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Plumbers & Steamfitters Local v. Danske Bank: Second Circuit Affirms Dismissal of Securities Class Action Arising from Money Laundering at Estonian Branch of Denmark Bank

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Summary

On August 25, 2021, the Second Circuit unanimously affirmed the lower court's dismissal of a securities class action accusing Danske Bank and several of its former executives of downplaying a money-laundering scandal at Danske's Estonian Branch. The court held that while the Estonian Branch's failure to follow anti-money laundering ("AML") protocols allowed over $200 billion worth of suspicious transactions to flow through that branch, the three suing pension funds (the "Funds") failed to identify any actionable misstatements or omissions regarding that conduct. The opinion offers important guidance for companies accused of making representations that minimize or otherwise fail to account for corporate misconduct. More broadly, *Danske Bank* further clarifies the line dividing "the realm of corporate mismanagement" from "the realm of securities fraud."[1]

Background

Danske is the largest financial institution in Denmark.[2] In 2006, Danske acquired its Estonian Branch, and soon thereafter, the branch began to face criticism from European regulators regarding its noncompliance with AML rules. Chief among the Estonian Branch's AML problems was its Non-Resident Portfolio ("NRP"), a portfolio comprising thousands of foreign clients, many of whom should have aroused suspicion with the Estonian Branch's employees: most NRP customers had "little apparent reason for doing their banking in Estonia," some "shared addresses with other NRP customers" and others "processed transactions incommensurate with their purported size."[3] Despite these red flags, the branch's employees "tended not to ask questions."[4]

Between 2013 and 2016, Danske grappled internally with the Estonian Branch's conduct. In 2013, after an internal investigation concluded that employees at the Estonian Branch were, among other things, "lax when inquiring into new NRP clients," Danske ceased opening new NRP accounts, hired an independent AML consultant in Estonia and commenced a multi-year wind-down of the NRP.[5] In 2014, Danske reported a goodwill impairment for its Estonia operations of around $326 million, which Danske represented was based on "long-term assessments" as opposed to short-term developments (such as the ongoing NRP issues).[6] By early 2016, the NRP was completely dissolved. [7]

Over the next several years, the Estonian Branch's AML violations became public. Between 2016 and 2018, Danish regulators publicly reprimanded the branch and fined Danske for failing to identify AML risks in Estonia; a Copenhagen newspaper published several articles detailing money laundering through the Estonian Branch; and Danske issued press releases acknowledging "major deficiencies" in its internal controls resulting in "significant sums" being "laundered through its Estonian Branch." [8] The bad publicity culminated in September 2018, when Danske released a report—the product of an independent investigation—that "observed that the scandal was much larger than initially anticipated and reported for the first time that over $200 billion worth of branch transactions were suspect."[9] As the "bad news accumulated," Danske's stock price fell.[10]

The Funds filed suit in early 2019, on behalf of a putative class of investors who purchased Danske shares between 2014 and 2019. The Funds brought claims under (1) Section 10 of the Exchange Act and Rule 10b-5(b); (2) Rule 10b-5(a) and (c); and (3) Section 20(a) of the Exchange Act.[11] The district court in the Southern District of New York dismissed the claims, holding that the Funds failed to allege any materially misleading statements or omissions.[12]

The Decision

The Second Circuit affirmed. The opinion divided the Funds' claims into five key categories of alleged misconduct and deemed each category nonactionable.

First, the court rejected the Funds' claim that it was misleading for Danske to release financial results during the class period that "baked in the … contracts unenforceable."[16]

> **"Accurately reported financial statements do not automatically become misleading by virtue of the company's nondisclosure of suspected misconduct that may have contributed to the financial results"**

Second, the court rejected the Funds' claim that it was misleading for Danske in 2014 to characterize its goodwill impairment write-down as a "purely technical" accounting matter when the impairment was really a consequence of Danske's decision to eliminate the NRP.[17] The court explained that whether or not the planned NRP closure in fact influenced the write-down was irrelevant because the passage of time and intervening disclosures made it implausible that any investor would be influenced by the 2014 disclosure. A "misstatement" can be "superseded or rendered stale by intervening events, not to mention memory"—in other words: "materiality can have a half-life."[18] The Funds did not purchase Danske shares until 39 months after the announcement of the goodwill impairment—and in that time, the Estonian Branch was the subject of extensive publicity making clear the branch was enmeshed in AML noncompliance.[19] The court held that this "outpouring of information … compel the conclusion that the 2014 statements about the goodwill impairment were too remote in time to have assumed actual significance."[20]

> **"Materiality can have a half-life"**

Third, the court rejected the Funds' claims that Danske made misleading corporate responsibility claims, *e.g.*, that Danske "strives to conduct business in accordance with internationally recognized principles in the area of anticorruption," "condemns money laundering" and "takes the steps necessary to comply with internationally recognized standards."[21] While acknowledging the principle that "ssertions of satisfactory regulatory compliance can be materially misleading if the descriptions of compliance efforts are detailed and specific," the court held that "Danske averred that it took steps to comply with AML protocols and vaguely recited some AML buzzwords," but "claimed no particular acts of compliance."[22] As such, no reasonable investor would weigh such "generic statements."[23]

Fourth, the court rejected the Funds' claim that it was misleading for Danske to state in its 2018 financial disclosures that it did not expect pending lawsuits or regulatory inspections regarding AML violations to "have any material effect on its financial position."[24] Reaffirming the vitality of *Denny v. Barber*, a 1978 Second Circuit decision,[25] the court reasoned that because the Funds purchased Danske shares *before* the challenged 2018 disclosure, the latter "could not have influenced the price of a purchase that had already been made."[26]

