the Securities Act, contain any untrue statement of a material fact or omit to state any material fact . . . ."

As a condition to the Merger Agreement, Hildes and certain of Harbinger's shareholders executed voting agreements with Peregrine in which each granted Peregrine an irrevocable proxy to vote his or her Harbinger shares in favor of the merger. Hildes' Voting Agreement and Irrevocable Proxy automatically terminated on the earlier of (1) the Merger Agreement's termination pursuant to Article VII, or (2) the effective date of the merger. His proxy was irrevocable "to the fullest extent permissible by law." Hildes was permitted to sell his Harbinger shares prior to the merger, but only if the purchaser executed a counterpart to the Voting Agreement and Irrevocable Proxy.

On May 22, 2000, Peregrine filed its Registration Statement with the SEC in connection with the merger. It included financial statements audited by Arthur Andersen LLP ("Andersen") and allegedly contained various material omissions and misrepresentations. Specifically, Hildes alleges that Peregrine overstated its revenue by over $120 million and understated its net losses by over $190 million. The former Peregrine outside directors named as defendants in the suit at bar signed the Registration Statement.

Shareholders of both companies subsequently approved the merger, and on June 16, 2000, the transaction was completed. Peregrine issued approximately thirty million shares of Peregrine common stock in exchange for all outstanding shares of Harbinger common stock. According to Hildes, as a

result of Peregrine's fraud, Peregrine's stock price was artificially inflated to a price of $25.56 per share as of the closing date of the merger.

On June 30, 2003, the SEC filed a complaint against Peregrine in the United States District Court for the Southern District of California, alleging financial fraud in which Peregrine had "filed materially incorrect financial statements with the [SEC] for 11 consecutive quarters between April 1, 1999 and December 31, 2001." Peregrine later consented to a final judgment enjoining it from further violations of the securities laws and requiring Peregrine to establish internal compliance procedures.

A consolidated class action was also brought by Peregrine shareholders for financial statement fraud. *In re Peregrine Sys., Inc. Sec. Litig*., No. 02-CV-870 (S.D. Cal. filed May 6, 2002). That class entered into settlement agreements with certain defendants, from which Hildes opted out. Hildes filed his own lawsuit in the United States District Court for the District of New Jersey, later transferred to the Southern District of California, against defendants Andersen, Thomas Watrous, Douglas Powanda, and John Doe as the Executor of the Estate of David Farley. He stated Section 11 claims against Andersen, Watrous, and Doe, along with several other claims not at issue in this appeal.

Andersen filed a motion to dismiss the claims against it. In response, Hildes moved for leave to amend his complaint to add scienter allegations as to Andersen and to add as defendants former Peregrine directors John Moores, Charles Noell, III, Richard Hosley, Norris Van Den Berg, and Christopher Cole. Hildes' proposed second amended complaint asserted Section 11 claims against all of the individual

defendants. The new proposed defendants moved to intervene to oppose Hildes' motion to amend.

On July 19, 2010, the district court granted Andersen's motion to dismiss, granted the outside directors' motion to intervene, and denied Hildes' leave to amend his complaint to add claims against the outside directors on grounds of futility. The court determined that Hildes entered into a binding commitment to exchange his shares for Peregrine's shares as a matter of law when he signed his Voting Agreement and Irrevocable Proxy on April 5, 2000, prior to the Registration Statement's effective date. It thus concluded that any alleged loss was not logically to be attributed to misrepresentations or omissions in the Registration Statement.

Hildes unsuccessfully sought certification of the district court's order under Fed. R. Civ. P. 54(b). Following disposition of Hildes' remaining claims, the district court entered final judgment. Hildes filed a timely notice of appeal, and now raises a single issue: whether the district court erred in denying him leave to amend his complaint to bring a Section 11 claim against the directors.[2]

II

We review de novo a district court's denial of leave to amend on grounds of futility. *Sanford v. MemberWorks, Inc.*, 625 F.3d 550, 557 (9th Cir. 2010). Although leave to amend is to be "freely given when justice so requires," denial of a motion to amend is

[2] The claims against Defendant Watrous were dismissed by stipulation, but Watrous has agreed to be bound by any decision of this Court with respect to the other directors. Hildes thus appeals the dismissal of his Section 11 claim against Watrous for the limited purpose of including him in this appeal.

proper if it is clear "that the complaint would not be saved by any amendment." *Carvalho v. Equifax Info. Servs., LLC*, 629 F.3d 876, 892–93 (9th Cir. 2010) (internal quotation marks omitted).

Section 11 of the Securities Act of 1933 imposes liability on "every person who signed [a] registration statement" containing "an untrue statement of a material fact or" one that "omitted to state a material fact required . . . to make the statements therein not misleading." 15 U.S.C. § 77k(a). The statute provides that "any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may . . . sue . . ." *Id*. It further provides:

> If such person acquired the security after the issuer has made generally available to its security holders an earning statement covering a period of at least twelve months beginning after the effective date of the registration statement, then the right of recovery under this subsection shall be conditioned on proof that such person acquired the security relying upon such untrue statement in the registration statement or relying upon the registration statement and not knowing of such omission, but such reliance may be established without proof of the reading of the registration statement by such person.

Id. The plain text of Section 11 thus imposes a reliance element only as to investors who purchased a security at least twelve months after the registration statement became effective.

The Supreme Court has recognized that Section 11 "places a relatively minimal burden on a plaintiff." *Herman & Maclean v. Huddleston*, 459 U.S. 375,

382 (1983). "The section was designed to assure compliance with the disclosure provisions of the Act by imposing a stringent standard of liability on the parties who play a direct role in a registered offering." *Id.* at 381–82 (footnotes omitted). As long as "a plaintiff purchased a security issued pursuant to a registration statement, he need only show a material misstatement or omission to establish his *prima facie* case." *Id.* at 382. "Liability against the issuer of a security is virtually absolute, even for innocent misstatements." *Id*. (footnote omitted).

