
## Careful Review of Litigation Disclosure in Periodic Reports and Registrations Statement Required Following U.S. District Court's Decision

As we enter the heart of Form 10-Q review season for calendar year-end companies and look ahead to Form 10-K review season early next year, a recent decision in a securities fraud class action suit reinforces the need to carefully review litigation disclosure in annual and quarterly reports and registration statements.

In City of Fort Lauderdale Police Firefighters' Retirement System v. Pegasystems, Inc., the plaintiffs brought suit (the "Securities Action") against Pegasystems, Inc. ("Pega" or the "Company") in the U.S. District Court for the District of Massachusetts. The complaint alleged that the Company violated anti-fraud provisions of the Securities Exchange Act of 1934. The claims relate to a separate lawsuit (the "Appian Suit") brought by Appian Corporation alleging that Pega willfully and maliciously misappropriated Appian's trade secrets. Appian, a Pega competitor, claimed that Pega's CEO directed a years-long espionage and trade secret theft program against it. Appian prevailed in the lawsuit, and Pega was awarded a $2 billion judgment. Once news of the judgment was released, Pega's share price dropped dramatically.

In the Securities Action, the plaintiffs alleged that Pega failed to disclose the Appian Suit,[1] falsely reassured investors that Appian's claims were "without merit," and misleadingly promised never to misappropriate trade secrets. The judge in the Securities Action denied the Company's motion to dismiss the complaint, agreeing, among other things, that Pega and its CEO misled investors when they reassured them in its Form 10-K and other statements that Appian's claims were "without merit." The Form 10-K disclosure, in relevant part, reads as follows:

> The Company believes the counterclaims brought by Appian against the Company are without merit, and the Company intends to vigorously pursue its claims against Appian and defend against the counterclaims brought against the Company in this matter. The Company is unable to reasonably estimate possible damages or a range of possible damages in this matter given the Company's belief that the damages claimed by Appian fail to satisfy the required legal standard, the status of the proceeding, and due to the uncertainty as to how a jury may rule if this ultimately proceeds to trial.

Pega's CEO issued a separate statement with substantially the same language.

The court ruled that the "without merit" reassurance was an actionable opinion statement given the CEO's awareness of, involvement in, and direction of Pega's espionage campaign against Appian. Citing the Supreme Court's decision in Omnicare, the judge noted that a reasonable investor "expects not just that the issuer believes the opinion (however irrationally), but that is fairly aligns with the information in the issuer's possession at that time." In this instance, the court found, "[g]iven the way [his] statement was

[1] The Appian Suit was filed in May 2020. Pega did not expressly disclose the Appian Suit in its Form 10-K and 10-Q filings until its Form 10-K filing on February 16, 2022. In those earlier filings, it did report that it had received, and may in the future receive, notices claiming that it has misappropriated, misused or infringed other parties' intellectual property rights.

couched and the identity of the speaker, a reasonable investor could justifiably have understood [the CEO's] message that Appian's claims were 'without merit' as a denial of facts underlying Appian's claims – as opposed to a mere statement that Pega had legal defenses against those claims."

Given the seemingly egregious facts of this case – a court finding that the CEO of a company knowingly directed multiple, long-running espionage campaigns against a competitor – it is difficult to draw a bright-line lesson that a company should never state that litigation against it is "without merit." That said, in the presence of such an attempt at reassurance, the risk of litigation or regulatory scrutiny is higher in the event of a subsequent loss or settlement in such litigation that leads to a significant decline in stock price.

In reviewing litigation disclosures in filings with the SEC, close attention needs to be paid to the language asserting that a litigation against the company is "without merit." To mitigate risk, and after consultation with the company's auditors, it may be best to avoid such language and rely on statements such as the following:

- We intend to vigorously pursue our claims against [defendant] in this matter.
- We intend to vigorously defend against the claims brought by [plaintiff] in this matter.
- We are unable to reasonably estimate possible damages or a range of possible damages in this matter given the uncertainty as to how a jury may rule if this ultimately proceeds to trial.
- We dispute these allegations and plan to vigorously defend ourselves.
- We have defenses to the claims raised in this lawsuit.

Because reserve considerations often drive the litigation disclosure (i.e., accounting firms may indicate that unless a company will state a belief that a particular litigation is without merit, the accounting firm will require the company to establish a reserve for possible loss), it is important to discuss any proposed disclosure with both counsel and the company's accountants and auditors.

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