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First Circuit Affirms Dismissal Of Putative Securities Class Action Against Bank For Alleged Failure To Disclose Deteriorating Bond Market Conditions.

On May 20, 2022, the United States Court of Appeals for the First Circuit affirmed the district court's dismissal of claims under Section 10(b) of the Securities Exchange Act (the "Exchange Act") and Rule 10b-5 thereunder against a bank and its affiliates (the "Bank"). *Ponsa-Rabell v. Santander Sec. LLC, et al.*, No. 20-01857 (1st Cir. May 20, 2022). Plaintiffs alleged the Bank devised a scheme to defraud investors into purchasing Puerto Rican government bonds by omitting material information about the state of the market and about its own alleged program to rid itself of those securities. The appeal did not pertain to the district court's dismissal of claims under Section 17(a) of the 1933 Securities Act or Plaintiffs' claims brought under Puerto Rican law for which the district court declined to exercise supplemental jurisdiction after dismissing plaintiffs' securities claims.

According to the Complaint, the Bank acted as broker to plaintiffs who allegedly purchased Puerto Rico Municipal Bonds, Puerto Rico Closed End Funds, and Puerto Rico Open End Funds (collectively the "PRMB securities") from December 1, 2012 to October 31, 2013 (the "Putative Class Period"). Plaintiffs alleged that the PRMB securities were marketed to the public via fund-specific prospectuses that disclosed the fund's investment objectives, risk factors, and tax consequences, along with investment risks associated with each particular fund. According to the Complaint, the PRMB securities were "attractive investments" that offered relatively high interest and were exempt from Puerto Rican and Federal income and estate taxes. Shortly before the Putative Class Period, however, the Complaint alleges that Puerto Rico began experiencing an economic recession, which made investments in the PRMB securities particularly risky. Plaintiffs alleged that during the recession, Puerto Rico issued billions of dollars in PRMB securities and used the proceeds to pay off existing debts rather than to stimulate the Puerto Rican economy. Puerto Rico's deficit allegedly increased to approximately $2.2 billion and became unpayable.

According to the Complaint, in 2012, various public sources began warning about the increased risks of holding PRMB securities, including a March 2012 published report that warned that Puerto Rico was "flirting with insolvency", and an August 2012 report from Moody's Investor Service ("Moody's") lowering Puerto Rico's bond credit rating to Baa1 and advising that "[c]onservative investors . . . should pursue portfolio diversification." Plaintiffs' alleged that on December 13, 2012, Moody's again downgraded Puerto Rico's credit rating to Baa3, "just above junk bond status." The Complaint alleges that the bond market "crashed" in the fall of 2013, resulting in financial losses for all those who invested in PRMB securities. Plaintiffs alleged that leading up to this crash, the Bank actively tried to rid itself of its PRMB securities inventory "at an accelerated pace," which, according to plaintiffs, motivated the Bank to sell the securities to plaintiffs. Plaintiffs filed their initial complaint against the Bank four years after the crash, alleging that they never would have purchased the PRMB securities if the Bank had disclosed the risk of the crash. The district court dismissed the federal securities claims with prejudice and the state law claims without prejudice, and plaintiffs appealed the dismissal of the Section 10(b) claims—specifically, whether plaintiffs sufficiently pled (i) a material misrepresentation or omission, and (ii) scienter.

The First Circuit first considered the misstatement or omission element of plaintiffs' Section 10(b) claim. Plaintiffs alleged that two disclosures in the fund prospectus were "fatally defective" because of information the Bank omitted. In the disclosures, the Bank allegedly disclosed that "there is no Assurance that a Secondary Market for the Offered Bonds will Develop," and that "the Underwriters are not obligated to do so [meaning to guarantee a secondary market] and any such market making may be discontinued at any time at the sole discretion of the Underwriters." Plaintiffs contended that these disclosures did not include material facts which were necessary to make them not misleading; namely, that market conditions were deteriorating in Puerto Rico and that the Bank was selling off its own inventory of PRMB securities for that very reason. Plaintiffs further alleged that even if the omitted information was public, it did not relieve the Bank of its duty to disclose the information at the time plaintiffs allegedly purchased the PRMB securities, or of its ongoing obligation to update its prospectuses.

In affirming the district court's decision, the Court rejected plaintiffs' argument that the Bank should have disclosed information regarding the deteriorating market conditions, holding that the Bank "was simply not under any duty to repeat information already known or readily accessible to investors." In so holding, the Court maintained that "it is not a material omission to fail to point out information of which the market is already aware" and added that "plaintiffs' own complaint points to public statements about the deteriorating economy in Puerto Rico."

Turning to plaintiffs' allegation that the Bank should have disclosed that it was divesting itself of the PRMB securities, the Court similarly affirmed the district court's dismissal. In particular, the Court distinguished *Tutor Perini Corp. v. Banc of Am. Sec. LLC*, 842 F.3d 71, 90 (1st Cir. 2016), a case in which a bank allegedly knew the market for a particular security was "on the brink of collapse" when it allegedly encouraged plaintiff to purchase more of the securities while rapidly selling the same securities. The Court distinguished Tutor on the basis that the bank there had a "special relationship" with plaintiff as its investment advisor; whereas, in contrast here, plaintiffs made no allegations that they had a special relationship or had given any particularized investment instructions to the Bank that would support a duty to disclose. The Court determined that plaintiffs merely alleged that the Bank "solicited" (or recommended) they purchase the PRMB securities, and that their investment objectives were to "preserve capital" and "current fixed income." Further, the Court held that, unlike in Tutor, plaintiffs made no allegation that the Bank promised to outline the risks of their investment or failed to inform plaintiffs of a market crash they knew was occurring. Therefore, the Court affirmed the district court's holding that plaintiffs failed to sufficiently allege an actionable omission. After making his finding, the Court noted that it was able to avoid a lengthy analysis concerning whether plaintiffs sufficiently pled scienter.

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