Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION—D. Ariz.: Lead plaintiff's inadequate fraud allegations: generalized puzzle pieces for the court to assemble, (Jul. 14, 2025)

Securities Regulation Daily Wrap Up

By Jay Fishman, J.D.

The plaintiff's only fact—a statement from a former employee who left defendant company before the fact could be proven misleading.

Arizona's District Court dismissed a lead plaintiff's class action fraud complaint under Exchange Act Sections 10(b)/Rule 10b-5 and 20(a) because the plaintiff's allegations were too general to overcome Federal Civil Procedure Rule 9(b) and Private Securities Litigation Reform Act (PSLRA) pleading standards. In granting the plaintiff leave to amend, the court cautioned his counsel to distinguish affirmative misstatements of fact from material omissions and support each theory separately so that the court is not again "left putting together the pieces of Lew's [lead plaintiff's] puzzle as he hides under a cloud of vagueness and imprecision" (*Lew v. ON Semiconductor Corporation*, No. 2:24-cv-00594-PHX-SMB (D. Ariz. July 11, 2025)).

Fraud allegedly emanates from semiconductor product orders. Before the class action period began, the defendant, a manufacturer and seller of automotive semiconductor products, would enter into short-term agreements with customers for products where delivery would often be delayed by a year due to Covid-19 pandemic-causing supply chain shortages. Because of the backlog, customers often placed product orders with multiple suppliers and upon receiving the product from one supplier would cancel their orders with the others. Meanwhile, the defendant, during the backlog periods, prepared quarterly reports for investors, detailing expected revenue and gross margins, which were released along with the company's earnings announcements.

Because the above-described customer behavior artificially inflated the demand for the products which, in turn, caused predictability issues for suppliers and manufacturers, the defendant company began using long-term supply agreements (LTSAs) to lock in purchase commitments over the term of the agreements; doing so was thought to curb the artificial market fluctuations by creating predictability in the supply chain. The use of LTSAs started in 2021 and coincided with the waning of Covid-19. The company's 2022 Form 10-K financial statement, filed in February 2023, stated that the LTSAs would span an average of four to five years, add predictability to the purchase commitments and require customers to provide some offset for the lost sales if those orders were not achieved. Additionally, the company's CEO repeatedly declared on financial statements at a various conferences that the LTSAs were a "win-win" and were "take-or-pay" and "legally binding."

Lead plaintiff's main contention. The lead plaintiff, in his class action complaint, primarily argued that during the relevant period, from May 1 to October 27, 2023, the CEO's "win-win, take-or-pay, and legally binding" "protections" were material misrepresentations because they were not enforced; customers simply amended their agreements without conferring the legally binding benefit on the company. To support his argument, the plaintiff cited a former employee who in late 2022 to early 2023 reported to his supervisor, who then reported to the CEO that: (1) a military customer was not placing orders according to its LTSA; (2) there was no penalty for failing to meet "significant" purchase commitments worth about $6 or $7 million; and (3) the military customer had yet to place an order when the employee left the company in July 2023. The plaintiff additionally alleged that the defendants' failure to tell the truth about the lack of LTSA enforceability was a material omission that when combined with the affirmative misrepresentations had led securities analysts to question the strength of the LTSAs. Ultimately, the plaintiff proclaimed, the analysts' news led to artificially inflated stock prices followed by massive investor losses for which he

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sought damages on the class's behalf.

Court finds generalized puzzle pieces don't overcome pleading burdens. ***Misrepresentations and omissions.*** The court first spent some time deciding whether certain plaintiff and defendant documents should be granted judicial notice and/or incorporated by reference, agreeing with both parties on particular items. When the court next delved into the Section 10(b) and Rule 10b-5 claims, it discovered that the lead plaintiff did not clearly delineate affirmative misrepresentations from material omissions and, instead, intertwined them together with overly generalized statements, rendering statements and omissions unable to overcome the Civil Procedure Rule 9(b) and PSLRA pleading standards.

Nevertheless, the court attempted to assemble the plaintiff's "puzzle pieces" into four distinct statement-claims:

1. The Q-1 2023 Earnings Call Statement where the CEO said the "LTSAs align with our customers on pricing and volume;"

2. The JPMorgan Conference where the CFO said "if we can create a win-win, we'll try to help the customer, and there's got to be a win for both companies;"

3. The Deutsch Bank Conference where the company executives stated, "so that LSTA and the conversations we're having with the customer have a win-win, although we may take some down and amend it, saying, yes, no problem, net-net, it's a win-win;" and

4. The Citi Conference where the CEO declared "so we'll have the conversation, but it has to be a win-winso all of these are win-win. Now if the customer is not interested in a win-win, but a win/lose, that's where it's ironclad. It's a legally binding agreement that both parties in a win-win will renegotiate an amendment. But net of that, we're not going to be left holding the bag."

The court's separate analysis of the above four statement-claims varied slightly but the overall theme against finding material misrepresentations or omissions was the lead plaintiff's failure to define the terms "win-win," "win-lose," "predictability," "take-or-pay" or "legally binding." Without placing any parameters on these terms, the court was unable to *objectively verify* the individual defendants use of them for determining fraud. And without those defined parameters, the terms are merely unactionable statements of puffery, optimism, or opinion or forward-looking statements. As for the one true fact in the complaint, namely the former employee's statements, the court concluded it was insufficient since the employee did not remain at the company long enough to find out if the military customer ever place any relevant orders, was not part of any negotiations, and did not purport to know whether the company's predictions accounted for any reductions based on the military customer.

Scienter. In at least one instance, the lead plaintiff, to prove the CEO and CFO had scienter, offered up the "core operations theory" that "corporate officers have knowledge of critical core operations of their companies." But the court pointed out that this theory works only in rare circumstances when the falsity of the fact is patently obvious. Essentially, the plaintiff premised his theory on the fact that the executive officers were aware renegotiations with customers could take longer than six to nine months and by virtue of the projected revenue reduction and refusal to comment on the customer's plans to place orders in 2024, the company did not obtain a "win." But the court debunked this premise, declaring that the plaintiff incorrectly based his theory on a subjective belief of what constitutes a "win" (which he never defined) rather than on any patently obvious fact; specifically, it would not be patently obvious to corporate management that the possibility of failing to recognize projected revenues for a product during a quarter or fiscal year would render a statement that renegotiations of LTSAs ensure a "win-win" objectively false.

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Section 20(a) fails as well. Lastly, the court stated the lead plaintiff's control person liability claim against the CEO and CFO failed since his underlying primary liability claims under Section 10(b) and Rule 10b-5 were deemed unactionable.

The case is No. 2:24-cv-00594-PHX-SMB.

Judge: Brnovich, S.

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Companies: ON Semiconductor Corp.

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