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Second Circuit Sets Materiality Standard in Securities Cases Concerning IPOs in *Stadnick v. Vivint Solar, Inc. et al.*

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On June 21, 2017, the Second Circuit affirmed the dismissal of a securities class action against Vivint Solar arising from the company's 2014 initial public offering. Of significance, the Second Circuit declined to adopt the First Circuit's "extreme departure" standard to determine when an IPO company must disclose interim financial information in its registration statement in order to make the disclosures not otherwise misleading. The investor plaintiff had argued that, under the First Circuit standard, Vivint should have released its third quarter results at the time of its IPO because those results were allegedly an "extreme departure" from the company's performance reflected in the registration statement. The district court rejected the plaintiff's argument. While affirming the dismissal, the Second Circuit rejected the "extreme departure" test, holding instead that the appropriate standard is whether a reasonable investor would consider the omitted information as having significantly altered the total mix of information available.

The Second Circuit faulted the First Circuit test for concentrating solely on whether the omitted information represented an "extreme departure" from prior reported results, noting the importance of examining context. In Vivint's case, the allegedly omitted negative information concerned only two financial metrics (net income and earnings-per-share). The Second Circuit noted that even if these metrics were an extreme departure from prior results, they "are not fair indicators of Vivint's performance." 2017 WL 2661597, at *5, – F.3d – (2d Cir. June 21, 2017). The Second Circuit noted that a fluctuation in these two metrics could be "attributable to the normal operation of the company's business model, in which the allocation of income . . . is subject to the vagaries of the timing of transactions between Vivint and [investment] funds." *Id.* According to the Second Circuit, these facts illuminated why "[t]he 'extreme departure' test makes little sense in this context and confuses the analysis." *Id.* On the other hand, the Second Circuit standard "examines omissions in the context of the total mix of available investor information," giving context to the alleged omission and whether it rises to the level of materiality. In addition to clarifying when an IPO company should consider updating its registration statement with interim financial results, the Second Circuit offered a sharp critique of the alternative standard promulgated by the First Circuit, labeling it "analytically counterproductive" and "unsound[]." *Id.*

Although it is unclear whether the divergent standards in the First and Second Circuits will actually yield different determinations on liability, this

case raises the possibility that the Supreme Court may be called upon to resolve this emergent circuit court split. In the interim, we recommend that companies preparing for an IPO continue to monitor this developing area of law and carefully assess

whether interim financial results could warrant the revision of registration statements under the First and Second Circuit tests.

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