

First Circuit: (1) Plaintiffs Asserting a Section 11 Claim Based on Aftermarket Purchases Must Specifically Plead Traceability; (2) Defendants Must Disclose Relevant “Troubling Developments” When Making Optimistic Statements

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On November 28, 2016, the First Circuit held that plaintiffs who assert Section 11 claims based on aftermarket purchases must specifically plead facts demonstrating that those shares are traceable to the offering corresponding to the allegedly misleading registration statement at issue. *In re ARIAD Pharm., Inc. Sec. Litig.*, 2016 WL 6933788 (1st Cir. 2016) (Howard, C.J.). The court held that “general allegations [of traceability] alone are not sufficient to avoid dismissal.”

The First Circuit also revived a securities fraud claim alleging that defendants had expressed optimism concerning FDA approval with a favorable label without mentioning the FDA’s request for a label with a black box warning. The court found defendants’ failure to disclose relevant “troubling developments created an impermissible risk of misleading investors.”

To Plead a Section 11 Claim, Aftermarket Purchasers Must Allege Particularized Facts Showing the Shares Are Traceable to the Offering at Issue

The First Circuit explained that a Section 11 claim “may be maintained only by those who purchase securities that are the direct subject of the prospectus and registration statement.” The court noted that “in order to state a claim, the plaintiffs need not have purchased shares in the offering.” Aftermarket purchasers also have standing to bring Section 11 claims “provided they can trace their shares back to the relevant offering.”

While satisfying the traceability requirement is straightforward in cases where “all of a company’s shares have been issued in a single offering under the same registration statement,” the First Circuit observed that the inquiry “becomes more complicated where . . . the company has issued shares under multiple registration statements.” In those cases, a plaintiff must establish that “her shares were issued under the allegedly false or misleading registration statement, rather than some other registration statement.”

The First Circuit rejected the argument that “mere ‘general allegations’ that [plaintiffs’] shares are traceable to the offering in question are

sufficient to avoid dismissal.” The court explained that in order to survive dismissal under the pleading standard set forth in *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007), plaintiffs cannot simply allege a “formulaic recitation” of the elements of a claim (quoting *Twombly*, 550 U.S. 544). Rather, plaintiffs must provide “enough facts to state a claim to relief that is plausible on its face.” *Id.* The First Circuit held that “almost by definition, a general allegation that a plaintiff’s shares are traceable to the offering in question is nothing more than a ‘formulaic recitation’ of that element.”

Plaintiffs Sufficiently Pled Scienter Where Defendants Allegedly Expressed Optimism Concerning the Likelihood of FDA Approval on Favorable Terms Without Disclosing the FDA’s Request for a Black Box Warning

The First Circuit reversed dismissal of a securities fraud claim brought in connection with defendants’ expressions of optimism concerning the likelihood that the FDA would approve the company’s new leukemia drug with a favorable label. Several weeks earlier, the FDA had allegedly rejected the company’s proposed label and instructed the company to submit a revised label for the leukemia drug that included a black box warning, yet defendants allegedly made no mention of the FDA’s concerns. The First Circuit found plaintiffs’ allegations were “sufficient to support a strong inference of scienter.” The court reasoned that although “management may have held out hope of achieving” FDA approval with a favorable label, “the expression of that hope without disclosure of recent troubling developments created an impermissible risk of misleading investors.”

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