UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE LIONS GATE ENTERTAINMENT CORP. SECURITIES LITIGATION	14 Civ. 5197 (JGK)

DEFENDANTS' MEMORANDUM OF LAW IN SUPPORT OF THEIR MOTION TO DISMISS

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PRELIMINARY STATEMENT

At issue in this case is whether Lions Gate Entertainment Corp. was required to disclose an SEC investigation. That investigation resulted in a settlement, announced on March 13, 2014, in which Lions Gate consented to a set of negotiated charges and agreed to pay a civil monetary penalty in an administrative proceeding before the SEC. The charges did not involve any assertion of intentional fraud. They did not involve any charges against individual officers and directors. And they did not involve the company's financials or the health of any line of the company's business, but rather only some unique events that had occurred during a takeover battle some four years earlier.

The settlement's only financial impact on the company was the civil penalty, which, at $7.5 million, amounted to *less than 0.27 percent* of Lions Gate's total assets at the time. The stock did not even drop (in fact, it *rose*) when, on February 6, 2014, little more than a month before the settlement was concluded, Lions Gate had announced that "[g]eneral and administrative expenses increased by $18.7 million," an amount that "included an accrual related to an anticipated settlement of a legal matter that goes back several years"—which turned out to be the SEC settlement that went through five weeks later.

Yet despite the economic insignificance of the settlement, plaintiffs insist on manufacturing a Rule 10b-5 securities-fraud class action out of the failure to disclose the SEC staff investigation that led up to the settlement. That claim fails as a matter of law.

No court has ever held that any statute or regulation imposes an affirmative duty to disclose a government investigation before the agency has even decided to institute proceedings. To the contrary: this Court has held that the SEC rules do *not* require disclosure of government investigations. This rule recognizes the obvious fact that agency staff conducting an investigation lack the authority to bring any charges. Staff investigations, by their very nature, are preliminary; they often result in no charges being brought at all. A rule that required premature disclosure of a staff investigation would essentially require a company to declare itself guilty of an alleged securities violation before the agency has even decided to bring charges. The enforcement staff that conducts the initial investigation has no power to bring or settle a case, and SEC Commissioners—the only ones who have that power—have publicly warned companies that it is misleading to disclose a potential settlement before the Commissioners have even had an opportunity to make a decision. Lions Gate promptly disclosed the legal proceedings when the Commission voted to institute proceedings. No disclosure was required before then.

Nor can plaintiffs create some backdoor disclosure duty by alleging that Lions Gate's earlier statements about pending litigation created a duty to describe an enforcement staff investigation that had not yet ripened into a proceeding. Plaintiffs try to create such an obligation by arguing that Lions Gate misled the market when it stated that there were no known legal proceedings currently pending that were likely to have a material adverse effect on the company's financials. But not only is a staff investigation not a "legal proceeding" under established law, but also there is no non-conclusory allegation that the charges under consideration were likely to have a material effect on the company's financials. The charges to which the company consented were for non-scienter reporting violations, not fraud—and not even negligence. The charges did not call into question the accuracy of any Lions Gate financials, or the health of any of the company's business streams, or any of the company's future revenues. The charges did not reveal any future risk or liability to the company. The charges had to do with the company's description of three lawful transactions completed almost four years before in unique circumstances long over and done with.

The only financial impact the settlement had on the company was the $7.5 million payment the company made to the SEC. But $7.5 million represented a fraction of a percent of Lions Gate's total assets at the time—again, 0.27 percent, to be precise. And plaintiffs cannot possibly allege that it was the size of the payment that made the SEC settlement material to investors, because as plaintiffs admit, and as described above, investors already knew about the payment before the settlement was even announced. When Lions Gate announced the final settlement the next month, it noted that the $7.5 million payment had already been recorded as part of the prior quarter's $18.7 million in expenses. So even if $7.5 million could be considered a material amount—and it is not, under settled law and SEC regulations—the amount was already reflected in the company's financials and was known to the market.

The complaint also fails to satisfy the PSLRA's burden of pleading particularized facts supporting a "strong inference" that Lions Gate or any individual defendant acted with scienter. The complaint does not even try to identify any motive that anyone at Lions Gate might have had for withholding material information. And the complaint also fails to allege any circumstantial evidence that could create a strong inference that anyone at Lions Gate failed to disclose the SEC investigation in the face of a "known and obvious duty" to disclose. To survive dismissal, the inference of scienter must be "cogent" and "at least as compelling as any opposing inference of nonfraudulent intent." Here, the much more cogent and compelling inference is that Lions Gate did not disclose the staff's investigation because the results of the investigation were uncertain until the Commission decided to act, because the nature of the charges and amount of the settlement payment were not likely to be material to a reasonable investor, and because no statute, rule, or judicial opinion had ever before imposed an affirmative duty to disclose an investigation that had not yet ripened into a legal proceeding. This failure to plead a strong inference of scienter requires dismissal.

The complaint regurgitates a lot of facts about the historical events that the SEC was investigating in an attempt to make their claim appear to be about more than it is. But those events have long been public and were in fact the subject of prior litigation that Lions Gate won. And while the complaint makes much of the fact that the SEC determined that some of Lions Gate's disclosures from 2010 omitted material information, those omissions are not the basis of plaintiffs' claims, and are utterly irrelevant here. Plaintiffs' claim poses two simple questions: before the Commission itself acted, did Lions Gate have a duty to disclose an SEC staff investigation that ultimately resulted in the company admitting to non-fraud reporting violations and paying

$7.5 million, and, if so, did the defendants intentionally, knowingly, or recklessly breach that duty. The answer to both questions is no.

