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Securities Litigation Trends That Will Matter Most In 2021

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Like most everything in 2020, securities litigation was dominated by cases arising out of the ongoing COVID-19 pandemic and resulting economic crisis.

Early in the pandemic, cruise line companies faced the first coronavirus-related securities fraud actions as shareholders challenged safety-related disclosures. But even companies whose businesses were boosted by the new remote work environment faced shareholder scrutiny as increased usage exposed previously undisclosed weaknesses.

Shareholders in pharmaceutical and biotechnology companies engaged in the fight against COVID-19 also brought numerous securities fraud actions alleging that overly optimistic or imprecise statements about vaccines or treatments still early in development misled investors.

As the pandemic rages on, 2021 promises not only the filing of many more COVID-19 related securities litigations across industries, but also significant developments in the law as courts begin to grapple with these new cases and legal theories.

Outside of COVID-19 litigation, there will be a continuation of certain securities litigation trends in 2021. Courts will grapple with the fallout from the U.S. Supreme Court's 2018 decision in Cyan Inc. v. Beaver County Employees Retirement Fund as defendants test the validity of federal forum provisions in an effort to return Securities Act cases to federal courts and end expensive multijurisdictional litigation.

We also expect to see more focus on environmental, social and governance, or ESG, issues. As investors have expanded their valuation metrics beyond traditional economic factors and focus on ESG issues, many companies have responded to this pressure by making voluntary ESG-related disclosures concerning, for example, safety standards, environmental consciousness, commitment to social justice and intolerance of discrimination. As discussed below, such disclosures can give rise to securities litigation.

In addition to these notable trends, 2021 also promises to be a significant year for securities litigation in light of the Supreme Court's opportunity to decide important issues relating to mandatory disclosures and rebutting the Basic presumption at class certification. This article highlights the trends and hot cases in securities litigation that will matter most in 2021.

COVID-19 Related Cases

The COVID-19 pandemic has given rise to a wide range of lawsuits, including shareholder derivative suits, class actions and government enforcement actions. Although it is still too early to assess fully how courts will view these cases, below we provide an overview of the types of coronavirus cases

that have been most prevalent.

We will likely see more coronavirus litigation filed in 2021 as the pandemic rages on and the economic fallout continues to unfold.

False Statements and Inadequate Disclosures About Safety Related to COVID-19

Some of the earliest COVID-19 securities cases were, perhaps unsurprisingly, aimed at the cruise line industry, which saw its business decimated by the pandemic after passengers fell ill, ports closed, ships faced long quarantines at sea and cruise operations were ultimately suspended.

The first of these class actions was filed in March 2020 against Norwegian Cruise Line and alleged violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. The complaint alleged that positive statements about Norwegian's financial outlook and safety measures were rendered false and misleading by Norwegian's failure to disclose its use of sales tactics that encouraged bookings by downplaying the virus.

When internal emails detailing these deceptive sales practices were leaked to The Washington Post and Miami News Times, according to the complaint, Norwegian's stock price declined significantly.[1] Shareholders of Carnival Corp.[2] and Royal Caribbean Cruises Ltd.[3] subsequently brought similar securities fraud actions.

These cruise line cases, all of which are currently pending in the U.S. District Court for the Southern District of Florida, will be bellwethers as to whether specific safety disclosures are actionable in light of subsequent COVID-19 developments.

Failure to Disclose Specific Risks Brought to Light by the Pandemic

Securities fraud cases have not been limited to industries hard hit by the pandemic. For some companies, increased usage of their products during pandemic-related lockdowns exposed operational weaknesses.

A prime example of this is the consolidated action In re: Zoom Video Communications Inc. Securities Litigation filed in the U.S. District Court for the Northern District of California in April 2020.[4] The complaint alleges that Zoom violated Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 by failing to disclose that Zoom had inadequate data privacy and security measures and that its video communications service was not end-to-end encrypted.

The complaint states that although the truth about deficiencies in Zoom's software encryption initially came to light in July 2019, it was not until the COVID-19 pandemic and the increased reliance on Zoom's services that the truth fully became known through a series of corrective disclosures.

False Claims Relating to COVID-19 Testing and Treatment

The race to test for and treat COVID-19 has also triggered increased shareholder scrutiny of pharmaceutical and biotechnology companies.

For example, in March 2020, a shareholder filed a class action lawsuit against Inovio Pharmaceuticals Inc., alleging that the company violated Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. In McDermid v. Inovio Pharmaceuticals Inc., filed in the U.S. District Court for the Eastern District of Pennsylvania, the plaintiffs allege that when, during television appearances, Inovio's CEO made claims that the company had successfully developed a vaccine against the spread of COVID-19 "in a matter of about three hours" and that it planned to start human trials in April.[5]

Similarly, in May 2020, shareholders filed a securities class action lawsuit against Sorrento Therapeutics Inc. in Wasa Medical Holdings v. Sorrento Therapeutics Inc. in the U.S. District Court for the Southern District of California.[6]

Such cases present stark warnings to corporations engaged in the development of diagnostics, testing and treatment of COVID-19. Executives must exercise extreme caution when discussing the prospects of as-of-yet unproven products to the media or in other public fora.