As numerous courts have held, and the appellees in this case concede, a plaintiff who purchases a security within twelve months of the registration statement need not show reliance to bring a Section 11 claim. *See Silverstrand Invs. v. AMAG Pharms., Inc*., 707 F.3d 95, 102 (1st Cir. 2013) ("[U]nlike § 10(b) of the Securities and Exchange Act, § 11 does not have a scienter or reliance requirement . . . ."); *Hutchison v. Deutsche Bank Sec. Inc.*, 647 F.3d 479, 484 (2d Cir. 2011) ("[P]laintiffs alleging violations of Section[] 11 . . . need [not] plead scienter, reliance, or loss causation." (internal quotation marks omitted)); *In re Constar Int'l Inc. Sec. Litig*., 585 F.3d 774, 784 (3d Cir. 2009) ("Since reliance is irrelevant in a § 11 case, a § 11 case will never demand individualized proof as to an investor's reliance or knowledge (except where more than twelve months have passed since the registration statement became effective)."). This court, among several, has also noted that Section 11 lacks a scienter requirement. *See Anderson v. Clow (In re Stac Elecs. Sec. Litig*.), 89 F.3d 1399, 1404 (9th Cir. 1996) ("No scienter is required for liability under § 11; defendants will be liable for innocent or negligent material misstatements or omissions." (internal quotation marks omitted)); *see also Krim v.*

pcOrder.com, Inc., 402 F.3d 489, 495 (5th Cir. 2005) ("Section 11's liability provisions are expansive—creating virtually absolute liability for corporate issuers for even innocent material misstatements . . . ." (internal quotation marks omitted)); *Carlon v. Thaman (In re NationsMart Corp. Sec. Litig.)*, 130 F.3d 309, 315 (8th Cir. 1997) ("To establish a prima facie § 11 claim, a plaintiff need show only that he bought the security and that there was a material misstatement or omission. Scienter is not required for establishing liability under this section.").

Despite the general rule that a plaintiff need not demonstrate reliance on a misleading registration statement in order to prevail on a Section 11 claim, the district court determined that because Hildes entered into his Voting Agreement and Irrevocable Proxy prior to the issuance of Peregrine's fraudulent Registration Statement, Hildes' claim was barred under the doctrine of "negative causation." The affirmative defense of negative causation prevents recovery for losses that the defendant proves are not attributable to the alleged misrepresentation or omission in the registration statement. *See* 15 U.S.C. § 77k(e); *see also McMahan & Co. v. Wherehouse Entm't, Inc.*, 65 F.3d 1044, 1048 (2nd Cir. 1995). This court recognized the doctrine in *Miller v. Pezzani (In re Worlds of Wonder Sec. Litig.)*, 35 F.3d 1407 (9th Cir. 1994), under the name "loss causation." *Id.* at 1421. "The defendant has the burden of proof on this defense," and bears a "heavy burden." *Id.* at 1422 (internal quotation marks omitted). A defendant must show "that the depreciation in value" of a plaintiff's stock "resulted from factors other than the alleged material misstatement." *Id.* (alteration and internal quotation marks omitted).

According to the district court, Hildes' losses could not have been caused by the misleading Registration Statement because Hildes made a binding commitment to exchange his Harbinger shares for Peregrine stock when he signed his Voting Agreement and Irrevocable Proxy on April 5, 2000, prior to the date misrepresentations were made in the Registration Statement. We disagree. Although the Voting Agreement and Irrevocable Proxy irrevocably committed Hildes to have his shares voted in favor of the merger, it did not irrevocably commit him to exchange his Harbinger shares for Peregrine shares. Any exchange of shares remained contingent on the consummation of the merger. As Hildes plausibly alleges in his proposed second amended complaint, the merger would not have occurred had the Registration Statement been truthful.

Hildes provides several theories under which the planned merger would have collapsed but for the misrepresentations in the Registration Statement. First, the proposed second amended complaint alleges that the Harbinger board would have declared Peregrine to be in breach of the Merger Agreement for providing materially false and misleading information in the Registration Statement, and terminated the Merger Agreement under Article VII. Had the Merger Agreement been terminated, Hildes' Voting Agreement and Irrevocable Proxy would have expired. Second, the proposed complaint alleges that a majority of Harbinger shares would have voted against the merger had the Registration Statement been truthful. Under this scenario, Hildes' Harbinger shares would not have been exchanged for Peregrine stock. Given the allegation that more than 85% of Harbinger shares were not bound by proxy agreements, coupled with the magnitude of the alleged financial misstatements,

these allegations provide a second plausible theory under which the Registration Statement's misrepresentations caused Hildes' loss.

Hildes also identifies several means by which he could have personally avoided the exchange of shares had the Registration Statement disclosed ongoing accounting irregularities by Peregrine. He could have attempted to sell his Harbinger shares to a third party (provided the third party executed a counterpart to the Voting Agreement and Irrevocable Proxy), sought to rescind the Voting Agreement and Irrevocable Proxy based on a claim of fraudulent inducement, or filed a shareholder suit seeking to enjoin the merger.

We conclude that the outside directors have not met their "heavy burden" of "prov[ing], as a matter of law, that the depreciation of the value of [the security] resulted from factors other than the alleged false and misleading statements." *Provenz v. Miller*, 102 F.3d 1478, 1492 (9th Cir. 1996) (internal quotation marks omitted). Overcoming a negative causation defense requires merely that "the misrepresentation *touches upon* the *reasons* for an investment's decline in value." *In re Worlds of Wonder*, 35 F.3d at 1422 (internal quotation marks omitted).Misrepresentations contained in Peregrine's Registration Statement certainly "touch[ed] upon" the decline in value of Hildes' investments because, he alleges, the merger would have failed but for those misrepresentations. Had the merger not been completed, Hildes would have retained Harbinger stock rather than obtaining shares in Peregrine.

Contrary to the directors' assertions, this is not a case in which "the decision is made and the parties are committed to the transaction" prior to the effective date of a registration statement. *APA Excelsior III L.P.*

v. Premiere Techs., Inc., 476 F.3d 1261, 1267 (11th Cir. 2007). In *APA Excelsior*, the Eleventh Circuit concluded that a Section 11 claim necessarily fails if a sophisticated investor "participating in an arms-length corporate merger make[s] a legally binding investment commitment months before the filing of a defective registration statement." *Id*. at 1277. The outside directors place great emphasis on this case, noting the striking resemblance of facts. There, a target corporation's shareholders brought a Section 11 claim against an acquiring corporation and certain directors and officers, alleging misrepresentations in a registration statement. *Id.* at 1264–65. Prior to the effective date of the registration statement at issue, the target corporation had entered into a stock-for-stock merger agreement, the board had voted to recommend the merger to the shareholders, and plaintiffs had granted irrevocable proxies binding themselves to have their shares voted in favor of the merger. *Id*. at 1264.

The Eleventh Circuit held that plaintiffs' Section 11 claim failed as a matter of law because "reliance [wa]s rendered impossible by virtue of a pre-registration commitment." *Id.* at 1272 (footnote omitted). "[B]y virtue of their binding commitment decision," the court determined, plaintiffs "effectively 'purchased' their [acquiring company's] stock months before the registration statement was filed." *Id.* at 1276. Significantly, because it deemed the issue waived, the court in *APA Excelsior* declined to consider plaintiffs' argument that they "were not fully committed to the merger before the registration statement because their commitment was revocable." *Id*. at 1269–70.

