Ninth Circuit Affirms Dismissal With Prejudice of Securities Class Action Against Yelp

November 21, 2017

On November 21, 2017, the Ninth Circuit issued a decision in ***Curry v. Yelp, Inc.,*** No. 16-15104, affirming the district court's dismissal with prejudice of a securities fraud action against Yelp and certain of its senior executives. The Ninth Circuit held that the plaintiffs had failed to plead facts establishing loss causation or a strong inference of the defendants' scienter (i.e., reckless or intentional misconduct).

In their complaint, the plaintiffs alleged that the defendants had consistently stated that reviews appearing on Yelp's website were "firsthand" and "authentic" information. However, in 2014, the FTC disclosed thousands of complaints from businesses claiming that Yelp had "manipulated reviews." Slip op. at 4-5. Yelp's stock declined by 6 percent following publication of a *Wall Street Journal* article discussing the FTC's disclosure. *Id.* at 5. The plaintiffs claimed that Yelp had misled investors by failing to disclose Yelp's reliance on manufactured content.

After the district court dismissed the initial class action complaint with leave to amend, the plaintiffs filed an amended complaint. The defendants filed a motion to dismiss, which the district court granted with prejudice. *Id*. at 5-6. The district court held that the plaintiffs failed to sufficiently plead material falsity, because no reasonable investor could have understood the defendants' statements "to mean that all Yelp reviews were authentic" and because the *Wall Street Journal* article was published after Yelp's stock price already had declined. *Id*. at 6. The district court also held that the complaints disclosed by the FTC only expressed business owners' "inferences" about Yelp manufacturing content, and did not prove the existence of any wrongdoing. *Id*. at 7. Concluding that the drop in Yelp's stock price was caused by "speculation" about whether a fraud had occurred, not by proof of fraud itself, the district court found that the plaintiffs had not properly pleaded loss causation (i.e., that misrepresentations or omissions caused the injury). *Id*. at 5, 7. The district court also found that the plaintiffs had not sufficiently alleged scienter, including because the executives were not personally responsible for the authenticity of online reviews. *Id*. at 5-7.

First, as to loss causation, the court held that the plaintiffs' allegations were inadequate because a plaintiff may not "rest[] on a number of customer complaints and assert[] that where there is smoke, there must be fire." *Id.* at 10. The court explained that the complaints made to the FTC were insufficient in the absence of any "subsequent investigation," because loss causation requires more than the mere "risk" or "potential" for fraud. *Id.* Second, as to scienter, the court rejected the plaintiffs' allegations regarding the sale of over one million shares of Yelp stock by insiders during the class period, holding that such allegations could only give rise to a strong inference of scienter if the sale of stock by individual defendants could be shown to be "dramatically out of line with prior trading practices." *Id.* at 12. The plaintiffs had failed to make any allegations regarding the individual defendants' prior trading history. *Id.* at 12-13. The court also rejected a number of different allegations as to scienter on the basis of certain business practices—including allegations regarding Yelp's use of "filtering software" and reliance on "scouts" who build "interest in new locales" by "writing initial business reviews"—on the ground that corporate management's "general awareness of the day-to-day workings of the company's business" is not sufficient of itself to establish scienter. *Id.* at 13-14 (citation omitted). In the absence of allegations that any of the individual defendants had "specific information" regarding the alleged business practices, the court held that the plaintiffs had failed to allege a "nexus between the wrongful behavior" and the individual defendants' knowledge. *Id.* at 14-15. Finally, because the amended complaint failed to remedy the deficiencies the district court had pointed out in its initial order dismissing the complaint, the court held that further amendment would have been futile. *Id.* at 15-16.

The opinion is by Circuit Judge Ronald M. Gould, joined by Circuit Judge Paul J. Watford and District Judge W. Louis Sands, sitting by designation.

Although the decision does not break new ground, the Ninth Circuit's ruling will be helpful to companies facing securities complaints in at least three respects. First, when allegations of misconduct at a company are made public, the stock price often suffers, frequently triggering the filing of class action complaints. This decision confirms that plaintiffs cannot reflexively rely on the stock price movement without compelling facts showing that the company in fact engaged in misconduct. And simply parroting someone *else*'s unproven allegations, without more, is insufficient. Second, although many cases have found that insider stock sales do not establish scienter, the decision emphasizes that for a plaintiff to rely on such sales, it must proffer evidence that those sales are "unusual" in the context of an executive's trading history. Third, and finally, the Ninth Circuit has long been known as a jurisdiction that takes a permissive approach to requests by plaintiffs to amend their complaints. Defendants in securities litigation no doubt will emphasize this ruling to argue that plaintiffs are entitled to no more than two bites at the apple.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

Christopher Hockett	**650 752 2009**	**chris.hockett@davispolk.com**
Edmund Polubinski III	**212 450 4695**	**edmund.polubinski@davispolk.com**
Neal Potischman	**650 752 2021**	**neal.potischman@davispolk.com**
Dana Seshens	**212 450 4855**	**dana.seshens@davispolk.com**
Andrew Yaphe	**650 752 2088**	**andrew.yaphe@davispolk.com**

© 2017 Davis Polk & Wardwell LLP | 1600 El Camino Real | Menlo Park, CA 94025

This communication, which we believe may be of interest to our clients and friends of the firm, is for general information only. It is not a full analysis of the matters presented and should not be relied upon as legal advice. This may be considered attorney advertising in some jurisdictions. Please refer to the firm's **privacy policy** for further details.