BACKGROUND

A. The Icahn Takeover Battle and the July 20, 2010 Transactions

The complaint in this case should have been much, much shorter, because most of its detail is fundamentally irrelevant to plaintiffs' claims here. Plaintiffs' claims are about Lions Gate's nondisclosure, in 2013 and 2014, of an investigation by the staff of the SEC's Enforcement Division. That investigation, in turn, involved three disclosures made by Lions Gate in the summer and fall of 2010, when Lions Gate was battling the notorious corporate raider, Carl Icahn. But that 2010 battle for corporate control, and the legality of the disclosures made in 2010 during the course of that battle, are *not* in any way at issue here. Plaintiffs' claims do not involve what happened in 2010, but instead concern whether, years later, Lions Gate should have disclosed that the SEC was investigating what Lions Gate said back then. Nevertheless, because plaintiffs have chosen to lard their complaint with extensive detail about events in 2010, and in order to provide context for the investigation, we briefly describe those events here.

In 2008, Icahn announced that he had taken a stake in Lions Gate, the movie studio behind hit movie franchises like *The Hunger Games* and television shows like *Mad Men*. Compl. ¶ 26.[1] Icahn's announcement was the first step in a multiyear struggle for control of the company—a struggle that included multiple tender offers that the board viewed as an opportunistic attempt to gain control of the company for too low a price. *Id.* ¶¶ 26–34. The market ultimately proved the board right. For example, in February 2010, Icahn launched a tender offer at $6.00 per share; in March 2014, the company's shares were trading above $30.00. *Id.* ¶¶ 29, 108.

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[1] "Compl." refers to the Amended Complaint filed Dec. 29, 2014 and attached as Exhibit 1 to the Declaration of Adam S. Hobson in Support of Defendants' Motion to Dismiss.

On July 20, 2010, in the middle of this takeover battle with Icahn, three highly-publicized transactions in Lions Gate securities took place. *Id.* ¶ 39. In the first of the three transactions, Kornitzer Capital Management, a large Lions Gate bondholder, exchanged some convertible Lions Gate notes that it held for new notes issued by Lions Gate. *Id.* ¶ 48. The new notes contained terms that made it more attractive to convert the notes into Lions Gate common stock, which would result in removing almost $100 million in debt from the company's balance sheet. *Id.* ¶¶ 36-37, 48. In the second transaction, Kornitzer sold the new notes to MHR, an investment partnership controlled by Mark Rachesky, a Lions Gate director who was also the company's second largest shareholder. *Id.* ¶ 48. In the third transaction, MHR converted the new notes, which caused Lions Gate to issue over sixteen million new shares. *Id.* ¶ 49.

Lions Gate issued a press release describing the transactions as a "deleveraging transaction in which approximately $100 million of its senior subordinated notes were converted into common shares at an effective conversion price of $6.20 per share." *Id.* ¶ 50. The press release also disclosed that the transactions had resulted in the issuance of 16,236,305 new shares. *Id.* This issuance of new shares had the effect of diluting Icahn's relative stake in the company from 37.87 percent to 33.5 percent. *Id.* ¶ 49.

Icahn immediately filed suit in British Columbia, where Lions Gate is incorporated, alleging that the transactions were an "oppressive" and improper attempt to thwart his takeover. The resulting litigation received major press coverage and included public airing of all of the underlying details of the transactions, including the negotiating history. On November 1, 2010, after a multiday hearing on the merits, the Supreme Court of British Columbia rejected Icahn's claim and upheld the legitimacy of the transactions. *Icahn Partners LP* v. *Lions Gate Entm't Corp.*, 2010 BCSC 1547 (Can.), *available at* http://bit.ly/1Asl8Cl. The court held that "the evidence simply does not support" Icahn's contention that "the purpose of the transactions was to entrench the existing Board, and thus thwart the Icahn Group at its proxy battle." *Id.* ¶ 259. The court noted that the directors "relied on the opinions of two sets of independent financial analysts," *id.* ¶ 257, and that the transactions were "well received in the marketplace." *Id.* ¶ 99. The court concluded that "the overwhelming evidence before the court is that the [July 20] Transactions, considered alone, were of benefit to Lions Gate," as they reduced Lions Gate's debt "by approximately US$110 million." *Id.* ¶ 253.

On May 10, 2011, the British Columbia Court of Appeal affirmed the trial court's opinion. *See Icahn Partners LP* v. *Lions Gate Entm't Corp.*, 2011 BCCA 228 (Can.), *available at* http://bit.ly/1EgNpLd. The Court of Appeal agreed that the board's actions did not amount to "oppression," "unfair prejudice," or "unfair disregard" of a relevant interest. *Id.* ¶ 2. It held that if the directors had "bypassed the opportunity proposed by Mr. Kornitzer," then "[s]uch a course would have been *contrary to* the Company's best interest, reasonably assessed by the directors," and "[a]ll the other shareholders would have had reason in that event to bring a derivative action for breach of fiduciary duty." *Id.* ¶ 80. The court also held that where, as here, "directors have carried out reasonable enquiries to inform themselves as to where their company's best interests lie and are *bona fide* of the belief, based on reasonable grounds, that a proposed takeover will run contrary to those interests, they are entitled to use their powers to take defensive measures," and that there was no reason to interfere with the trial court's "findings regarding improper motive or 'self-dealing' on the part of Lions Gate's board, nor with [its] conclusion that the Transactions were carried out in the Company's best interests." *Id.* ¶ 76.

B. The SEC Investigation

The enforcement staff of the SEC ultimately wound up conducting an investigation into some of the public disclosures Lions Gate issued about the July 20 transactions. The investigation concerned three disclosures: the July 20, 2010 Form 8-K that announced the transactions; Item 6 of the Schedule 14D-9 filed on August 2, 2010; and a September 8, 2010 amendment to the Schedule 14D-9.

