Attack of the Indirect Investor, Again

September 28, 2017

A Texas-based retirement fund that *does not own any Uber securities* sued Uber and its former chief executive officer Travis Kalanick for making misleading statements to investors.[1] The retirement fund claims that it was harmed when the value of its *indirect* investment in Uber fell after investors learned that Uber was "operating a business far different than what investors had been led to believe."

The retirement fund does not own any Uber securities. Rather, it owns an interest in a Delaware limited partnership managed by Morgan Stanley Investment Management Inc. which was formed for the purpose of investing in Uber's Series G preferred shares. In short, the fund invested in Uber securities indirectly through another entity.

In its complaint, the retirement fund alleges that Uber's false and misleading statements violated Sections 25400(d) and 25500 of the California Corporations Code. Section 25400(d) makes it unlawful for people selling securities to make false or misleading statements for the purpose of inducing others to purchase or sell such securities.[2] Section 25500 establishes liability for people who willfully participate in activities that violate Section 25400(d).[3] That liability is owed to any person who purchases any security at a price that was affected by the false or misleading statements.[4]

The retirement fund may be able to proceed with its lawsuit against Uber and Kalanick even though the fund does not own any Uber securities. A federal court in California recently ruled that indirect investors have standing to sue under the California Corporations Code, reasoning that the purpose of Section 25400(d) is to "prevent the manipulation of the market by fraud" and noting that the statute "focuses on the actions of the seller of the securities, not the relationship between seller and buyer."[5]

Lawsuits by indirect investors can adversely affect investment managers who use special purpose vehicles to pool investors for specific investments. Read more about what managers can do to protect themselves in *Attack of the Indirect Investor*, my previous article about a lawsuit filed by indirect investors in a consumer healthcare technology company.

For more information, please contact a member of our Private Investment Funds and Advisers Practice.

Footnotes.

1. *Irving Firemen's Relief & Retirement Fund v. Uber Technologies Inc.*, 17-cv-05558, U.S. District Court, Northern District of California.

2. "It is unlawful for any person, directly or indirectly, in this state: … (d) If such person is a broker-dealer or other person selling or offering for sale or purchasing or offering to purchase the security, to make, for the purpose of inducing the purchase or sale of such security by others, any statement which was, at the time and in the light of the circumstances under which it was

made, false or misleading with respect to any material fact, or which omitted to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, and which he knew or had reasonable ground to believe was so false or misleading." (Cal. Corp. Code Sec. 25400(d))

3. "Any person who willfully participates in any act or transaction in violation of Section 25400 shall be liable to any other person who purchases or sells any security at a price which was affected by such act or transaction for the damages sustained by the latter as a result of such act or transaction. Such damages shall be the difference between the price at which such other person purchased or sold securities and the market value which such securities would have had at the time of his purchase or sale in the absence of such act or transaction, plus interest at the legal rate." (Cal. Corp. Code Sec. 25500)

4. Indirect investors have argued that the legislature's reference to "any" security in Section 25500, without the use of limiting words (i.e., "such" security), indicates that it intended to protect both direct and indirect investors from fraudulent conduct by issuers.

5. *Robert Colman et al. v. Theranos Inc. et al.*, 5:16-cv-06822, U.S. District Court, Northern District of California.