Beck v. Dobrowski: The Application of the PSLRA and Bell Atlantic to Section 14(a) Securities Claims
By Andrew F. Merrick & Howard S. Suskin

In an important matter addressing the Private Securities Litigation Reform Act (PSLRA), the Seventh Circuit has ruled that although the PSLRA applies to claims under section 14(a), which forbids material misrepresentations or omissions in soliciting a shareholder’s proxy vote, the plaintiff is not required to plead with specificity that the defendant acted with a particular state of mind. The Seventh Circuit also concluded that the plaintiff’s allegations “were too feeble to allow the suit to go forward” under the standard set forth by the U.S. Supreme Court in 2007 in Bell Atlantic Corp. v. Twombly. The Seventh Circuit’s decision is a very significant one for practicing securities lawyers, because the court discusses at length the interplay between section 14(a) and the PSLRA and how Bell Atlantic applies in a securities case.

In Beck v. Dobrowski, the Seventh Circuit affirmed the dismissal of the plaintiff’s claims under section 14(a) of the Securities Exchange Act of 1934 (Exchange Act) and held that the plaintiff failed to meet the standard set forth by the Supreme Court in Bell Atlantic. The plaintiff, Philip Beck, was a shareholder in Equity Office Property Trust, a real estate investment trust that owned and managed commercial properties. In November 2006, Equity Office entered into an agreement with a private equity firm, Blackstone Group L.P., to sell the company for cash consideration. The agreement required Equity Office’s shareholders to accept the transaction and included a termination provision. On December 29, 2006, Equity Office’s board of directors mailed an initial proxy solicitation to its shareholders and scheduled a shareholder meeting for February 5, 2007.

Following Blackstone’s initial offer, another potential buyer, Vornado Realty Trust, submitted a substantially higher bid, though it required the approval of Vornado’s shareholders and included stock consideration. Blackstone responded to the Vornado bid by increasing its initial offer. The board of directors promptly accepted Blackstone’s new offer and agreed to increase the termination fee. On January 29, 2007, the board of directors issued a press release, filed the press release with the Securities and Exchange Commission (SEC), and disseminated a “first supplemental proxy” solicitation, which informed shareholders that the meeting would be delayed until February 7, 2007.

On February 1, 2007, Vornado responded by increasing its offer price, but also reducing the percentage of cash consideration, thereby increasing the risk to the Equity Office shareholders. On February 2, 2007, the board of directors issued another press release, filed the press release with the SEC, and disseminated a “second supplemental proxy” to its shareholders. Although Vornado offered a higher price per share than Blackstone, the board of directors continued to recommend the Blackstone transaction. In response, Vornado again increased its offer.

Blackstone responded to this offer by raising its cash offer, but on the condition that the board substantially increase the termination fee. On February 6, 2007—one day prior to the shareholder vote—the board issued another press release, filed the press release with the SEC, and disseminated a “third supplemental proxy” solicitation. The board continued to recommend that shareholders approve the Blackstone transaction. At this point, Vornado withdrew from the bidding, announcing that “the premium it would have to pay to top Blackstone’s latest bid, protected by a twice increased breakup fee, would not be in its shareholders’ interests.” On February 7, 2007, Equity Office shareholders voted overwhelmingly in favor of the Blackstone offer.

Plaintiff Beck then filed a purported class action against the nominal defendant Equity Office and its board of directors under sections 14(a) and 20(a) of the Exchange Act. Section 14(a) prohibits the solicitation of any proxy “containing any statement which, at the time and in light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary to in order to make the statements therein not false or misleading[.]” Section 20(a) imposes liability on any person “who, directly or indirectly, controls any person liable under any provision of this title or of any rule or regulation thereunder.” The plaintiff also asserted a state law claim for breach of fiduciary duty under Maryland law.

The plaintiff alleged that Equity Office’s initial and supplemental proxies contained untrue statements of material fact and omitted to state material facts related to the sales process and the value of the company. The plaintiff...
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also alleged that the initial proxy was rendered materially false and misleading because the board of directors disseminated the supplemental proxies too late for shareholders to consider the information. The plaintiff argued that this information was material because it alerted shareholders to the bidding war between Blackstone and Vornado.15

The defendants moved to dismiss the complaint under Rule 12(b)(6), arguing that the plaintiff failed to meet the minimum pleading standards in the PSLRA. Section (b)(1) of the PSLRA requires a plaintiff in a securities fraud case to “specify each statement alleged to have been misleading . . . [and] the reason or reasons why the statement is misleading.”16 Section (b)(2) provides that “[i]n any private action arising under this chapter in which the defendant may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall . . . state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.”17 Last, section (b)(4) provides that “the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this chapter caused the loss for which the plaintiff seeks to recover damages.”18