July 20, 2010 Form 8-K. On July 20, 2010, Lions Gate issued a press release announcing the transactions, which it attached as an exhibit to a Form 8-K filed the same day. The Form

8-K announced that the company "had completed a deleveraging transaction in which approximately $100 million of its senior subordinated notes were converted into common shares at an effective conversion price of $6.20 per share." Compl. ¶ 50. It also described the transactions as a "key part of the Company's previously announced plan to reduce its total debt, as well as its nearer term maturities." *Id.* But the press release and Form 8-K did not disclose that in addition to reducing the company's debt, Lions Gate's management also hoped and expected the July 20 transactions would effectively block Icahn's takeover, and that management viewed that as a desirable benefit. Compl. Ex. 1 ¶ 36. The press release and Form 8-K also did not disclose that it was MHR that purchased and converted the notes, *id.*, though MHR announced this fact the same day in its own press release. And the press release did not disclose the fact that Lions Gate changed its insider trading policy to allow MHR to purchase the notes and had lowered the conversion price for the new notes following discussions with Rachesky. *Id.* The SEC enforcement staff took the position that these additional details were material, and Lions Gate ultimately consented to this finding. *Id.*

Item 6 of Schedule 14D-9. On August 2, 2010, Lions Gate filed a Schedule 14D-9 recommending that shareholders not tender into Icahn's latest offer. *Id.* Ex. 1 ¶¶ 37-38. Item 6 of Schedule 14D-9 lists recent transactions in Lions Gate securities by its directors. Lions Gate did not, however, list the MHR conversion of notes (though the conversion was described elsewhere in the Schedule 14D-9). *Id.* The SEC enforcement staff took the position that this omission was material, and Lions Gate ultimately consented to this finding. *Id.*

September 8, 2010 Amendment to Schedule 14D-9. On September 8, 2010, Lions Gate filed an amendment to its Schedule 14D-9 that included additional information about the July 20 transactions. The amendment stated that the "[Note] Exchange was not part of a pre-arranged series of transactions to issue shares to MHR." *Id.* Ex. 1 ¶ 43. The disclosure did not include some details that would have shown the extent to which Lions Gate planned and enabled the note exchange and note sale, including the fact that the board amended its insider trading policy to allow MHR to immediately convert the notes, that the board approved Rachesky's request to change the conversion price, and that Lions Gate provided MHR a draft term sheet for the new notes before it provided it to Kornitzer. *Id.* The SEC enforcement staff took the position that these additional details were material, and Lions Gate ultimately consented to this finding. *Id.*

C. The SEC Settlement and Lions Gate's Disclosures About It

On March 13, 2014, Lions Gate entered into a settlement with the SEC that resolved the investigation into the disclosures Lions Gate had made in 2010. Compl. ¶ 72. The SEC's consent order stated that the omitted information in the three disclosures that the enforcement staff had identified was in fact material and should have been disclosed. The order did not find that these omissions were intentional, knowing, or reckless, and did not include any fraud-based charges under Section 10(b) of the Exchange Act or SEC Rule 10b-5; the only charges were reporting violations under Sections 13(a) and 14(d) of the Exchange Act and SEC Rules 12b-20, 13a-11, and 14d-9. *Id.* ¶ 73. The SEC also did not bring charges against any individuals at Lions Gate involved in the drafting or review of the disclosures. Lions Gate agreed to pay $7.5 million to the SEC and to admit that the information should have been disclosed. *Id.*

Lions Gate announced the settlement the day it happened, March 13, 2014. *Id.* ¶ 72. Lions Gate had not publicly commented on the investigation, one way or another, before this announcement. Nevertheless, although the details of the investigation and settlement had not been previously disclosed, Lions Gate's March 13, 2014 disclosure did note that the $7.5 million payment "was previously recorded as a charge to general and administrative expenses by the Company in the third quarter of 2014." *Id.* The disclosure of that previously recorded charge had come on February 6, 2014, in a Lions Gate Form 10-Q that had disclosed that "[g]eneral and administrative expenses increased by $18.7 million primarily due to increases in shared services and corporate expenses, share-based compensation." *Id.* ¶ 68. And on a February 7, 2014 earnings call with investors and analysts, Lions Gate told investors that these quarterly expenses "included an accrual related to an anticipated settlement of a legal matter that goes back several years"—an unspecific reference to the SEC matter. *Id.* ¶ 69.

The disclosure of the $18.7 million charge (which included the $7.5 million for the SEC settlement) had no discernible negative impact on Lions Gate's stock price. The stock closed at $30.68 on February 5, 2014. On February 6, the day Lions Gate disclosed the increase in general and administrative expenses, the stock went up, closing at $31.73; on February 7, the day Lions Gate referred to the "anticipated settlement of a legal matter that goes back several years," the stock went up again, to $33.11. Nor was there a significant impact on the stock price when the SEC settlement was disclosed. On March 12, 2014, the day before Lions Gate announced the SEC settlement, Lions Gate's stock price closed at $33.26 per share. *Id.* ¶ 108. On March 13, 2014, Lions Gate's stock closed at $32.20 per share, *id.*—a drop of only three percent, well within the normal ups and downs of the stock.

Nevertheless, in a transparent effort to maximize their supposed damages—and despite their reliance on the fraud-on-the-market presumption of reliance, and their allegations that the stock of Lions Gate "was actively traded on the NYSE, an informationally efficient market, throughout the Class Period," and "reacted promptly to public information disseminated" by the company, *id.* ¶ 115(a), (e)[2]—plaintiffs seek to recover damages for the much larger drop in Lions Gate's stock to $30.33 on March 17, 2014, *id.* ¶ 111, some *four days* after the SEC settlement was announced. On the merits, as shown below, plaintiffs similarly overreach.

