

Blog Entry: Ninth Circuit Holds That Securities Class Action Based on Violations of Ethics Code Properly Dismissed

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On January 19, 2017, the Ninth Circuit affirmed the dismissal of a shareholder class action lawsuit alleging securities fraud violations, arising out of Hewlett-Packard's former CEO's alleged misrepresentations about HP's ethical compliance. In a case of first impression, the Ninth Circuit held that there was no actionable securities fraud claim where a CEO violates the corporation's corporate code of ethics, even after publicly touting the corporation's high standards for ethics and compliance.

In *Retail Wholesale*, HP's Board initiated an investigation of its CEO and his relationship with a former independent contractor after allegations of sexual harassment. During the investigation, the CEO lied to the Board and investigators, and doctored expense reports to hide their relationship. After his subsequent resignation in 2010, HP's stock dropped, resulting in an alleged loss of \$10 billion.

HP shareholders brought a class action lawsuit alleging violations of § 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934. The shareholders alleged that in 2006, the CEO had publicly touted HP's high standards for ethics and compliance, and that HP made other various public statements promoting its ethics standards, which in light of the CEO's conduct were misrepresentations.

The district court dismissed the shareholders' class claims for failure to adequately allege materiality and falsity, and the Ninth Circuit agreed. The Ninth Circuit first held that the shareholders failed to establish that HP made a material misrepresentation, because representations regarding a "code of ethics" or ethical compliance are not objectively verifiable and are "inherently aspirational." Each one of HP's statements relied on by the shareholders, the Ninth Circuit held, were not capable of objective verification. Underscoring the Ninth Circuit's decision was that a contrary interpretation could turn all noncompliance with an ethical code into securities fraud.

Second, the Ninth Circuit agreed with the district court that HP's alleged failure to disclose the CEO's noncompliance was not actionable under § 10(b) and Rule 10b-5. HP did not have a duty to disclose the CEO's activities, even in light of HP's statements regarding its high ethical compliance, because HP "did not reasonably suggest that there would be no violations" of its ethical code. These affirmative statements simply did not create an impression of complete compliance, and so the shareholders could not hold HP liable under a material omission theory.

The case is *Retail Wholesale & Dep't. Store Union Local 338 Ret. Fund v. Hewlett-Packard Co.*, No. 14-16433 (9th Cir. Jan. 19, 2017).