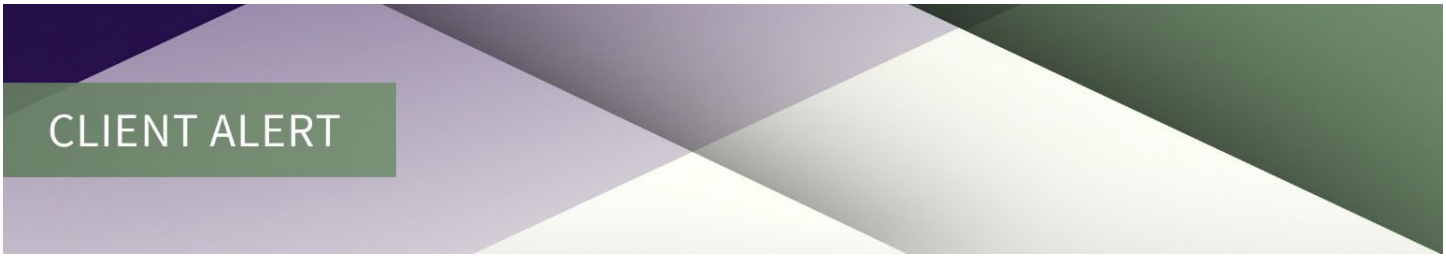

A Win for Investment Funds and Sponsors: Federal Judge Distinguishes Large Investors From Issuers in Dismissing Securities Claims

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On September 29, 2023, Willkie Farr delivered a significant victory for longtime clients Third Point LLC, Third Point Ventures LLC (collectively "Third Point") and Daniel Loeb by achieving dismissal of all claims against Third Point and Mr. Loeb in a putative securities class action lawsuit by shareholders seeking upwards of $2.2 billion in damages.[1] The decision, authored by Chief Judge Algenon L. Marbley of the United States District Court, Southern District of Ohio, provides clear guidance for investment funds and private equity investors—who are often named as "control party" defendants in securities class actions, particularly after a busted initial public offering or when the companies in which they invest face high-profile setbacks.

The lawsuit relates to Upstart Holdings, Inc., a well-known AI lending platform that matches banks and credit unions to consumers seeking loans. The lawsuit alleged that Upstart misled investors concerning the superiority and reliability of its AI model and demand for its loans as market conditions softened. Plaintiffs alleged that Third Point, an early-stage 20% investor with one employee on the board, sold its stake before the alleged "truth" regarding the AI model emerged. The action alleged that Third Point was a controlling shareholder of Upstart and asserted primary and control person claims against the Third Point defendants under the federal securities laws.

[1] *In re Upstart Holdings, Inc. Sec. Litig.*, No. 2:22-cv-02935-ALM-EPD, Slip. Op. at 2 (S.D. Ohio Sept. 29, 2023) (ECF No. 68).

Chief Judge Marbley granted the Third Point defendants' motion to dismiss in its entirety.[2] The decision, ruling for Third Point and Mr. Loeb on nearly every issue in dispute, touches on a vast array of hot topics in securities litigation, including topics of particular relevance for investment funds and other large investors who may be named as defendants in such lawsuits:

- ***Janus***: The Court found that the Third Point defendants were not the "makers" of any statements for purposes of Rule 10b-5 under the Supreme Court's seminal decision in *Janus Cap. Grp., Inc. v. First Derivative Traders*, 564 U.S. 135, 142 (2011). This was so even though Third Point had appointed a director to the Upstart Board who signed off on Upstart's SEC filings. The Court reasoned that an outside director should not be presumed to be acting at the direction of his outside employer, here Third Point. Hence, absent allegations that "he was violating his fiduciary duties to Upstart and acting on behalf of Third Point Ventures while carrying out his director duties," putative misstatements made by the director could not be imputed to Third Point. Slip Op. at 19.

- **Scheme Liability**: The Court rejected allegations that the Third Point defendants participated in a scheme with Upstart to deceive investors. Noting that they neither made nor disseminated any false statements, the Court carefully reviewed the allegations against the Third Point defendants, finding they, at best, alleged aiding and abetting liability—a claim squarely foreclosed by the Supreme Court's decision in *Stoneridge Inv. Partners, LLC v. Sci.-Atlanta, Inc.*, 552 U.S. 148, 162 (2008). Notably, the Court rejected plaintiffs' allegations that the Third Point defendants were party to the scheme by virtue of having engaged in commercial transactions with Upstart, participated on Upstart's Board, and assisted the Company in navigating capital markets. Slip Op. at 50–52.

- **Control**: The Court found that Third Point was not a controlling shareholder in Upstart—despite having a 20% stake, board seat, and commercial dealings with the Company—for purposes of Section 20(a) of the Securities Exchange Act. Importantly, the Court reinforced that ownership of a minority position, especially one at 20%, "rarely" suffices to plead corporate control. *Id*. at 53. Nor did Third Point's right to appoint one of eight directors "move the needle." *Id*. at 54. Finally, the Court considered allegations that Third Point in various ways participated in the management of Upstart, but found that, while its participation was substantial, it did not amount to "functional intertwinement" or "direct and supervisory involvement in [] day-to-day operations." *Id*. at 53–54.

On this basis, the Court dismissed claims under Rule 10b-5 and Section 20(a) of the Exchange Act against Third Point and Mr. Loeb, along with a Section 20A claim for "insider trading," concluding that the plaintiffs failed to plead the required predicate violation under the securities laws against them. *Id*. at 56.

In ruling for Third Point and Mr. Loeb, Chief Judge Marbley handed them—and investment funds and private equity investors generally—a major victory. The decision underscores that start-up investors may be dismissed from securities class action

[2] At the same time, the Upstart defendants' motion to dismiss was granted in part and denied in part, allowing the case to move forward as to certain of the alleged misstatements.

lawsuits, even when those lawsuits are allowed to proceed against the corporate defendants. In particular, a large ownership stake, board participation, even "substantial" participation in the management of the company will generally be insufficient to state a claim for securities fraud, absent particularized allegations that the investor actually participated in the alleged fraud. This is a welcome development given the increasing tendency of securities class action plaintiffs in recent years to bring claims against investment funds in the hope of finding another "deep pocket" to fund a potential settlement.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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