Federal Forum Provisions

There has been a proliferation of parallel securities class action lawsuits filed in both federal and state courts since the Supreme Court's 2018 ruling in Cyan Inc. v. Beaver County Employees Retirement Fund, which held that state courts maintained concurrent jurisdiction over securities class actions brought under the Securities Act.

In response to Cyan, many companies have sought to limit their exposure to duplicative state court litigation by adopting federal forum provisions in their corporate charters. Such provisions generally provide that all Securities Act claims against the company must be brought exclusively in federal court.

In 2020, the Delaware Supreme Court issued its highly anticipated decision in Salzberg v. Sciabacucchi, holding that federal forum provisions are facially valid under Delaware law and noting that such provisions can provide "certain efficiencies in managing the procedural aspects of securities litigation" following Cyan.

Salzberg did not, however, resolve the questions of (1) whether these provisions will be enforced in Securities Act cases filed against Delaware corporations in other jurisdictions, or (2) whether defendants who are not signatories to a corporate charter, such as underwriters, can nonetheless benefit from such provisions.

These issues were recently addressed in In re: Uber Technologies Inc. Securities Litigation in the California Superior Court. Following Uber's May 2019 initial public offering, the plaintiffs filed numerous virtually identical putative class action complaints in both federal and state courts in California, asserting claims under Sections 11, 12 and 15 of the Securities Act.

The defendants sought dismissal of the consolidated state court action, arguing that Uber's federal forum provisions required Uber's investors to bring their Securities Act claims exclusively in federal court. The court held that the federal forum provisions was valid and enforceable in California, dismissing the state court action.

The court also specifically held that the federal forum provisions, by its terms and as a matter of California law, warranted dismissal of the complaint in its entirety, including claims against non-signatories such as the underwriters.

While it remains to be seen whether courts outside California will enforce federal forum provisions, the decision in Uber is encouraging for both corporations and underwriters who view federal forum provisions as a potential path to have Securities Act class actions litigated in federal courts and put an end to expensive and often duplicative multijurisdictional securities litigation.

ESG-Based Derivative Lawsuits

In recent years investors have become increasingly focused on ESG factors beyond profit maximization and other traditional metrics of success. This focus, in turn, has led many companies to voluntarily make ESG-related disclosures. In seeking to ease this pressure from investors through ESG-related disclosures, however, companies may be exposing themselves to new risks.

Specifically, companies may be confronted with shareholder derivative suits alleging, for instance, that directors breached their fiduciary duties in focusing on ESG issues to the detriment of shareholder value. Alternatively, companies may also be subject to U.S. Securities and Exchange Commission enforcement actions or private securities class actions if they fail to live up to their ESG disclosures or if such disclosures are used to mask true financial problems.

In the summer of 2020, a slew of ESG-related shareholder derivative lawsuits were filed in California federal courts by the same law firm — Bottini & Bottini Inc. — against current and former directors and officers of Facebook Inc.,[7] Qualcomm Inc.,[8] NortonLifeLock Inc.,[9] Oracle Corp.[10] and The Gap Inc.[11]

While the facts alleged in each complaint differ, the complaints are identical in asserting claims for

breach of fiduciary duty, aiding and abetting breach of fiduciary duty, abuse of control, unjust enrichment, and violations of Section 14(a) of the Exchange Act and Rule 14a-9.

The complaints essentially allege that the companies' boards and executive teams are not diverse despite public statements emphasizing the importance of, and their dedication to, diversity and inclusion. The complaints are notable in that they seek extensive injunctive relief in addition to monetary damages.

While it is too early to predict the outcome of these lawsuits, securities lawyers and companies should watch them closely. If courts allow such novel claims to proceed, it could signal a significant expansion of liability for companies and their officers and directors and an additional enforcement mechanism for investors seeking to hold companies to their aspirational diversity and other ESG-related rhetoric.

Disclosure Standards

In M&T Bank Corp. v. David Jaroslawicz, the Supreme Court has the opportunity to address the scope of disclosures required under Item 105 of Regulation S-K.[12] Regulation S-K sets forth the disclosure requirements, other than financial statements, of various SEC filings required under the Securities Act.

Item 105 of Regulation S-K directs issuers to provide a discussion of "the most significant factors that make an investment in the registrant or offering speculative or risky."[13] The disclosed risk factors must be (1) concise and organized; (2) specific, not generic; and (3) include an explanation connecting the risks to the offer.