In the present case, as noted above, we have concluded that Hildes was not irrevocably bound to

exchange his Harbinger shares for Peregrine stock at the time the Registration Statement was filed. Rather, misrepresentations contained in the Registration Statement played a role in the causal chain that resulted in the exchange of stock. We are thus not presented with the issue decided in *APA Excelsior*. Although that court did not consider whether plaintiffs were committed to exchange stock based on a set of agreements similar to those at issue in this case, it did note that a plaintiff seeking to recover under Section 11 "need only show a material misstatement and/or omission in the registration statement and be able to 'trace' the security he acquired to that defective statement." *Id*. at 1271 (citations omitted). Hildes' allegations satisfy this traceability requirement.

Other cases relied upon by the outside directors are also inapposite. In *In re HealthSouth Corp. Securities Litigation*, 261 F.R.D. 616 (N.D. Ala. 2009), the court held that plaintiffs who purchased unregistered bonds with the intent of converting them to registered bonds after the filing of a registration statement could not assert a Section 11 claim. *Id*. at 647. It explained that the decision to purchase the unregistered bonds was made prior to filing of the registration statement and thus causation was impossible. *Id*. The court rejected plaintiffs' theory that the SEC would not have permitted the registration statement to become effective had it been truthful—and thus the unregistered bonds would not have been exchanged for registered bonds—because in that hypothetical scenario plaintiffs "would have been stuck with" the less valuable unregistered bonds and thus the loss "would have occurred" anyway. *Id*. at 648. Accordingly, the court concluded that plaintiffs' losses were "not traceable to a registration statement and no

basis arises for a Section 11 claim." *Id.; see also In re Refco, Inc. Sec. Litig.*, 503 F. Supp. 2d 611, 634, 636 (S.D.N.Y. 2007) (concluding alleged misrepresentations were immaterial given that unregistered bondholders would have incentive to exchange their bonds for registered ones regardless of contents of registration statement, and thus plaintiffs were not "caused to suffer damages"). As the foregoing discussion demonstrates, however, Hildes' losses can be causally traced to the misrepresentations contained in the Registration Statement.

This case is more analogous to *SEC v. National Student Marketing Corp*., 457 F. Supp. 682 (D.D.C. 1978). That case also involved a stock-for-stock merger of two companies. *Id*. at 688-89. After the merger agreement was executed, but before the transaction closed, the acquiring company made certain adjustments to its interim financials. Id. at 691. The SEC charged various individuals with Securities Act violations for failing to disclose this material information. *Id*. at 699-700. Defendants contended that there was no nexus between their conduct and the "sale" of stock because the principals of the target corporation had already committed themselves to the merger. *Id*. at 702. However, the court concluded that the plaintiffs "had no expectation or duty to proceed with the sales if the merger was aborted" and that "[s]uch a conditional commitment is not what the courts had in mind when setting the time of commitment as the critical point for antifraud analysis." *Id*. at 704 (footnote omitted). Because the "Merger Agreement specifically stated that the obligation of either company to proceed with the merger was subject to the performance of certain conditions," the court held that it did not create "a binding, irrevocable commitment." *Id.*

As with the purchasers in *National Student Marketing Corp.*, Hildes was not obliged to obtain Peregrine stock at the time the Registration Statement was filed. His commitment to the exchange of shares was contingent on a number of conditions, and he plausibly alleges that the misrepresentations contained in the Registration Statement caused those conditions to occur. Under these circumstances, we do not observe any flaw in Hildes' claim that his losses were caused by misrepresentations in Peregrine's Registration Statement.

In concluding that Hildes entered into a binding commitment to purchase Peregrine stock prior to the Registration Statement's effective date, the district court conflated the issue of loss causation and the question of whether the Registration Statement's misrepresentations caused Hildes to enter into the Voting Agreement and Irrevocable Proxy in the first place. *See Akerman v. Oryx Commc'ns, Inc.*, 609 F. Supp. 363, 369 (S.D.N.Y. 1984) (negative causation defense to Section 11 claim "does not focus on the causal relationship between the misstatement and the original purchase, but rather on the relationship between the misstatement and any subsequent decline in value"), *aff'd in part and dismissed in part on other grounds*, 810 F.2d 336 (2d Cir. 1987). Hildes' proposed second amended complaint alleges that he purchased Peregrine stock—through the post-Registration Statement exchange of shares—issued and sold pursuant to a misleading registration statement,[3] and that his subsequent losses were

[3] SEC Rule 145 provides:

> An offer, offer to sell, offer for sale, or sale shall be deemed to be involved, within the meaning of section 2(3) of the [Securities] Act, so far as the security holders of a

caused by the misrepresentations in that registration statement. This is enough to state a Section 11 claim. *See Rubke v. Capitol Bancorp Ltd.*, 551 F.3d 1156, 1161 (9th Cir. 2009) (noting heightened pleading standards of the Private Securities Litigation Reform Act of 1995 do not apply to Section 11 claims and that Fed. R. Civ. P. 9(b) applies only if the complaint sounds in fraud); *see also Silverstrand Invs.*, 707 F.3d at 102 (because Section 11 does not have a reliance requirement, "neither the heightened pleading standard of Fed. R. Civ. P. 9(b) nor of the Private Securities Litigation Reform Act applies unless a § 11 claim sounds in fraud"); *Provenz*, 102 F.3d at 1492 (although defendants bear a heavy burden of proof in establishing negative causation, a plaintiff can establish loss causation by "simply alleging that the false and misleading statements touch upon the reasons for the investment's decline in value" (alteration and internal quotation marks omitted)).

Because the misrepresentations contained in the Registration Statement allegedly caused the ultimate exchange of Hildes' Harbinger shares for Peregrine stock, we disagree with the district court's conclusion that the negative causation defense applies. And because the exchange of shares—which occurred after

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> corporation or other person are concerned where . . . there is submitted for the vote or consent of such security holders a plan or agreement for . . . [a] statutory merger or consolidation or similar plan or acquisition in which securities of such corporation or other person held by such security holders will become or be exchanged for securities of any person . . . .

17 C.F.R. § 230.145(a)(2). Under this definition, Hildes' exchange of stock did not become a "sale" under the Securities Act until the merger plan was submitted to Harbinger shareholders for a vote, after the issuance of Peregrine's Registration Statement.

the Registration Statement was filed—constituted Hildes' acquisition of those securities pursuant to a registration statement, he has stated a potentially meritorious Section 11 claim.

III

For the foregoing reasons, the judgment of the district court is REVERSED. The case is REMANDED for further proceedings consistent with this opinion.