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[2] Certainly plaintiffs cannot contest that "well developed markets are efficient processors of public information," and that, "in an efficient market, a misrepresentation's impact on market price is quickly nullified once the truth comes to light." *Amgen Inc.* v. *Conn. Ret. Plans and Trust Funds*, 133 S. Ct. 1184, 1192, 1198 (2013). By definition, "[a]n efficient market is one which rapidly reflects new information in price." *Cammer* v. *Bloom*, 711 F. Supp. 1264, 1276 n.17 (D.N.J. 1989), *quoted in In re Initial Pub. Offering Secs. Litig.*, 544 F. Supp. 2d 277, 295 n.123 (S.D.N.Y. 2008).

ARGUMENT

To state a claim for securities fraud under Section 10(b) and Rule 10b, a complaint "must allege that each defendant (1) made misstatements or omissions of material fact, (2) with scienter, (3) in connection with the purchase or sale of securities, (4) upon which the plaintiff relied, and (5) that the plaintiff's reliance was the proximate cause of its injury." *Stratte-McClure* v. *Morgan Stanley*, No. 13-627-cv, 2015 WL 136312, at *5 (2d Cir. Jan. 12, 2015).

In pleading these elements, the complaint must not only "contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face,'" *Ashcroft* v. *Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Bell Atlantic Corp.* v. *Twombly*, 550 U.S. 544, 570 (2007)), but it must also meet the heightened pleading standard imposed by the Private Securities Litigation Reform Act of 1995. And the PSLRA's heightened standard requires the plaintiff to "specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed." 15 U.S.C. § 78u-4(b)(1). It also requires plaintiffs must also "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind," 15 U.S.C. § 78u-4(b)(2)—particularized facts that raise an inference of scienter as "cogent and at least as compelling as any opposing inference of nonfraudulent intent," *Tellabs, Inc.* v. *Makor Issues & Rights, Ltd.*, 551 U.S. 308, 314 (2007).

The amended complaint fails to meet these standards.

POINT I

THE AMENDED COMPLAINT DOES NOT PLEAD ANY ACTIONABLE MATERIAL MISSTATEMENT OR OMISSION.

"The Supreme Court has instructed that '[s]ilence, absent a duty to disclose, is not misleading under Rule 10b-5.'" *Stratte-McClure*, 2015 WL 136312, at *5 (quoting *Basic Inc.* v. *Levinson*, 485 U.S. 224, 239 n.17 (1988)). As a result, "'[e]ven if information is material, there is no liability under Rule 10b-5 unless there is a duty to disclose it.'" *Glazer* v. *Formica Corp.*, 964 F.2d 149, 156 (2d Cir. 1992) (quoting *Backman* v. *Polaroid Corp.*, 910 F.2d 10, 12 (1st Cir. 1990) (en banc)). Indeed, the Second Circuit and other courts have consistently "rejected the proposition that 'a corporation has an affirmative duty to disclose'" allegedly material information when "'there is no insider trading, no statute or regulation requiring disclosure, and no inaccurate, incomplete, or misleading prior disclosures.'" *Id.* at 157 (quoting *Backman*, 910 F.2d at 12).

As a result, to succeed on their claims here, where no insider trading is alleged, the plaintiffs must identify (1) a "statute or regulation requiring disclosure,'" or (2) a "'corporate statement that would otherwise be 'inaccurate, incomplete, or misleading'" absent disclosure of the omitted fact. *Stratte-McClure*, 2015 WL 136312, at *5 (quoting *Glazer*, 964 F.2d at 157). The amended complaint fails to identify either a statute or regulation that required Lions Gate to disclose the SEC enforcement staff's investigation, or a statement that was rendered misleading by the failure to disclose that investigation. As a result, the plaintiffs have failed to plead any actionable misstatement or omission.

A. Lions Gate had no affirmative duty to disclose the investigation.

The law is clear that there is no affirmative duty to disclose an SEC investigation. Indeed, as a recent decision from this Court in a similar case holds, that rule applies even when the enforcement staff of the SEC has decided to recommend that the Commission bring charges. As that decision explained, "[t]he SEC provides a target of an investigation with a Wells Notice 'whenever the Enforcement Division staff decides, even preliminarily, to recommend charges.'" *Richman* v. *Goldman Sachs Grp., Inc.*, 868 F. Supp. 2d 261, 272 (S.D.N.Y. 2012) (citation omitted). Yet this Court held that a Wells Notice does *not* trigger a duty to disclose; indeed, it observed that "***no*** *court has ever held that a company's failure to disclose receipt of a Wells Notice constitutes an actionable omission under § 10(b) or Rule 10b-5*." *Id.* at 272 (emphasis added); *see also In re Morgan Stanley Deriv. Litig.*, 542 F. Supp. 2d 317, 325 (S.D.N.Y. 2008) (no duty to disclose Wells Notice under proxy rules).

The principle is hardly confined to SEC investigations. To the contrary, courts have repeatedly held that the existence of a government investigation—even criminal investigations—does not create a disclosure obligation. *See, e.g.*, *City of Westland Police and Fire Ret. Sys.* v. *MetLife, Inc.*, 928 F. Supp. 2d 705, 718 (S.D.N.Y. 2013) (no duty to disclose pending state attorneys general investigations into violations of state law); *City of Austin Police Ret. Sys.* v. *ITT Educ. Servs., Inc.*, 388 F. Supp. 2d 932, 945-46 (S.D. Ind. 2005) (no duty to disclose pending state attorney general criminal investigation into violations of state law).

Plaintiffs nonetheless allege that an affirmative duty to disclose the staff's investigation into Lions Gate's disclosures was created by three separate regulations: Items 103, 303, and 503(c) of SEC Regulation S-K. *See* Compl. ¶¶ 86-95. None creates the duty that plaintiffs require to save their case.