As a threshold matter, the district court ruled that the PSLRA applies to claims under section 14(a). Although the court noted that the Seventh Circuit had not yet addressed the issue, it found the statutory language providing that the PSLRA applies to “any private action arising under this chapter” to be unambiguous. The district court then ruled that a plaintiff must plead with specificity that the defendant acted with a particular state of mind, even though a section 14(a) claim can be based on negligent conduct. The district court found that “[s]ince negligence is a state of mind, the language of section (b)(2) by its terms encompasses negligence-based securities actions.”19 Finally, the district court noted that regardless of whether the statute imposes a scienter standard, the PSLRA requires the plaintiff to specify each statement alleged to be false.

The district court then dismissed the complaint for failure to meet the minimum pleading requirements. First, the court found that the plaintiff failed to plead loss causation, noting that the complaint “contain[ed] no loss allegations at all.”20 Second, the court ruled that the omission allegations were insufficient because the plaintiff failed to explain how the missing information rendered any statement misleading. Third, the court ruled that the plaintiff failed to plead any false statements of material fact; to the contrary, the court found the statements to be matters of opinion. Finally, the court rejected the plaintiff’s argument that the proxies were misleading because there was insufficient time for the shareholders to consider the supplemental information.

On appeal, the Seventh Circuit affirmed the dismissal but on a different basis. Although the Seventh Circuit agreed that the PSLRA applies to claims under section 14(a), it ruled that the district court erred in requiring the plaintiff to plead state of mind with particularity for that claim. The court explained that section 14(a) does not impose a state of mind requirement; a proxy solicitation containing a misrepresentation or omission violates section 14(a) even where an issuer believes in good faith that the information is accurate. This implies negligence at worst on the part of the issuer, but negligence is not a state of mind; it is a failure to conform one’s actions to the appropriate standard of care.

The Seventh Circuit then ruled that “the plaintiff’s allegations that the proxy solicitations contained misrepresentations or misleading omissions were too feeble to allow the suit to go forward under the standard set forth by the Supreme Court in the Bell Atlantic Corp. v. Twombly. . . .”22 In Bell Atlantic, the Supreme Court held that the plaintiff must state a plausible claim for relief to survive a motion to dismiss.23 The rationale underlying the Court’s decision in Bell Atlantic was that a defendant should not be burdened with the heavy costs of pretrial discovery unless the plaintiff raises the prospect of relief beyond a speculative level. Although Bell Atlantic was decided under the antitrust laws, most courts to consider the issue have since extended its holding to other actions, including securities cases.24

In Beck, the Seventh Circuit applied the standard set forth in Bell Atlantic to hold that the plaintiff’s complaint failed
to state a plausible claim for relief.25 First, the court ruled that the plaintiff failed to establish that the missing information rendered the proxies misleading. Second, the court rejected the plaintiff’s argument that shareholders did not have sufficient time to consider the supplemental information. The court noted that the longer the interval between the issuance of the proxy and the shareholder vote, the more likely that market forces and changing share prices could cause the transaction to fall apart. In addition, the court expressed concern that, under the plaintiff’s view, a bidder could delay the shareholder vote indefinitely by continuously submitting new offers. Finally, the court also declined the plaintiff’s invitation to impose a minimum time requirement between the issuance of a proxy and a shareholder vote, noting that rule-making authority belongs to the SEC, not to the court.

Beck is important for practicing securities lawyers because it addresses the interplay between section 14(a) and the PSLRA, and it also discusses at length how the Supreme Court’s decision in Bell Atlantic applies to a securities case. Attorneys prosecuting or defending section 14(a) claims should be mindful of how Beck may have consequences for their case. Z

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20. Id. at *5.
21. In so holding, the Seventh Circuit joined other circuits that have found the PSLRA applicable to section 14(a) claims. See, e.g., Knollenberg v. Harmonic, Inc., No. 03-16238, 152 Fed. App’x 674, 682–83 (9th Cir. 2005); Hayes v. Crown Cent. Petroleum Corp., No. 02-2190, 78 Fed. App’x 857, 861 (4th Cir. 2003).
24. See, e.g., ATSI Comm’ns, Inc. v. Shaar Fund, Ltd., 493 F.3d 87, 98, n.2 (2d Cir. 2007) (applying the Bell Atlantic standard in the context of a securities fraud claim).