APPENDIX B

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

[Filed July, 19, 2010]

Case No. 08-cv-0008-BEN (RBB)

DAVID HILDES, individually and as Trustee for the David and Kathleen Hildes 1999 Charitable Remainder Unitrust dated June 25, 1999,

Plaintiff,

vs.

ARTHUR ANDERSEN; Thomas Watrous, Sr., Douglas S. Powanda; and John Doe as Executor of the Estate of David A. Farley,

Defendants.

ORDER:

(1) Granting Defendant Arthur Andersen's Motion to Dismiss Counts II, III, and V;

(2) Granting Motion of Outside Directors for Leave to Intervene for Limited Purpose; and

(3) Granting in Part and Denying in Part Plaintiff's Motion for Leave to Amend Complaint

[Docket Nos. 2, 12, 16]

Currently before this Court is Defendant Arthur Anderson's Motion to Dismiss Counts II, III, and V of Plaintiff's First Amended Complaint ("Motion to Dismiss")[Docket No. 2] and Plaintiff's Motion for Leave to Amend Complaint ("Motion to Amend") [Docket No. 16]. For the reasons set forth below, the Motion to Dismiss and Motion to Intervene are GRANTED, and the Motion to Amend is GRANTED IN PART AND DENIED IN PART.

BACKGROUND

This action relates to a securities class action lawsuit against Peregrine Systems, Inc. ("Peregrine") that is also pending before this Court. The Peregrine class action involves individuals who bought or acquired stock in Peregrine between July 22, 1999 and May 3, 2002. Plaintiff is one of these individuals. Plaintiff held stock in Harbinger Corporation ("Harbinger") but then acquired Peregrine stock when Harbinger merged with Peregrine. (First Am. Compl., TT 1, 18.) The merger was completed on or around June 16, 2000. *Id.* Plaintiff does not allege he acquired Peregrine stock at any other time.

On June 5, 2006, the class action plaintiffs entered into a settlement in the Peregrine class action, which the Court later approved. Plaintiff opted out of the settlement and brought this separate action against Andersen and three individual defendants for various securities violations. The operative complaint is the First Amended Complaint filed on July 24, 2007. The First Amended Complaint asserts five causes of action: (I) Violation of Section 11 of the Securities Act (against Defendants Watrous and Farley); (II) Violation of Section 11 of the Securities Act (against Defendant Andersen); (III) Violation of Section 10(b) of the Exchange Act and Rule 10b-5 (against all

Defendants); (IV) Violation of Section 14(a) of the Exchange Act and Rule 14a-9 (against Defendants Watrous and Farley); and (V) Violation of Section 14(a) of the Exchange Act and Rule 14a-9 (against Defendant Andersen).

On January 25, 2008, Defendant Andersen filed its Motion to Dismiss Counts II, III and V of Plaintiff's First Amended Complaint. These counts are the only counts asserted against Andersen. [Docket No. 2.] Plaintiff filed an opposition, and Andersen filed a reply. [Docket Nos. 11, 18.]

On December 7, 2009, in opposing the Motion to Dismiss, Plaintiff also filed a Motion for Leave to File Second Amended Complaint. [Docket No. 12.] Andersen filed an opposition, and Plaintiff filed a reply. [Docket Nos. 23, 27.] Peregrine's former directors filed a motion to intervene for the limited purpose of opposing the Motion to Amend, to which Plaintiff filed a Statement of Non-Opposition. [Docket Nos. 16, 17.]

This action was stayed for several months pending resolution of an appeal in the Peregrine lawsuit. The stay having now been lifted, and the motions having now been fully briefed, the Court finds the motions ready for disposition on the papers, without oral argument. CivLR 7.1.d. 1 .

For the reasons set forth below, the Court GRANTS Defendant Andersen's motion to dismiss and GRANTS the former directors' Motion to Intervene. The Court also GRANTS IN PART AND DENIES IN PART Plaintiffs motion for leave to amend the complaint. Specifically, the Court grants Plaintiff leave to amend only to correct the deficiencies outlined below with respect to Count III; Plaintiff is denied leave to amend

Counts II or V, or to add Peregrine's former directors as defendants in this action.

MOTION TO DISMISS COUNTS II, III AND V

Defendant Andersen moves to dismiss Counts II, III and V of Plaintiffs First Amended Complaint pursuant to Federal Rule of Civil Procedure 12(b)(6). These counts are the only counts asserted against Andersen in this case.[1]

Under Federal Rule of Civil Procedure 12(b)(6), dismissal is appropriate if, taking all factual allegations as true, the complaint fails to state a plausible claim for relief on its face. Fed. R. Civ. P. 12(b)(6); *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 556-57 (2007). Under this standard, dismissal is appropriate if the complaint fails to state enough facts to raise a reasonable expectation that discovery will reveal evidence of the matter complained of, or if the complaint lacks a legally cognizable theory under which relief may be granted. *Id.* at 556.

Andersen argues Counts II and V must be dismissed because Plaintiff acquired Peregrine stock before the date of the alleged false statements and, thus, Plaintiff cannot allege he relied upon those misrepresentations. With respect to Count III, Andersen argues Plaintiff has not sufficiently pled scienter. As detailed below, the Court finds dismissal appropriate under Rule 12(b)(6).

I. COUNT II (Section 11 Claim)

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[1] Count III is also asserted against the individual defendants; however, those defendants are not parties to the Motion to Dismiss.

Count II is based on alleged violations of Section 11 of the Exchange Act.

To state a claim under Section 11, a plaintiff "must demonstrate (1) that the registration statement contained an omission or misrepresentation, and (2) that the omission or misrepresentation was material, that is, it would have misled a reasonable investor about the nature of his or her investment." *In re Stac. Elecs. Sec. Litig*., 89 F.3d 1399, 1403-04 (9th Cir. 1996) (quotations and citation omitted), *cert. denied sub. nom. Andersen v. Clow*, 520 U.S. 1103 (1997). Defendants are liable for innocent or negligent material misstatements or omissions, subject to a few affirmative defenses. Andersen argues dismissal is proper because Plaintiff made a binding commitment to acquire his Peregrine stock before the date of the alleged misstatements and omissions and, therefore, cannot prove reliance.

It is well-established that reliance is generally presumed and, therefore, need not be pled. *See, e.g., Hertzberg v. Dignity Partners, Inc*., 191 F.3d 1076 (9th Cir. 1999); *In re Gap Stores Sec. Litig*., 79 F.R.D. 283, 297 (N.D. Cal. 1978). However, where it appears from the face of the complaint that a plaintiff cannot have actually relied on the registration statement, there is some authority for the position that reliance must be proved. *See, e.g., APA Excelsior III L.P. v. Premiere Techs., Inc*., 476 F.3d 1261, 1271 (11th Cir. 2007). As one circuit has stated, "it would be illogical to cloak Plaintiffs with a presumption of reliance [if] Plaintiffs made their investment decision and were legally committed to the transaction (and thus could not possibly have relied on the registration statement) months before the registration statement was in existence." *APA Excelsior*, 476 F.3d at 1273.

