

Fourth Circuit: Once a Company Decides to Speak on a Topic, the Company Has a Duty to Disclose All Material Information Concerning That Topic

03.23.18



(Article from *Securities Law Alert*, March 2018)

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On February 22, 2018, the Fourth Circuit revived a dismissed securities fraud action alleging that a medical device company failed to disclose its fraudulent insurance coding scheme. *Singer v. Reali*, 883 F.3d 425 (4th Cir. 2018) (King, J.). Because the company chose “to speak about its reimbursement practices,” the court found plaintiffs adequately alleged that the company had “a duty to disclose its alleged illegal conduct” in connection with those practices. The court further held that plaintiffs sufficiently pled scienter by alleging that the individual defendants were personally involved in executing the alleged scheme. Finally, the court found plaintiffs adequately alleged loss causation based on partial disclosures concerning a government subpoena into the company’s reimbursement practices.

Duty to Disclose the “Whole Material Truth” Attaches Once a Company Chooses to Speak on an Issue

The Fourth Circuit emphasized that Section 10(b) and Rule 10b-5 “do not create an affirmative duty to disclose any and all material information.” *Id.* (quoting *Matrixx Initiatives v. Siracusano*, 563 U.S. 27 (2011)). Rather, “companies can control what they have to disclose ... by controlling what they say to the market.” *Id.* (quoting *Matrixx*, 563 U.S. 27). Here, the Fourth Circuit found that once the company decided to inform the market that it was training surgeons on how to obtain reimbursements for its medical devices, the company allegedly “possessed—and breached—a duty to disclose the fraudulent reimbursement scheme.”

The Fourth Circuit rejected defendants’ argument that there were no allegations that any court or government agency had deemed the reimbursement scheme illegal. The court explained that “the duty to disclose may extend to uncharged and unadjudicated illegal conduct.”

The Fourth Circuit also found meritless defendants’ contention that the company had never “specifically asserted it was complying with a particular law.” The court noted that plaintiffs did not rely on “mere generic assertions of legal compliance.” Rather, plaintiffs based their claim on “the [c]ompany’s choice to speak about its reimbursement practices ... without telling the whole, material truth.”

Finally, the Fourth Circuit held that “general warnings about the risks of regulatory scrutiny and litigation” were insufficient to satisfy the company’s duty to disclose. The court emphasized that “[a] generic warning of a risk will not suffice when undisclosed facts on the ground would substantially affect a reasonable investor’s calculations of probability.” *Id.* (quoting *Meyer v. Jinkosolar Holdings Co.*, 761 F.3d 245 (2d

Cir. 2014)).

Allegations That the Individual Defendants Executed the Fraudulent Scheme Were Sufficient to Plead Scienter

The Fourth Circuit determined that plaintiffs adequately alleged scienter because the complaint was “premised on the proposition that the [individual defendants] directed the fraudulent reimbursement scheme, not that lower-level agents or employees independently conjured up and carried out the scheme without the [individual defendants’] knowledge.”

The court found plaintiffs’ allegation that “the fraudulent reimbursement scheme was known to the” individual defendants supported “a strong inference that [defendants] intended to deceive the market, or at the very least acted recklessly,” by failing to disclose the scheme.

Partial Disclosures Concerning a Government Subpoena, Taken Together, Sufficed to Plead Loss Causation

Plaintiffs relied on the company’s disclosure in its Form 8-K that the company had received a subpoena from the Department of Health and Human Services, as well as an analyst report addressing the subpoena, to allege loss causation. The Fourth Circuit found the “Form 8-K and the analyst report revealed enough facts for the market to finally recognize ... the existence of the [c]ompany’s fraudulent reimbursement scheme.”

The court emphasized that “neither a single complete disclosure nor a fact-for-fact disclosure of the relevant truth to the market is a necessary prerequisite to establishing loss causation.” The court further stated that these “partial disclosures need not precisely identify the misrepresentation or omission” but “must at least relate back to the misrepresentation or omission and not to some other negative information about the company.”

In a Dissenting Opinion, Judge Agee Expressed His View That Plaintiffs Failed to Plead Material Misrepresentations, Scienter or Loss Causation

Judge George S. Agee dissented from the majority’s opinion on several grounds. Among other reasons, he opined that “the majority’s analysis errs in its central assumption that the [c]ompany, if speaking about its reimbursement practices at all, not only had to characterize those practices fairly, but also had to further describe them as fraudulent or illegal.” Judge Agee stated that “the majority’s holding creates an inflexible rule that requires a publicly traded corporation engaged in ambiguous activity to represent its behavior as illegal or else risk being the subject of a securities fraud lawsuit.” In his view, “neither [S]ection 10(b) nor the [Private Securities Litigation Reform Act] requires that result.”

Judge Agee further opined that the majority “incorrectly assume[d] that, because the [c]ompany’s reimbursement framework was allegedly illegal, the [c]ompany axiomatically intended to defraud its investors.” He stated that “[e]ven if it were fair to infer that the [c]ompany’s officers were aware that the [c]ompany’s reimbursement scheme was illegal, it is unfair to carry that inference one step further and conclude that *because* the [c]ompany acted illegally it therefore *also* intended to deceive its investors.” Judge Agee expressed his view that “[j]ust because a plaintiff alleges an illegal act does not mean he has also pled fraud.”

Finally, Judge Agee stated that plaintiffs failed to plead any “revelation of the truth” as required to allege loss causation. He noted that “the Form 8-K suggested, and the analyst’s report speculated, only that the [c]ompany was involved in a government investigation.” Judge Agee observed that “[t]he possibility that some unspecified negative information may eventually come to light as a result of the investigation is not the same thing as the possibility that information about fraud will also be reflected” because “fraud is but one of a panoply of reasons that a given company could be under investigation.”

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