

[Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION](#) [—D.N.J.: Court mostly denies motions to dismiss in Valeant class action, \(May 1, 2017\)](#)

Securities Regulation Daily Wrap Up

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By Joseph Arshawsky, J.D.

Shareholders who filed a putative class action against Valeant Pharmaceuticals International, Inc. adequately alleged scienter, material misrepresentations and omissions, and loss causation, and therefore stated claims against Valeant, its officers and directors for securities fraud under Exchange Act Section 10(b) and Rule 10b-5, a federal court in New Jersey ruled. Because there was primary liability the court also denied the motion to dismiss the Exchange Act Section 20(a) and Securities Act Section 15 counts against the company and certain senior officers. The court also found that a shareholder had standing under Securities Act Sections 11 and 12(a)(2) because it adequately alleged purchasing shares directly in the offering. However, the court dismissed without prejudice four counts under Section 12(a)(2) that related to the bond offering, holding that a Rule 144A registration exempts Section 12 liability claims (*In re Valeant Pharmaceuticals International, Inc. Securities Litigation*, April 28, 2017, Shipp, M.).

This securities class action was brought on behalf of purchasers of Valeant equity securities and senior notes between January 4, 2013, and March 15, 2016 (the “Class”). Valeant’s CEO’s strategy was to grow the company through acquisitions, as opposed to research and development, and compensation plans resembled those of a hedge fund. One allegedly deceptive practice was price gouging. In order not to get caught, Valeant “created a secret network of specialty pharmacies.” On January 2, 2013, as part of its captive pharmacy network, Valeant created Philidor, a seemingly independent pharmacy that was controlled by Valeant. Eventually the truth came out, Congress investigated, disclosures were finally made, and the stock plummeted. This suit followed against the company, officers, directors, underwriters, and the auditor. Six separate motions to dismiss were filed and considered at once, and for the most part they were denied.

Exchange Act. The first count of the complaint was against the company and its officers and directors for violation of Exchange Act Section 10(b) and Rule 10b-5, based on their dissemination or approval of false statements related to Valeant’s deceptive practices. The court considered the scienter allegations first.

Scienter. The company, officers, and directors argued that “the more compelling inference from the circumstances alleged in the complaint is that congressional inquiries, Philidor’s collapse and a short-seller—not securities fraud—drove down Valeant’s stock price.” The shareholders pointed to their allegations that the officers and directors had direct roles in deceptive practices, patterns of denials and subsequent admissions, failure to pursue remedies, and Valeant’s restatement and material weaknesses in internal controls, among others. The court also noted that it is plausible that the executives and directors were caught before they had a chance to sell their shares, and thus the mere fact that they did not sell their shares is insufficient. Similarly, the court found that the fact that the shareholders had no confidential informants or internal documents does not preclude a finding of adequate pleading of “scienter based on the Court’s holistic review of the Complaint.”

Materiality. While the company, officers, and directors targeted certain portions of alleged statements and omissions, they failed to sufficiently address numerous alleged misstatements and omissions regarding Valeant’s purported deceptive practices, which a “reasonable investor would have considered important,” the court said. Accordingly, the court found that the complaint sufficiently pleaded actionable statements regarding the company, officers, and directors. The court specifically addressed statements attributed to certain board members. The court found it was proper to attribute statements made in certain press releases to those board

members because the communications appeared to have been made on behalf of the whole board or a committee thereof.

Loss causation. The court found that loss causation is governed by Rule 8(a)(2) pleading standards, and under those standards, loss causation was adequately alleged in the complaint. Therefore, the court denied the motion to dismiss the 10b-5 count.

Control person liability. The shareholders brought a claim under Exchange Act Section 20(a) against Valeant and certain senior officers and directors, and a claim under Securities Act Section 15 against the company and two officers on non-fraud based claims for strict liability for their control over material misstatements and omissions relating to Valeant's deceptive practices. The motion to dismiss essentially argued that there should be no liability on these counts because there was no liability pursuant to 10b-5. Since the court denied the motion to dismiss the 10b-5 claim, it denied the motion as to these control persons' liability claims as well.

Standing. The City of Tucson brought two counts under Securities Act Sections 11 and 12(a)(2) against the company, officers and directors, the auditor and the underwriters. The defendants challenged whether City of Tucson in fact bought stock in the particular offering. In the complaint, the plaintiffs pleaded that the City of Tucson "purchased Valeant stock in the March 2015 Stock Offering." The court found this was sufficient to allege standing, but the court warned that if defendants are eventually to prove that the shares came from the secondary market, these claims would be subject to dismissal. With regard to the audit opinion, the court found that it fell within one of the *Omnicare* exceptions, and was therefore actionable. Thus, the motion to dismiss these claims were denied.

Motion granted. Lead Plaintiff TIAA-CREF brought four counts under Securities Act Section 12(a)(2) against the company, executives and the "Bank Offering Defendants" for non-fraud based, strict liability claims for material misstatements and omissions in the offering materials tied to four different debt offerings by Valeant. This raised an issue of first impression in the Third Circuit: whether Rule 144A registration requires dismissal of Section 12 claims. The court found that "exemption from registration and non-public status are necessary consequences of compliance with the conditions of Rule 144A." The court adopted the "majority approach" and dismissed these claims, without prejudice.

The case is [No. 3:15-cv-07658-MAS-LHG](#).

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Companies: Valeant Pharmaceuticals International, Inc.; Tucson Supplemental Retirement System; TIAA-CREF

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