Furthermore, "as a matter of common sense reasoning, the presumption should only apply to those who purchase securities at the time of or after the registration statement." *Id.* at 1274.

The Ninth Circuit has not addressed this issue, although courts sitting in the Ninth Circuit have recognized the *APA Excelsior* decision in the context of reliance under Section 11. *In re Countrywide Financial Corp. Sec. Litig.*, 588 F. Supp. 2d 1132, 1162 n. 34 (C.D. Cal. 2008); *In re Levi Strauss & Co. Sec. Litig.*, 527 F. Supp. 2d 965, 974-78 (N.D. Cal. 2007). These courts have also recognized the relatedness of reliance to standing, materiality and causation. *See, e.g., Levi*, 527 F. Supp. 2d at 976. Other courts sitting in the Ninth Circuit have analyzed this issue not in the context of reliance, but rather in the context of causation, more specifically under the "negative causation" defense. *See, e.g., In re McKesson HBOC, Inc.*, 126 F. Supp. 2d 1248, 1260-62 (N.D. Cal. 2000) (granting motion to dismiss certain Section 11 claims on the grounds that certain plaintiffs exchanged their stock before issuance of the false registration statements and, therefore, defendants had an absolute "negative causation" defense); *Guenther v. Cooper Life Sciences, Inc.*, 759 F. Supp. 1437, 1441 (N.D. Cal. 1990) (dismissing Section 11 claims of plaintiffs who could not trace their stock purchase to the allegedly defective registration amendment because they purchased their stock prior to its issuance). The Ninth Circuit has likewise recognized a general "negative causation" defense, also known as "loss causation" defense, to Section 11 claims. *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1422 (9th Cir. 1994); see also 15 U.S.C. § 77k(e) ("if the defendant proves that any portion or all of such damages represents other than the depreciation in value. . . resulting from such part

of the registration statement, with respect to which his liability is asserted. . . such portion or all such damages shall not be recoverable."). In light of the Ninth Circuit's silence on reliance under Section 11 but recognition of the "negative causation" defense, the Court analyzes this issue under the "negative causation" defense.

The "negative causation" defense is set forth in 15 U.S.C. §77k(e) and provides that a defendant may limit its liability to the extent that plaintiff's alleged loss was not attributable to the alleged misrepresentations or omissions. Under the circumstances of this case, the "negative causation" defense turns on whether Plaintiff made a binding commitment on April 5, 2000 to exchange his Harbinger stock for Peregrine stock.

According to Plaintiff, the alleged misrepresentations and omissions for purposes of Section 11 occurred on April 25, 2000. (First Am. Compl., ¶¶ 26, 126, 131, 159.) Therefore, if Plaintiff made a binding commitment on April 5, 2000 to acquire Peregrine stock, i.e., before the alleged misrepresentations and omissions were made, the "negative causation" defense bars Plaintiff's Section 11 claim as a matter of law. Because this issue is a matter of contract interpretation where all facts necessary for the determination appear on the face of the complaint or from judicially noticeable documents, this issue is a question of law that the Court may decide under a Rule 12(b)(6) motion. *Operating Engineers Pension Trust v. Charles Minor Equipment Rental, Inc.*, 766 F.2d 1301, 1303 (9th Cir. 1985); *Countrywide*, 588 F. Supp. 2d at 1171 (recognizing that a negative causation defense is fact-intensive but may be decided on a Rule 12(b)(6) motion to dismiss where the face of

the complaint and/or judicially noticeable facts demonstrate the defense applies).

According to Plaintiff, on April 5, 2000, Peregrine and Harbinger entered into the merger agreement, subject to the approval of both companies' shareholders. (First Am. Compl., 67; see also Vick Decl.[2] [Docket No. 2-2], Exs. A, B.) At the same time, Peregrine and certain insider Harbinger shareholders, including Plaintiff, entered into a voting agreement under which each such shareholder, including Plaintiff, granted Peregrine an irrevocable proxy to vote in favor of the merger with Peregrine. *Id.* The agreement stated the proxy to vote Plaintiff's shares was "irrevocable to the fullest extent permissible by law. . ." (Vick Decl., Ex. B.) Pursuant to these agreements, Plaintiff agreed to exchange his Harbinger stock for Peregrine stock. (First Am. Compl., IN 18, 67; Vick Decl., Exs. A, B..) In neither the Complaint nor his opposition to the Motion does Plaintiff allege he acquired any Peregrine stock outside of the merger.

The date of the "sale" of the securities occurs when the parties become obligated to perform. *See Radiation Dynamics, Inc. v. Goldmuntz*, 464 F.2d 876, 891 (2nd Cir. 1972); *Amoroso v. Southwestern Drilling Multi-Rig Partnership No. 1*, 646 F. Supp. 141, 143 (N.D. Cal. 1986). For purposes here, the obligation to perform is defined as "the point at which. . . there was a meeting of the minds of the parties; it marks the point at which

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[2] The Court may consider these documents because they were an integral part of the transaction referred to in the Complaint and upon which Plaintiff's claims are based, and Plaintiff does not dispute their authenticity. *Branch v. Tunnell*, 14 F.3d 449, 454 (9th Cir. 1994), overruled on other grounds in *Galbraith v. County of Santa Clara*, 307 F.3d 1119, 1127 (9th Cir. 2002).

the parties obligated themselves to perform what they had agreed to perform even if the formal performance of their agreement is to be after a lapse of time." *See Radiation Dynamics*, 464 F.2d at 891; *Amoroso*, 646 F. Supp, at 143.

Plaintiff concedes he signed the proxy titled "Irrevocable Proxy" and concedes the "Irrevocable Proxy" lacks language giving him a personal right to stop the merger. Nonetheless, Plaintiff argues the proxy was revocable because third parties had the right to stop the merger and, in any event, Plaintiff relied upon false financial statements when agreeing to the voting agreement and proxy. (Opp. [Docket No. 11], pg. 9 and n. 7.) Regardless of whatever actions could have been taken by third parties, both parties clearly manifested their intent to exchange stock when they entered into the voting agreement and Irrevocable Proxy. No other action by the parties was required. That Plaintiff may have relied upon false financial statements in making this decision, even if true, is irrelevant, as such argument focuses on the merger rather than the registration statement that is the basis of a Section 11 claim. 15 U.S.C. § 77k(a). Accordingly, the Court finds that the date of sale/purchase of the Peregrine stock at issue here is the date the parties entered into the binding commitment to exchange stock as part of the merger, *i.e*., April 5, 2000. Because this date precedes the date of the alleged false statements (April 25, 2000), the Court concludes that the negative causation defense bars Plaintiff's Section 11 claim.