Item 103 of Regulation S-K. Item 103 is the only item that expressly concerns disclosure of "material legal proceedings" in an issuer's periodic filings. It requires an issuer to "[d]escribe briefly any material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which the registrant or any of its subsidiaries is a party or of which any of their property is the subject" and to "[i]nclude similar information as to any such proceedings known to be contemplated by governmental authorities." 17 C.F.R. § 229.103.

That regulation does not help plaintiffs. There was no "pending legal proceeding" here until the SEC commenced one on March 13, 2014—the very day that Lions Gate disclosed it. The complaint concedes the point: it admits that "the SEC did not institute an administrative proceeding until it settled the charges," and that the SEC staff "conducted only informal discovery during the Class Period." Compl. ¶ 79. And this Court has ruled on the point: in *Richman*, it observed that "[a] Wells Notice may be considered an indication that the staff of a government agency is considering making a recommendation, but that is well short of litigation." 868 F. Supp. 2d at 272. But the Court concluded that "[t]here is nothing in Regulation S-K, Item 103 which mandates disclosure of Wells Notices. Item 103 does not explicitly require disclosure of a Wells Notice, and no court has ever held that this regulation creates an implicit duty to disclose receipt of a Wells Notice." *Id.* at 274.

The rule makes sense. More often than not, government investigations end with no charges ever being brought—and even where charges are brought, the scope of the final charges can be much narrower than the scope of the initial investigation. In an SEC investigation, a target receives a Wells Notice "whenever the Enforcement Division staff decides, even preliminarily, to recommend charges," *id.* at 272; but notice that the staff has decided to recommend charges does not mean that the *Commission* will, or is even likely, to actually bring charges. The target of an investigation "is then entitled, under SEC rules, to make a 'Wells submission,'" *id.*, in which the target sets forth reasons why the staff should not recommend charges, and why the Commission should not accept the recommendation if one is made. The whole Wells process is "obviously based on recognition that staff advice is not authoritative," *id.* (citations omitted)—that even if the staff recommends a particular course of action, the five SEC Commissioners are not bound to follow that recommendation. As a result, until the question of whether to bring a particular set of charges (or to accept a particular proposed settlement) is actually presented by the staff to the Commissioners for a vote and the vote is held, there is no "material pending legal proceeding[]" or "material … legal … proceeding[] known to be contemplated by government authorities" required to be disclosed under Item 103.

In fact, Commissioners of the SEC have expressed "frustration" at companies that disclose a settlement "in principle" with the SEC when their only settlement discussions have been with the staff. Paul S. Atkins, Commissioner, SEC, *Remarks before the U.S. Chamber Institute for Legal Reform* (Feb. 16, 2006), *available at* http://1.usa.gov/1CfrViX. As then-Commissioner Paul Atkins explained in a 2006 speech:

> In the settlement process, the settling party deals directly with our enforcement staff, but the staff does not have the authority to bind the Commission to the terms of a settlement. … *At this stage nothing is final, and because of that lack of finality I find it hard to believe that the agreement by the staff to recommend settlement to the Commission is, by it-*

> *self, necessarily an event that must be reported to shareholders.* Although we Commissioners have deep respect for the work of enforcement staff, I can assure you that the next step in the process is not a rubber stamp approval by the Commission.

Id. (emphasis added). Only the Commission can institute legal proceedings, and no matter how strongly the staff feels that charges should be brought, a company cannot know whether the Commission will agree until the staff has brought its recommendation to the Commission, and the Commission has acted.

Any other approach to disclosure of investigations, indeed, would harm the very people that disclosure was meant to protect—shareholders. Premature disclosure of the investigation could create a cloud over the company and suggest wrongdoing where none exists. Courts have long held that the securities laws do not "impose a duty to disclose uncharged, unadjudicated wrongdoing," *Ciresi* v. *Citicorp*, 782 F. Supp. 819, 823 (S.D.N.Y. 1991), and "do not require a company to accuse itself of wrongdoing," *In re Citigroup, Inc. Sec. Litig.*, 330 F. Supp. 2d 367, 377 (S.D.N.Y. 2004). Disclosure of an investigation could imply that the underlying charges had merit, even before the results of the investigation are in. Public disclosure of a confidential investigation could jeopardize the company's ability to mount a defense, moreover, if public pressure pushes the government to bring charges lest it be perceived as backing down. Public disclosure could also impair the government's ability to conduct a confidential investigation. The confidentiality of government investigations serves important purposes for both the targets and the investigators, and the value of confidentiality would be undone if the securities laws required automatic disclosure of every public company investigation.

Accordingly, Item 103 imposes no duty on Lions Gate to disclose the SEC staff's investigation. But even apart from the question of whether investigations must be disclosed at all under Item 103, there is another reason why Item 103 could not have imposed any disclosure obligation on Lions Gate here. For Item 103 not only limits itself to disclosure of "*material*" legal proceedings, it also provides that "[n]o information need be given with respect to any proceeding that involves primarily a claim for damages if the amount involved, exclusive of interest and costs, *does not exceed 10 percent of the current assets of the registrant and its subsidiaries on a consolidated basis*." 17 C.F.R. § 229.103 (emphasis added).

That language strikes yet another fatal blow to plaintiffs' reliance on Item 103 here. Lions Gate's total current assets for the period ending March 31, 2014 was over $2.8 billion, making the $7.5 million payment to the SEC approximately 0.27 percent of total current assets—far below the 10 percent threshold. *See* Ex. 2 (Lions Gate Form 10-K dated March 31, 2014) at F-3. Thus, even if the investigation did somehow constitute a proceeding under Item 103, it did not meet the monetary threshold that would require disclosure. Not even close.

