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Ninth Circuit Takes Notice of “Concerning Pattern in Securities Cases”

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On August 13, 2018, a three-judge panel of the Ninth Circuit issued its opinion in [*Khoja v. Orexigen Therapeutics Inc.*](#) The Ninth Circuit affirmed in part and reversed in part the district court’s dismissal of a securities fraud class action complaint. More importantly, the Ninth Circuit analyzed in great detail the district court’s granting of the defendants’ requests for judicial notice of documents not attached to the complaint and the trial court’s use of the incorporation-by-reference doctrine in deciding a motion to dismiss, both commonly used by defendants seeking to dismiss securities fraud class actions at the pleading stage.

The District Court Dismisses the Case

Lead plaintiff Karim Khoja sued Orexigen Therapeutics Inc. and several of its executives in [*the Southern District of California*](#), alleging violations of Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 promulgated thereunder, and Section 20(a) of the Securities Exchange Act. He alleged that the defendants made false or misleading statements and omitted material information about clinical trials involving Orexigen’s drug in development to treat obesity.

The defendants moved to dismiss the complaint, requesting that the court take into account 22 documents not attached to the complaint. These documents included filings with the Food and Drug Administration (FDA) and the Securities and Exchange Commission (SEC), press releases, patent filings, blog posts, and news articles. The district court granted the request for judicial notice for 21 of the 22 documents, finding that those 21 documents were properly subject to judicial notice under Federal Rule of Evidence 201, or the incorporation-by-reference doctrine.¹ The district court concluded that those documents were incorporated by reference because they were “explicitly referenced and relied on in the [Consolidated] Complaint . . . and Plaintiff [did] not contest their authenticity.” The district court then relied on these documents in dismissing the complaint with prejudice.

¹ The district court did not elaborate on why it declined to take judicial notice of the one remaining document, an article published on [TheStreet.com](#).

The Ninth Circuit Affirms in Part and Reverses in Part

On appeal, the Ninth Circuit affirmed in part and reversed in part, holding that the district court abused its discretion in taking judicial notice of certain of the documents submitted by the defendants in support of their motion to dismiss.

The Ninth Circuit began its analysis by reviewing the district court's ruling on the request for judicial notice. The Ninth Circuit prefaced its legal analysis by noting "a concerning pattern in securities cases like this one: exploiting [judicial notice and the incorporation-by-reference doctrine] improperly to defeat what would otherwise constitute adequately stated claims at the pleading stage." Recognizing that these doctrines are useful in assessing securities fraud claims, the Ninth Circuit nonetheless cautioned that "overuse and improper application of judicial notice and the incorporation-by-reference doctrine, however, can lead to unintended and harmful results." The court went on: "[i]f defendants are permitted to present their own version of the facts at the pleading stage—and district courts accept those facts as uncontroverted and true—it becomes near impossible for even the most aggrieved plaintiff to demonstrate a sufficiently 'plausible' claim for relief."

After warning of the dangers of expansive interpretations of these doctrines, the Ninth Circuit made clear that a court may only take judicial notice of an adjudicative fact if it is "not subject to reasonable dispute," which means that it must be "generally known" or "can be accurately and readily determined from sources whose accuracy cannot reasonably be questioned." Thus, a court "cannot take judicial notice of disputed facts contained in [] public records." Applying this standard to the three documents at issue on appeal, the Ninth Circuit found that only one of them, a patent application, was properly subject to judicial notice. The other two—an investor call transcript and a European regulatory report—were deemed not properly subject to judicial notice because the documents and their implications were "subject to varying interpretations."

Turning to the incorporation-by-reference doctrine, the Ninth Circuit noted that the doctrine is "straightforward in its purpose," but "not always easy to apply." Citing a prior Ninth Circuit decision,² the court stated that a defendant may seek to incorporate a document into the complaint "if the plaintiff refers extensively to the document or the document forms the basis of the plaintiff's claim."³ The court explained that the "mere mention of the existence of a document is insufficient" and that "if the document merely creates a defense to the well-pled allegations in the complaint, then that document did not necessarily form the basis of the complaint."

The Ninth Circuit then analyzed each of the documents that the lead plaintiff contended were improperly considered. The Ninth Circuit found that certain of the documents were incorporated by reference and, thus, properly considered because they were either extensively referenced or they formed the basis of the lead plaintiff's claim. These included: (1) a blog post that was quoted nearly in its entirety and contained numerous facts pled in support of the alleged fraud; (2) a news article that "triggered the alleged scheme"; (3) a registration statement filed with the SEC; and (4) an FDA report that was cited "numerous" times in the complaint.

² *United States v. Ritchie*, 342 F.3d 903 (9th Cir. 2003).

³ It bears noting that most courts assessing motions to dismiss in securities fraud cases do not include this "extensive" requirement when analyzing the incorporation-by-reference doctrine. See, e.g., *In re Gold Resource Corp. Securities Litigation*, 776 F.3d 1103, 1108 (10th Cir. 2015); *Podraza v. Whiting*, 790 F.3d 828, 833 (8th Cir. 2015); *Winer Family Trust v. Queen*, 503 F.3d 319, 328-29 (3d Cir. 2007).

As for the remaining documents, the Ninth Circuit found that the district court abused its discretion in considering them in ruling on the motion to dismiss because they were referred to only in passing (if at all) and did not form the basis of the lead plaintiff's claim. These included: (1) a blog post that was quoted only one time in a two-sentence footnote; (2) an SEC filing that was not even referenced in the complaint; (3) several other SEC filings that were not referred to "extensively enough to warrant incorporation"; and (4) a press release that was not referenced in the complaint.

In light of these findings, the Ninth Circuit unsurprisingly reversed a considerable portion of the district court's decision on the merits. The Ninth Circuit affirmed dismissal of certain of the alleged misstatements, but it allowed the lead plaintiff an opportunity to amend the complaint and reversed dismissal of the remaining misstatements.

It is rare for a circuit court to devote a significant portion of an opinion to the issues of judicial notice and incorporation by reference. Usually, these issues are resolved in a footnote at the beginning of an opinion, if they are addressed at all. It remains to be seen whether *Orexigen* will be an outlier or will begin a more extended examination of the issues of incorporation by reference and judicial notice in motions to dismiss securities class actions or other complex litigation.

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