Count II is DISMISSED. As set forth below, because no amendments can correct this deficiency, Count II is dismissed WITH PREJUDICE.

II. COUNT V (Section 14(a) and Rule 14a-9 Claim)

Count V is based on alleged violations of Section 14(a) of the Exchange Act, 15 U.S.C. § 78n(a) and Rule 14a-9. Section 14(a) prohibits false or misleading statements in proxy solicitations. Causation is a necessary element. *Virgina Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1102 (1991); *Desaigoudar v. Meyercord*, 223 F.3d 1020, 122 (9th Cir. 2000).

The parties assert the same arguments under Count V as they do above under Count II. As detailed above, the Court finds that Plaintiff entered into an irrevocable, binding commitment to acquire Peregrine stock on April 5, 2000 in connection with the merger. As this date precedes the date of the alleged false statements, i.e, April 25, 2000, the Court concludes that, based on the face of the complaint and judicially noticeable facts, Plaintiff cannot establish causation. Thus, Plaintiff's Section 14(a) claim fails to state a claim upon which relief may be granted.

Count V is DISMISSED. As set forth below, because no amendments can correct this deficiency, Count V is dismissed WITH PREJUDICE.

III. COUNT III (Section 10(b) and Rule 10b-5 Claim)

Count III is based on alleged violations of Section 10(b) and Rule 10b-5. Section 10(b) prohibits, "any person . . . to use or employ . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe . . ." 15 U.S.C. § 78j(b). Rule 10b-5, in turn, provides: (1) "it is unlawful . . . [t]o employ any device, scheme, or artifice to defraud;" (2) "it is unlawful. . . [t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances

under which they were made, not misleading;" and (3) "it is unlawful. . . [t]o engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person . . ." 17 C.F.R. § 240.10b-5(a), (b), (c). Unlike Section 11, Section 10(b) covers statements made not only in the registration statement or prospectus but also other documents and in oral communications. *Stac Elec*., 89 F.3d at 1404.

This Court has previously recognized that "No survive dismissal, the Complaint must allege, with respect to each Defendant: (1) a primary act; (2) falsity; (3) scienter; (4) reliance; and (5) causation." (In re Peregrine Sys. Inc., 02-cv-0870, Docket No. 614, at pg. 52.) Andersen argues Count III should be dismissed on the grounds that scienter is insufficiently pled. Plaintiff does not dispute Andersen's argument, but rather seeks leave to amend the complaint to include additional allegations to support this claim. Accordingly, Count III is DISMISSED. As set forth below, Count III is dismissed WITHOUT PREJUDICE.

MOTION FOR LEAVE TO INTERVENE

Before addressing Plaintiffs Motion to Amend, the Court considers the motion of certain former outside directors of Peregrine who seek leave to intervene for the purpose of opposing Plaintiffs motion. [Docket No. 16.]

John J. Moores, Charles E. Noell, III, Richard Hosley, Norris van den Berg and Christopher A. Cole, former outside directors of Peregrine (the "Outside Directors") seek leave to intervene under either Federal Rule of Civil Procedure 24(a) or 24(b). The Outside Directors seek to intervene for the limited purpose of opposing Plaintiffs Motion to Amend which

seeks to add these individuals as defendants. Plaintiff filed a Statement of Non-Opposition pursuant to Civil Local Rule 7.1.f.3.a.

To intervene as a matter of right under Rule 24(a)(2): "(1) the motion must be timely; (2) the applicant must claim a 'significantly protectable' interest relating to the property or transaction which is the subject of the action; (3) the applicant must be so situated that the disposition of the action may, as a practical matter, impair or impede [the applicant's] ability to protect that interest; and (4) the applicant's interest must be inadequately represented by the parties to the action." *California ex rel. Lockyear v. United States*, 450 F.3d 436, 440 (9th Cir. 2006); *see also* Fed. R. Civ. P. 24(a)(2).

Applying Rule 24(a)(2) here, the Court finds the Motion to Intervene was timely because it was filed within the time allowed for the named defendants to oppose Plaintiffs Motion to Amend and was filed at the first relevant opportunity. The Outside Directors also have a significant protectable interest in that they seek to oppose a motion that requests leave to add them as defendants in this case. If the Motion to Amend is granted, the Outside Directors will incur legal expenses to litigate the action, which they would not have otherwise incurred absent an order granting that motion. Moreover, the Outside Directors' interest is not adequately represented by the other parties in the action because the other parties do not have the same incentive to oppose the Motion to Amend. Therefore, the Court finds that leave to intervene is appropriate under Rule 24(a)(2). The Court does not address intervention under Rule 24(b), as that issue is now moot in light of the above finding.

The Outside Directors' Motion to Intervene [Docket No. 16] is GRANTED. The Outside Directors' opposition, supporting request for judicial notice and declaration, attached as Exhibits A, B and C to the Motion to Intervene, respectively, are deemed filed as of February 8, 2010.

MOTION FOR LEAVE TO AMEND

The Court now turns to Plaintiff's Motion to Amend. (Docket No. 12.) Plaintiff seeks leave to: (1) more specifically allege that his commitment to acquire Peregrine stock was revocable; (2) to add new allegations of scienter against Andersen; and (3) to add the Outside Directors as defendants to Counts I, III and IV. (*Id*.) Specifically, Plaintiff seeks to add the Outside Directors as defendants to his claims for: (1) violation of Section 11 of the Securities Act (Count I); (2) violation of Section 10(b) and Rule 10b-5 of the Securities Exchange Act (Count III); and (3) violation of Section 14(a) and Rule 14a-9 of the Securities Exchange Act (Count IV). (Lynn Decl. [Docket No. 12-1], Ex. 5.)

Federal Rule of Civil Procedure 15 governs amendments of pleadings and provides, in relevant part, "[t]he Court should freely give leave when justice so requires." Fed. R. Civ. P. 15(a)(2). Factors relevant to this determination include undue delay, repeated failure to cure deficiencies by amendments previously allowed, prejudice to the opposing party, futility of amendment, and bad faith. *Foman v. Davis*, 371 U.S. 178, 182 (1962); *see also Ditto v. McCurdy*, 510 F.3d 1070, 1079 (9th Cir. 2007).