Item 303 of Regulation S-K. Plaintiffs also invoke Item 303, which requires disclosure of a "material event[] and uncertaint[y] known to management that would cause reported financial information not to be necessarily indicative of future operating results or of future financial condition," would "have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations," and would cause "significant economic changes that [were] materially affect[ing] the amount of reported income from continuing operations." Compl. ¶ 90 (quoting Item 303).

But the SEC investigation and settlement do not fit this bill. Item 303 imposes a disclosure duty only "where a trend, demand, commitment, event or uncertainty is both [1] presently known to management and [2] reasonably likely to have material effects on the registrant's financial condition or results of operations." *In re Bank of America AIG Disclosure Sec. Litig.*, 980 F. Supp. 2d 564, 584 (S.D.N.Y. 2013) (quoting *Panther Partners Inc.* v. *Ikanos Commc'ns, Inc.*, 681 F.3d 114, 120 (2d Cir. 2012)). As shown above, the SEC settlement could not have been "presently known to management" before the proposed settlement had gone beyond the enforcement staff and was under consideration by the Commission, and even then there was a substantial chance the Commission would not agree with the staff's recommendation.

But even more importantly—the SEC settlement did not even come close to being "economic[ally]" "significant" or otherwise material to Lions Gate. There is no non-conclusory allegation, and no plausible basis to allege, that the settlement would have "material effects on the registrant's financial condition or results of operations." The settlement identified no underlying issue with any Lions Gate line of business, had no effect on Lions Gate's future income streams, and revealed no error in Lions Gate's reported financials or results of operations. The only effect plaintiffs have pointed to is that Lions Gate incurred a one-time $7.5 million charge—a charge that it had already disclosed in February, with no market reaction, and that represented less than 0.27 percent of the company's total current assets. Thus, even if Item 303's general disclosure requirements could impose a duty to disclose a litigation contingency even where the item that expressly addresses legal proceedings—Item 103—does not, *see In re Bank of America AIG*, 980 F. Supp. 2d at 585 n.7 (holding it "unnecessary to reach" the argument that Item 303 cannot require disclosure of legal proceeding where Item 103 does not otherwise require disclosure), the $7.5 million SEC settlement would not satisfy Item 303's materiality test. Again, not even close.

Item 503(c) of Regulation S-K. Finally, plaintiffs allege that Lions Gate had a duty to disclose the SEC investigation under Item 503(c), which requires "a discussion of the most significant factors that make the [securities] speculative or risky." Compl. ¶ 91. Item 503(c) explains that these "risk factors" could include factors such as a company's "lack of an operating history," "lack of profitable operations," its "financial position," its "business or proposed business," and "the lack of a market for" its securities. 17 C.F.R. § 229.503(c). The staff's investigation did not fall into any of these categories. There is no allegation—nor could there plausibly be—that the investigation put the company's profitability at risk or made the company's stock "risky" or "speculative." The subject of the investigation did not involve Lions Gate's ongoing operations; it involved a unique set of disclosures about transactions that happened four years ago and pose no further legal exposure. The complaint includes no explanation for how the SEC investigation represented one of the "most significant" risks to Lions Gate's business.

B. Nondisclosure of the investigation did not make any Lions Gate disclosures false or misleading.

Because nothing in the SEC's regulations created an affirmative duty to disclose the SEC investigation, the plaintiffs can establish "'a duty to disclose only when silence would make other statements misleading or false.'" *Glazer*, 964 F.2d at 157 (quoting *Taylor* v. *First Union Corp*., 857 F.2d 240, 243-44 (4th Cir. 1988)). They must thus identify a "corporate statement" made by Lions Gate that was rendered materially "'inaccurate, incomplete, or misleading'" by the omission of the SEC investigation. *Stratte-McClure*, 2015 WL 136312, at *5 (quoting *Glazer*, 964 F.2d at 157). And because of the PSLRA, they must do so specifically: they must state "with particularity" the "reason or reasons why the statement[s] [are] misleading." 15 U.S.C. § 78u-4(b)(1). The complaint fails to identify any statement rendered materially misleading by the failure to disclose the SEC investigation, and, as a result, there was no duty to disclose it.

Plaintiffs point to the same statement—repeated in five of the company's Form 10-Qs from February 11, 2013 through February 6, 2014—describing the currently pending legal proceedings to which Lions Gate was a party:

> From time to time, the Company is involved in certain claims and legal proceedings arising in the normal course of business. While the resolution of these matters cannot be predicted with certainty, *the Company does not believe, based on current knowledge, that the outcome of any* ***currently pending claims or legal proceedings*** *in which the Company is currently involved will have a* ***material adverse effect*** *on the Company's financial statements.*
>
> …
>
> From time to time, the Company is involved in certain claims and legal proceedings arising in the normal course of business. While the resolution of these matters cannot be predicted with certainty, *we do not believe, based on current knowledge, that the outcome of any currently pending legal proceedings in which the Company is currently involved will have a material adverse effect on the Company's consolidated financial position, results of operations or cash flow.*

Compl. ¶ 59 (emphasis added by plaintiffs); *see also id.* ¶¶ 61, 63, 65, 67.

Plaintiffs do not and cannot allege that these statements were false. There is no allegation that Lions Gate was, in fact, subject to any "currently pending claims or legal proceedings," material or not. The complaint recognizes this and alleges only that it was "reasonably possible" at the time Lions Gate issued the statements that the company could be charged by the SEC in the future. *Id.* ¶¶ 59, 60(b). As discussed above, there were no pending claims or proceedings until the Commission voted to institute proceedings on March 13, 2014, well after these disclosures were issued. There is no "duty to disclose uncharged, unadjudicated wrongdoing," *Ciresi*, 782 F. Supp. at 823, and Lions Gate did not create such a duty by disclosing the accurate fact that there were no currently pending claims or legal proceedings. The fact that, before March 13, 2014, there was *no* "currently pending [SEC] proceeding" entirely disposes of plaintiff's contention here—period.

