Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION —D.Conn.: Investors were warned that acquisition could be problematic, (Mar. 11, 2019)

Securities Regulation Daily Wrap Up

Click to open document in a browser

By Rodney F. Tonkovic, J.D.

Frontier Communications gave adequate warning that its acquisition of Verizon wireline operations could be problematic or cost more than was forecast.

A district court dismissed a complaint challenging a communications company's positive statements related to its takeover of another company's assets. While the company assured investors that there would be a smooth and seamless transition, costs were almost double what was projected, and some customers experienced service interruptions or outages. The court found that the company's statements before the acquisition amounted to puffery or protected forward-looking statements and that the challenges to the post-acquisition statements were not pleaded with the required particularity (*In re Frontier Communications, Corp. Stockholders Litigation*, March 8, 2019, Bolden, V.).

Flash cut. In early February 2015, Frontier Communications Corp. announced a plan to acquire the California, Texas, and Florida wireline operations of Verizon Communications, Inc. (the "CTF Acquisition"). At the time, Frontier's COO said that integration of these operations would cost approximately $450 million and that the company had a proven track record in this area, so customers would experience no disruption in service. Shortly afterward, the company disclosed continuing service issues and cost overruns from an earlier acquisition in Connecticut. Nevertheless, over the next several months, Frontier continued to state publicly that existing customers would experience a smooth transition during the CTF Acquisition.

Certain Frontier employees, however, had reservations about the company's ability to execute the transition. In contrast to the standard industry practice of a gradual merger of the acquired company's equipment and accounts, Frontier engaged in a "flash cut" method in which the assets were turned over in one transfer and without a phase-in period. Behind the scenes, these Frontier technical staffers predicted that the flash cut would not go well, in part due to the gap between Verizon's and Frontier's respective technologies and systems. In June 2015, Frontier raised over $2.5 billion from investors to finance the CTF Acquisition. In the following months, Frontier's officers continued to assert that the flash cut would be a success.

The CTF Acquisition and flash cut occurred on April 1, 2016. According to the complaint, Frontier's management and employees knew that the transfer had been a "colossal disaster," but kept touting its success. For example, the California State Assembly's Utilities & Commerce Committee complained of "alarming" problems, such as the inability to dial 911, and indicated that it would hold a formal hearing.

In late 2016, Frontier told investors that the CTF Acquisition's integration had cost 66% more than predicted. More disappointing news followed over the course of 2017, and Frontier's stock price fell. In February 2018, Frontier announced that the total cost of integrating the CTF Acquisition was $962 million and that Frontier was canceling its dividend completely. The shareholder plaintiffs then brought this amended complaint asserting fraud claims against Frontier and its underwriters under the Exchange Act and the Securities Act.

No misstatements. The court first found that the complaint failed to plead that Frontier made material misstatements in three categories of pre-acquisition statements related to Frontier's track record, seasoned integration team, and ability to deliver a seamless or smooth transition for CTF customers. According to the court, while Frontier painted a rosy scene, it simultaneously warned investors of the complexity of telecommunications acquisitions, including the troubles with previous acquisitions. And, a reasonable investor

would have been aware of lawsuits and other actions based on the earlier acquisitions and would not have been duped or defrauded by Frontier's optimism and puffery, the court said.

The court then determined that Frontier's cost projections were non-actionable forward-looking statements. Frontier's SEC filings and offering documents contained numerous references to costs, including both boilerplate warnings and specific cautions based on the experience with other recent acquisitions. Given the number and specificity of the warnings, the court concluded, reasonable investors would have been cautioned and not misled to believe that the costs of CTF acquisition could not be more—even significantly more—than $450 million.

Post-acquisition statements. The plaintiffs also challenged Frontier's post-acquisition statements related to the success of the CTF acquisition, the percentage of CTF customers facing service interruptions and the number and cost of non-paying Verizon accounts. The statements about the acquisition's success were puffery, at best. Claims as to the remainder of the statements failed for lack of particularity. For example, the complaint failed to show just how many customers had service issues, and there was no data as to the impact of the non-paying accounts.

Other elements and claims. The lack of a material misstatement was a sufficient basis to dismiss the complaint, but the court also went on to find that the plaintiffs similarly failed to plead loss causation and scienter. Further, to the extent that the claims were otherwise not dismissed, many would likely be barred by the statute of limitations, since a number of key events occurred more than two years before the complaint was initially filed in September 2017. Finally, the court dismissed the complaint's claims under the Securities Act claims, which were based on the Exchange Act claims, for the same reasons, including the potential failure to meet the applicable statute of limitations.

The case is No. 3:17-cv-1617.

Attorneys: Brian P. Murray (Glancy Prongay & Murray LLP) for Chris Bray. Archis A. Parasharami (Mayer Brown) for Frontier Communications Corp.

Companies: Frontier Communications Corp.

LitigationEnforcement: FraudManipulation ConnecticutNews