First, the Court notes that, although Plaintiff initiated the case in January 2007 (Docket No. 1), the case was stayed for several months pending a Multi-

District Litigation transfer to this Court, as well as resolution of certain issues in the related Peregrine class action. (See Docket Nos. 3, 5.) The stay was not lifted until December 1, 2009 (Docket No. 8), and Plaintiff filed his request for leave to amend on December 7, 2009. Under these circumstances, the Court finds Plaintiff did not unduly delay seeking leave to amend his claims. Additionally, no previous amendments have been sought or granted by this Court. Accordingly, Plaintiff did not fail to cure his deficiencies from amendments previously allowed. There is also no evidence that Plaintiff's request is made in bad faith or that Andersen would be unduly prejudiced from amendment. The remaining issue, therefore, is whether amendment would be futile. "Futility of amendment can, by itself, justify the denial of a motion for leave to amend." *Bonin v. Calderon*, 59 F.3d 815, 845 (9th Cir. 1995), *cert. denied*, 516 U.S. 1051 (1996).

I. SECTION 11 CLAIMS (COUNT II AGAINST ANDERSEN AND PROPOSED COUNT I AGAINST THE OUTSIDE DIRECTORS)

As noted, the binding nature of Plaintiffs commitment to acquire Peregrine stock was integral to the Court's dismissal of Plaintiff's Section 11 claim. Plaintiff seeks leave to add allegations that his commitment to acquire Peregrine stock was non-binding and, thus, his Section 11 claims (i.e., Count II asserted against Andersen and Count I proposed against the Outside Directors) are not barred.

Specifically, Plaintiff seeks to add allegations that his voting agreement was revocable if the merger agreement was terminated. (Reply [Docket No. 28], pg. 5.) Plaintiff also seeks to add allegations that, in entering into the agreements, Plaintiff relied upon

false representations. *Id.* However, as detailed above, the Court finds that, regardless of whatever actions could have been taken by third parties, both parties clearly manifested their intent to exchange stock when they entered into the voting agreement and Irrevocable Proxy. No other action by the parties was required. That Plaintiff may have relied upon false financial statements in making this decision, even if true, is irrelevant, as this argument focuses on the merger rather than the registration statement that is the basis of a Section 11 claim. 15 U.S.C. § 77k(a).

Because Plaintiffs proposed amendment does not cure the deficiencies of his Section 11 claims, the Court finds that amendment would be futile and, thus, denies Plaintiff leave to amend. Accordingly, Count II is dismissed with prejudice. Likewise, the Court denies Plaintiff leave to add the Outside Directors as defendants to Count I.

II. SECTION 14(a) AND RULE 14a-9 CLAIMS (COUNT V AGAINST ANDERSEN AND PROPOSED COUNT IV AGAINST THE OUTSIDE DIRECTORS)

The binding nature of Plaintiff's commitment was also integral to the Court's dismissal of Plaintiff's Section 14(a) claims. This finding affects Count V asserted against Andersen and Count IV proposed against the Outside Directors. Plaintiff seeks to correct this deficiency by adding allegations that his commitment was nonbinding. Plaintiff proposes the same amendments for this claim as he does for his Section 11 claim listed above. For the same reasons those amendments fail to cure the deficiencies under Section 11, they fail here as well. Accordingly, the Court finds that amendment would be futile and, thus, denies Plaintiff leave to amend his Section 14(a) and

Rule 14a-9 claims. Count V is, therefore, dismissed with prejudice. Likewise, Plaintiff is denied leave to add the Outside Directors as defendants to Count IV. The Court does not address the Outside Directors' argument that Plaintiff's claim is also barred for failure to sufficiently plead negligence, as that issue is now moot.

III. SECTION 10(b) AND RULE 10b-5 CLAIM (COUNT III)

Plaintiff seeks to add new allegations of scienter for purposes of his Section 10(b) and Rule 10b-5 claim under Count III (asserted against all defendants). Andersen and the Outside Directors oppose amendment on the grounds that this Court previously found such allegations insufficient to state a claim for relief under Rule 12(b)(6).

The Court first notes that Plaintiff is not legally bound by the Court's prior decision in the Peregrine lawsuit because Plaintiff was an unnamed plaintiff in that action. *See Aguilera v. Pirelli Armstrong Tire Corp*., 223 F.3d 1010, 1013 n. 1 (9th Cir. 2000) ("[w]hen a motion is maintained against an uncertified class, only the named plaintiffs are affected by the ruling. There is no res judicata effect as to unnamed members of the purported class."); *see also Becherer v. Merrill Lynch, Pierce, Fenner, and Smith, Inc*., 193 F.3d 415, 426 (6th Cir. 1999). Andersen and the Outside Directors have cited no authority to the contrary.

As noted, scienter is a required element of a claim under Section 10(b) and Rule 10b-5. *Paracor Finance, Inc. v. General Elec. Capital Corp*., 96 F.3d 1151, 1157 (9th Cir. 1996). Scienter is defined as "a mental state embracing intent to deceive, manipulate, or defraud," which includes "recklessness." *Proven v. Miller*, 102

F.3d 1478, 1490 (9th Cir. 1996) ("To establish scienter, plaintiffs must show that defendants had a mental state embracing an intent to deceive, manipulate, or defraud. Plaintiffs can establish scienter by proving either actual knowledge or recklessness."). For purposes here, allegations of scienter must be considered collectively and must be considered in light of any opposing inferences. *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, U.S. , 127 S.Ct. 2499, 2509-10 (2007); *Broudo v. Dura Pharm., Inc.*, 339 F.3d 933, 940 (9th Cir. 2003).

A. Defendant Arthur Andersen

As to Andersen, the alleged auditor of Peregrine, "the mere publication of inaccurate accounting figures, or a failure to follow GAAP, without more, does not establish scienter. Rather, scienter requires more than a misapplication of accounting principles. The plaintiff must prove that the accounting practices were so deficient that the audit amounted to no audit at all, or an egregious refusal to see the obvious, or to investigate the doubtful, or that the accounting judgments which were made were such that no reasonable accountant would have made the same decisions if confronted with the same facts." *DSAM Global Value Fund v. Altris Software, Inc.*, 288 F.3d 385, 390 (9th Cir. 2002); *see also In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1426 (9th Cir. 1994).

To support his Section 10(b) claim, Plaintiff seeks to add allegations involving (1) Andersen's former audit manager Daniel Stulac and his alleged knowledge of Peregrine's revenue recognition fraud from April 1999 to May 2002; and (2) Peregrine's alleged GAAP violations, including the use of write-offs to overstate revenue. (Reply [Docket No. 27], pgs. 5-7.) Plaintiff contends that the length of time Andersen knew of this

fraud provides a strong inference of scienter that survives Rule 12(b)(6) dismissal.