But even if, somehow, a yet-to-be-brought SEC proceeding could constitute a "currently pending proceeding," the result would still be the same. Lions Gate's disclosure confined itself to "currently pending claims or legal proceedings [that] will have a *material adverse effect* on the Company's financial statements," Compl. ¶ 59 (emphasis added), and materiality is an element of plaintiffs' claim anyway. There is simply no way that the SEC investigation could have been expected to have a "material adverse effect" on Lions Gate's financial statements, consolidated financial position, results of operations, or cash flow. The settlement resulted in a one-time payment of a mere $7.5 million—less than 0.27 percent of Lions Gate's consolidated assets, far below what any court has held to be material. *See, e.g.*, *ECA, Local 134 IBEW Joint Pension Trust* v. *JP Morgan Chase Co.*, 553 F.3d 187, 204 (2d Cir. 2009) (citing SEC guidance that a "five percent numerical threshold is a good starting place for assessing the materiality of the alleged misstatement" and that "an alleged misrepresentation relating to less than two percent of defendant's assets, when taken in context, could be immaterial as a matter of law").

Even apart from that, an alleged omission is material only if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Basic Inc.* v. *Levinson*, 485 U.S. 224, 231-32 (1988). The complaint includes no well-pled allegation as to how the total mix of information about Lions Gate's pending litigation would have been "significantly altered" by disclosing the staff's investigation into uncharged, non-fraud-based disclosure errors that posed no threat to any of the company's lines of business and that, when ultimately charged, resulted in a financial loss of only 0.27 percent of the company's total assets.

Finally, the only other statement alleged to be misleading is Lions Gate's February 6, 2014 disclosure in a 10-Q that the company's "[g]eneral and administrative expenses increased by $18.7 million primarily due to increases in shared services and corporate expenses, share-based compensation," which was followed by an oral statement on a conference call the next day that those expenses "included an accrual related to an anticipated settlement of a legal matter that goes back several years." Compl. ¶¶ 68-69. All that was true, and plaintiffs do not—cannot—say how it wasn't. Thus, plaintiffs fail to explain why this statement was materially misleading, let alone how the "total mix" of information about the accrual would have been "significantly altered" by disclosing that the legal matter in question was an SEC investigation. Having disclosed that the company's general and administrative expenses had increased by $18.7 million, and that part of that increase included an accrual related to the anticipated settlement, Lions Gate had already provided investors all the information needed to understand the minimal financial impact the potential settlement would have on the company.

POINT II

THE AMENDED COMPLAINT DOES NOT ADEQUATELY PLEAD SCIENTER.

Even if the complaint had pled an actionable, material omission, it fails to meet the PSLRA's heightened requirement that plaintiffs plead "with particularity" facts showing a "strong inference" that defendants omitted the information with the "intent to deceive, manipulate, or defraud, or at least knowing misconduct." *In re Bank of America AIG*, 980 F. Supp. 2d at 585 (quoting *SEC* v. *First Jersey Sec., Inc.*, 101 F.3d 1450, 1467 (2d Cir. 1996)). The inference of scienter "must be . . . cogent and at least as compelling as any opposing inference one could draw from the facts alleged." *Stratte-McClure*, 2015 WL 136312, at *10 (quoting *Tellabs*, 551 U.S. at 324). Scienter may be shown by "alleging facts (1) showing that the defendants had both motive and opportunity to commit the fraud or (2) constituting strong circumstantial evidence of conscious misbehavior or recklessness," which is "a state of mind approximating actual intent, and not merely a heightened form of negligence." *Id.* And here, where "the plaintiffs allege fraudulent omissions, rather than false statements, 'it is especially important to rigorously apply the standard for pleading intent.'" *In re Bank of America AIG*, 980 F. Supp. 2d at 586 (quoting *In re GeoPharma, Inc. Sec. Litig.*, 411 F. Supp. 2d 434, 437 (S.D.N.Y. 2006)).

A. The complaint does not allege any motive to commit fraud.

To plead scienter by showing "motive and opportunity to commit fraud," the complaint must allege that Lions Gate or its officers "'benefitted in some concrete and personal way from the purported fraud.'" *ECA Local 134*, 553 F.3d at 198 (quoting *Novak* v. *Kasaks*, 216 F.3d 300, 307–08 (2d Cir. 2000)). It is not enough to allege "[m]otives that are common to most corporate officers, such as the desire for the corporation to appear profitable and the desire to keep stock prices high to increase officer compensation." *Id.* Here, the complaint does not even purport to identify any motive for not disclosing the staff's investigation. There is no allegation, for example, that any officer made "a misrepresentation in order to sell their own shares at a profit"—in other words, engaged in insider trading—which is how motive is generally shown. *Id.* Nor is there any other factual allegation to explain what concrete benefit any of the defendants had to gain by not disclosing the investigation.

B. The complaint does not allege conscious misbehavior or recklessness.

This failure to allege motive is strike one: under the settled law of this Circuit, the burden imposed upon plaintiffs by the PSLRA becomes even greater. With no alleged motive, plaintiffs may still try to establish scienter by pleading "facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness"—but "*the strength of the circumstantial al-*

legations must be correspondingly greater if there is no motive." *Richman*, 868 F. Supp. 2d at 275-76 (emphasis added); *see also ECA Local 134*, 553 F.3d at 198. Plaintiffs utterly fail to satisfy this "correspondingly greater" burden, and, indeed, offer no plausible basis to establish "conscious misbehavior or recklessness" at all.