Fifth and finally, the court rejected the Funds' claim under subsections (a) and (c) of Rule 10b-5 that Danske committed a deceptive or manipulative act in furtherance of a scheme to defraud.[27] The court held that the Funds failed to "articulate with precision the contours of an alleged scheme to defraud investors" and instead "rest upon the incorporation of the previous 140 pages of the pleading paired with the conclusory assertion" that Danske carried out a fraud to inflate its share price.[28] This was not enough to tie the issues at the Estonian Branch to misconduct on behalf of Danske: "Money-laundering at a single branch in Estonia cannot alone establish that Danske itself carried out a deceptive scheme."[29]

> **"Money-laundering at a single branch in Estonia cannot alone establish that Danske itself carried out a deceptive scheme"**

Implications

The Second Circuit's decision contains a number of important takeaways:

- Accurately reported financial statements do not become misleading simply because the company does not also disclose suspected misconduct that may have contributed to the financial results. Defendants are obligated to truthfully report historical data; there is no concomitant duty to self-report unconfirmed suspicions about the underlying conduct.
- To state a claim that a company's financial disclosures are *per se* misleading because of a predicate violation of law or accounting standards, plaintiffs must specify the law or standard violated *and* how that violation occurred. As *Danske Bank* illustrates, this hurdle can have bite. The Second Circuit held that it was not enough for the Funds to allege that Danske violated accounting rules that permit contract revenue to be reported only if the

underlying contract is enforceable—the Funds were also obligated to (and did not) identify a specific law or contractual provision that rendered the disputed NRP contracts unenforceable.

- Materiality has a "half-life." The more time that passes between an alleged misstatement and the purchase of stock, and the more relevant intervening information that reaches the market, the less likely the initial misstatement will be material. This will be a fact-specific inquiry that turns on (1) the "nature" of the alleged misstatement, (2) the "intervening load of information on the subject" and (3) "other developments affecting the market and the enterprise."[30]
- Absent reference to specific company acts, generalized comments about "being good and upright"—such as Danske's statements that it strived to comport with anti-corruption principles—are "plainly puffery."[31]
- Stating a claim for scheme liability may require more than misconduct—even egregious misconduct—at a single branch of a larger entity. The Estonian Branch's AML failures were glaring and had far-reaching consequences: In taking a lax approach to confirming the identity of suspicious customers, the branch's employees may have opened the door to over $200 billion in laundered money passing through Danske. Despite this, the Funds could not implicate Danske in a scheme just by describing the laundering in detail and asserting that this constituted part of a larger scheme. The Funds were required to state what "specific acts constituted an alleged *scheme* in connection with the purchase or sale of securities."[32]

Last, the court's decision leaves one significant question unanswered. The Funds asked the Second Circuit to reexamine its precedents on scheme liability, in light of the Supreme Court's decision in *Lorenzo v. Securities & Exchange Commission*. In *Lorenzo*, the Supreme Court held that disseminating false or misleading statements is punishable under Rules 10b-5(a) and (c), even if the disseminator did not "make" the statement within the meaning of Rule 10b-5(b).[33]

Several district courts in the Second Circuit have suggested that *Lorenzo* is in tension with earlier Second Circuit cases holding that misrepresentations or omissions cannot alone sustain a claim for scheme liability.[34]

But because the Funds failed at the threshold to allege a scheme, the Second Circuit declined to address the issue.[35]

Notes

[1] *Plumber & Steamfitters Local 773 Pension Fund v. Danske Bank A/S*, — F.4th —, 2021 WL 3744894, at *1 (2d Cir. Aug. 25, 2021).
[2] *Id*.
[3] *Id*. at *2.
[4] *Id*.
[5] *Id*.
[6] *Id*. If "a company purchases assets at more than fair market value, it can record the difference as goodwill on its balance sheet. But if the value of the assets subsequently declines, the company may be required to record a goodwill impairment." *Id*. at *2 n.1.
[7] *Id*. at *2.
[8] *Id*. at *3.
[9] *Id*.
[10] *Id*.
[11] *See* 15 U.S.C. § 78j(b), (t); 17 C.F.R. § 240.10b-5(b).
[12] *See Plumbers & Steamfitters Local 773 Pension Fund v. Danske Bank*, 19 Civ. 235, 2020 WL 4937461, at *4–8 (S.D.N.Y. Aug. 24, 2020).
[13] *Danske Bank A/S*, 2021 WL 3744894, at *4.
[14] *Id*.
[15] *Id*.
[16] *Id*. at *5.
[17] *Id*.
[18] *Id*. at *6
[19] *Id*.
[20] *Id*. (quotation marks omitted). The court applied the same logic to the Funds' claim that Danske's 2015 statement that "three cases were reported in whistleblower system" was misleading because the 2018 law firm report found that one whistleblower report was handled improperly. *Id*. at *7 ("The Bank issued this statement in 2015, three years before the Funds purchased .").
[21] *Id*. at *7–8 (alterations omitted).
[22] *Id*. at *8 (quotation marks omitted).
[23] *Id*.
[24] *Id*.
[25] *Denny v. Barber*, 574 F.2d 465, 468 (2d Cir. 1978).

[26] *Danske Bank A/S*, 2021 WL 3744894, at *9.
[27] *Id*.
[28] *Id*.
[29] *Id*.
[30] *Id*. at *6.
[31] *Id*. at *7.
[32] *Id*. at *9 (emphasis added).
[33] *Lorenzo v. Securities & Exchange Commission*, 139 S. Ct. 1094, 1098–99 (2019).
[34] *See*, *e.g.*, *Puddu v. 6D Global Technologies, Inc.* 15 Civ. 8061, 2021 WL 1198566, at *10 (S.D.N.Y. Mar. 30, 2021).
[35] *Danske Bank A/S*, 2021 WL 3744894, at *9 n.6.

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