This Court has previously found that the length of time a defendant knows of potential issues, compounded by other factors such as the gravity of the issues and the frequency of meetings at which the issues were discussed, sufficiently supported an inference of scienter that survived Rule 12(b)(6) dismissal. *In re Dura Pharm., Inc. Sec. Litig*., 548 F. Supp. 2d 1126, 1140-41 (S.D. Cal. 2008). Applied here, the Court finds that Plaintiff's proposed amendments, including the degree of alleged specific knowledge by Andersen of the alleged false statements and alleged length of time of such knowledge, supports an inference of scienter for purposes of Section 10(b). Accordingly, the Court finds that leave to amend Plaintiff's Section 10(b) claim would not be futile. As such, Plaintiff is granted leave to amend Count III to more specifically allege scienter.

B. (Proposed) Defendants Outside Directors

Plaintiff also seeks leave to add the Outside Directors as defendants under his Section 10(b) claim (Count III).

To state a claim against individual board or committee members, a complaint must "allege specific contemporaneous conditions known to the [D]efendants that would strongly suggest that the [D]efendants understood that their recognition of revenues . . . would result in overstated revenues." *In re Vantive Corp. Sec. Litig*., 283 F.3d 1079, 1091 (9th Cir. 2002); *see also Ronconi v. Larkin*, 253 F.3d 423, 432 (9th Cir. 2001). "General allegations of defendants' hands-on' management style, their interaction with other officers and employees, their

attendance at meetings, and their receipt of unspecified weekly or monthly reports are [also] insufficient." *In re Daou Systems, Inc. Sec. Litig*., 397 F.3d 704, 718 (9th Cir. 2005). Additionally, "allegations that the defendant possessed knowledge of facts that are later determined by a court to have been material, without more, is not sufficient to demonstrate that the defendant intentionally withheld those facts from, or recklessly disregarded the importance of those facts to, a company's shareholders in order to deceive, manipulate, or defraud." *City of Philadelphia v. Fleming Companies, Inc*., 264 F.3d at 1260 -1261; *see also Schlifke v. Seafirst Corp*., 866 F.2d 935, 946 (7th Cir. 1989). Rather, the Complaint must allege a Defendant both: "(1) . . . knew of the potentially material fact, and (2) . . . that failure to reveal the potentially material fact would likely mislead investors." *City of Philadelphia v. Fleming Companies, Inc*., 264 F.3d at 1260-1261. In other words, "a fact [must be] so obviously material that the defendant must have been aware both of its materiality and that its non-disclosure would likely mislead investors." *Id*.

To support his Section 10(b) claim against the Outside Directors, Plaintiff alleges the Outside Directors were told of and approved management's suggestion that Peregrine change its method of revenue recognition; these directors were aware of the material effect of such change on Peregrine's financial condition; and this change was not disclosed to the public. ((Proposed) Second Am. Compl., 61-70, ¶¶ 212-222; First Am. Compl., 44-53, ¶¶ 169-179.) Plaintiff's claim appears to be based on an April 1999 internal report as well as an April 1999 Board of Directors meeting. *Id*.

The Court finds that these allegations are insufficient to establish scienter on the part of the Outside Directors. With respect to the internal report, the allegations do not show the Outside Directors had insider knowledge that contradicted their public statement. The allegations also fail to show that the Outside Directors could have learned of information contradicting their public statements, much less that they did actually learn such information (or that they were deliberately reckless as to the falsity of their statements). With respect to the board meeting, the allegations likewise fail to demonstrate the Outside Directors understood that the change in revenue recognition would overstate revenue or that they knew the new method was not the preferred method or that it violated GAAP. There are also no allegations identifying specific conversations, board meetings, or reports where the Outside Directors purportedly learned of the true and adverse information regarding Peregrine's fraud. The Court notes that these findings are consistent with prior findings issued by the Court in the Peregrine class action. (*See In re Peregrine Sys. Inc. Sec. Litig*., 02-cv-0870 BEN, Docket No. 614.)

Accordingly, the Court finds that leave to amend to add the Outside Directors as defendants to Count III (Plaintiff's Section 10(b) claim) would be futile. As such, Plaintiff is denied leave to amend to add the Outside Directors as defendants.

CONCLUSION

In light of the above, the Court GRANTS Defendant Andersen's Motion to Dismiss Counts II, III and V (Docket No. 2) and GRANTS the Outside Directors' Motion to Intervene (Docket No. 16). The Court GRANTS IN PART AND DENIES IN PART Plaintiff's

Motion for Leave to Amend (Docket No. 12.) Specifically:

(1) Counts II and V are DISMISSED WITH PREJUDICE' Plaintiff is denied leave to amend Counts II and V;

(2) Count III is DISMISSED WITHOUT PREJUDICE; Plaintiff is granted leave to amend Count III only to correct the deficiencies outlined above;

(3) Plaintiff is denied leave to add the Outside Directors as defendants in this action; and

(4) Plaintiff must file is amended complaint no later than August 9, 2010.

IT IS ORDERED.

Date: July 19, 2010.

/s/ Roger T. Benitez
Hon. Roger T. Benitez
Judge, United States District Court

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

[Filed October 1, 2013]

No. 11-56592
D.C. No. 3:08-cv-00008-BEN-RBB
Southern District of San Diego, California

DAVID HILDES, Individually and as Trustee of The David and Kathleen Hildes 1999 Charitable Remainder Unitrust dated June 25, 1999,

Plaintiff - Appellant,

v.

ARTHUR ANDERSEN LLP; THOMAS G. WATROUS, SR.; DOUGLAS S. POWANDA; JOHN DOE, as the Executor of the Estate of David A. Farley,

Defendants - Appellees,

and

JOHN J. MOORES; CHRISTOPHER A. COLE; RICHARD A. HOSELY; CHARLES A. NOELL, III; NORRIS VAN DEN BERG, Outside Directors,

Intervenors - Appellees.

Before: TROTT, LUCERO*, and W. FLETCHER, Circuit Judges.

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* The Honorable Carlos F. Lucero, Circuit Judge for the U.S. Court of Appeals for the Tenth Circuit, sitting by designation.

The panel has voted to deny the petition for rehearing.

Judge W. FLETCHER has voted to deny the petition for rehearing en banc; and Judges Trott and Lucero so recommend.

The full court has been advised of the petition for rehearing en banc and no judge of the court has requested a vote on whether to rehear the matter en banc. Fed. R. App. P. 35.

The petition for rehearing and the petition for rehearing en banc, filed September 3, 2013, are DENIED.