Plaintiffs argue that someone at the company should have known about the staff's investigation and known that the investigation had not been disclosed. Compl. ¶¶ 75-84. But that cannot suffice. There are countless things that large companies do not disclose about their business at any given time, but the failure to disclose them does not necessarily establish scienter. There are many perfectly good and lawful reasons not to disclose facts—there may be no obligation to disclose them, the facts may be immaterial, the facts may not be known with sufficient certainty, the facts might give competitors an edge. Indeed, as to immateriality, the Supreme Court has cautioned that the federal securities laws should not be interpreted to encourage companies "to bury the shareholders in an avalanche of trivial information—a result that is hardly conducive to informed decisionmaking." *TSC Indus., Inc.* v. *Northway, Inc.*, 426 U.S. 438, 448-49 (1976). As a result, pointing to "the fact of non-disclosure itself" is "the type of 'broad and conclusory' allegation that is considered 'meaningless.'" *In re Canandaigua Sec. Litig.*, 944 F. Supp. 1202, 1213 (S.D.N.Y. 1996) (quoting *Shields* v. *Citytrust Bancorp, Inc.*, 25 F.3d 1124, 1129 (2d Cir. 1994)). "It is not enough for plaintiffs to allege that defendants knew that the disclosures did not reveal the [underlying information] or that the omitted information was material, for that alone does not suggest 'conscious misbehavior or recklessness.'" *Id.*

Instead, to allege that an omission was the result of conscious misbehavior or recklessness, the complaint must "sufficiently allege that the defendants acted with reckless disregard for a *known or obvious duty*." *In re Bank of America AIG*, 980 F. Supp. 2d at 586 (emphasis added). "The requirement that the duty be 'obvious' ensures that fraudulent intent will not be imputed to a company every time a public statement lacks detail." *Richman*, 868 F. Supp. 2d at 276. And this Court has already held that the "Regulation S-K, Item 103 and FINRA and NASD Rules do not create an obvious duty to disclose" an SEC investigation, even where the staff has sent a Wells Notice. *Id.* No court has ever held there to be such a duty. *Id.* SEC Commissioners have publicly stated that they do not believe the rules impose such a duty—and have in fact expressed frustration when companies prematurely disclose details about staff investigations. All of this means that even if the Court were to find that Lions Gate should have disclosed the investigation sooner, the duty to disclose "was not so clear" and "recklessness cannot be inferred from the failure to disclose." *Kalnit* v. *Eichler*, 264 F.3d 131, 143 (2d Cir. 2001).

Accordingly, plaintiffs' conclusory allegation that the defendants intentionally omitted information about the investigation in the face of a known and obvious duty to disclose is not "at least as compelling as any opposing inference one could draw from the facts alleged." *Tellabs*, 551 U.S. at 324. Instead, the "much more compelling conclusion is that the defendants did not think that there was any need for public disclosure" given "the lack of any definitive regulatory requirement requiring the disclosure of a possible" SEC proceeding and settlement. *In re Bank of America AIG*, 980 F. Supp. 2d at 587. "[T]he most likely inference from the facts alleged is that defendants did not make [the] disclosure[] . . . because they believed that they were under no obligation to do so." *In re Hardinge, Inc. Sec. Litig.*, 696 F. Supp. 2d 309, 332 (W.D.N.Y. 2010). Here, where the outcome of the investigation was uncertain until the Commission voted to institute proceedings, where no charges were brought against individual officers or directors, where the only charges that were brought were non-fraud reporting violations that did not relate to Lions Gate's underlying business, where the settlement payment being discussed was less than 0.27 percent of the company's net assets, and where no statute or rule clearly required disclosure, the more compelling inference is that Lions Gate did not believe the information was material.

Finally, the complaint fails to allege particular facts "supporting a strong inference of scienter with respect to any individual defendant," and "fail[s] to show that any individual whose intent can be imputed to [Lions Gate] acted with scienter." *In re Bank of America AIG*, 980 F. Supp. 2d at 588. The complaint alleges only that the "fraudulent scheme described herein could not have been perpetrated during the Class Period without the knowledge and complicity or, at least, the reckless disregard of the personnel at the highest levels of the Company, including the Individual Defendants." Compl. ¶ 76. This conclusory allegation falls far short of "pleading with specificity that the defendants had 'knowledge of facts or access to information contradicting their public statements.'" *In re Bank of America AIG*, 980 F. Supp. 2d at 585 (quoting *Novak*, 216 F.3d at 308). There is no specific allegation that any of the individual defendants—none of whom is alleged to have responsibility for overseeing the company's legal affairs—had knowledge of the status of the SEC investigation or its likely outcome, or had knowledge of any statute or rule that would require disclosure of the investigation.

POINT III

THE AMENDED COMPLAINT FAILS TO STATE A SECTION 20(a) CLAIM AGAINST ANY OF THE INDIVIDUAL DEFENDANTS.

The Section 20(a) claims for control person liability against the individual defendants also fail. A claim for control person liability must allege "(1) a primary violation by the controlled person, (2) control of the primary violator by the defendant, and (3) that the defendant was, in some meaningful sense, a culpable participant in the controlled person's fraud." *ATSI Commc'ns, Inc.* v. *Shaar Fund, Ltd.*, 493 F.3d 87, 108 (2d Cir. 2007). The complaint fails to show a primary violation by Lions Gate for the reasons discussed in Points I and II. The complaint also fails to allege that any individual defendant was a "culpable participant" in the alleged fraud. Culpable participation requires scienter, pled with particularity. *See, e.g.*, *Cohen* v. *Stevanovich*, 722 F. Supp. 2d 416, 435 (S.D.N.Y. 2010). As discussed in Point II, the complaint fails to plead facts creating a "strong inference" that anyone at Lions Gate acted with intent, knowledge, or recklessness.

CONCLUSION

It is respectfully submitted that the amended complaint should be dismissed with prejudice.

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