At issue in M&T Bank Corp. is a securities class action lawsuit against M&T Corp. arising out of M&T's merger with Hudson City Bancorp. The lawsuit was filed after the Federal Reserve delayed approval of the merger citing concerns with M&Ts Bank Secrecy Act and anti-money laundering compliance program and M&T was required to pay $2 million to settle a Consumer Financial Protection Bureau enforcement action concerning its consumer checking practices.

The plaintiffs allege that M&T violated Section 14(a) of the Exchange Act and Rule 14a-9 by failing to disclose these risks in the joint proxy statement issued in connection with the merger as required by Item 105.

The U.S. District Court for the District of Delaware dismissed the complaint. On appeal, however, the U.S. Court of Appeals for the Third Circuit vacated and remanded, holding that the plaintiffs had adequately pleaded that the Item 105 risk factor disclosures were deficient as they omitted company-specific details and offered nothing more than generic, boilerplate discussions of the risks. Notably, the court stated that "whether M&T had actual knowledge of the shortcomings in its BSA/AML compliance or its consumer checking practices is of no moment."[14]

In its petition for a writ of certiorari, M&T argues that the Third Circuit's decision conflicts with other circuit court decisions — including the U.S. Court of Appeals for the First Circuit's 2013 decision in Silverstrand Investments v. AMAG Pharmaceuticals Inc. and the U.S. Court of Appeals for the First Circuit's 2014 decision in City of Pontiac Policemen's and Firemen's Retirement System v. UBS AG.

If the Supreme Court allows the Third Circuit's decision to stand, issuers will likely face a slew of hindsight-based securities claims alleging a failure to disclose unknown or uncharged material risks under Item 105.

Rebutting the Basic Presumption at Class Certification

The Supreme Court recently granted certiorari in Arkansas Teacher Retirement System v. Goldman Sachs Group Inc., giving the court an opportunity to provide much needed guidance on the issue of how defendants at the class certification stage may rebut the presumption of classwide reliance first recognized in Basic Inc. v. Levinson.

Before the court are two questions: (1) whether a defendant may rebut the Basic presumption by pointing to the generic nature of the alleged misstatements, even though that evidence is also

relevant to the substantive element of materiality; and (2) whether a defendant seeking to rebut the Basic presumption has only a burden of production or also the ultimate burden of persuasion.

The petition arose out of a multiyear battle over class certification waged in the Second Circuit and district court. The lawsuit, filed in 2011, alleges that Goldman Sachs committed securities fraud by making certain aspirational and generic statements — for example, that "[o]ur clients' interests always come first" — and omitting material information about alleged conflicts of interest.

Proceeding on an inflation maintenance theory, the plaintiffs argued that Goldman Sachs' statements maintained the stock price at an already inflated level and that the plaintiffs were harmed when government investigations later exposed those conflicts to the market causing Goldman Sachs' stock price to drop.

The district court initially granted class certification in 2015, which the Second Circuit subsequently reversed. On remand, the district court again certified a class holding that defendants failed to rebut the Basic presumption despite putting forth evidence that 36 prior disclosures regarding the company's conflicts had not moved the market.

In April, the Second Circuit affirmed the class certification decision, rejecting defendants' attempts to rebut the Basic presumption by pointing to the generality of the alleged misstatements.

The court reasoned that such an argument would permit a defendant to "smuggle" the merits issue of materiality into the class certification analysis in violation of the Supreme Court's 2013 opinion in Amgen Inc. v. Connecticut Retirement Plans and Trust Funds. The court also held that a defendant seeking to rebut the Basic presumption bears the ultimate burden of persuasion, deepening the split amongst the courts of appeals with respect to the proper burden.

If allowed to stand, the Second Circuit's decision could have significant practical and legal consequences for public companies, which routinely make the types of generic statements of corporate principle challenged by the plaintiffs in Goldman Sachs. Moreover, the Second Circuit's decision contravenes the mandate in the Supreme Court's 2014 opinion in Halliburton Co. v. Erica P. John Fund Inc. that a defendant be allowed to rebut the Basic presumption at the class-certification stage regardless of whether the relevant evidence also bears on merits issues.

The decision renders the Basic presumption virtually irrebuttable whenever plaintiffs' claims are premised on an inflation maintenance theory. Accordingly, if the Supreme Court affirms the Second Circuit's decision, it could have significant practical and legal consequences for public companies, which routinely make the types of generic statements of corporate principle challenged by the plaintiffs in Goldman Sachs. Class certification would be essentially a foregone conclusion in any inflation maintenance cases filed in the Second Circuit.

Conclusion

Undoubtedly, 2021 is shaping up to be an important year for securities litigation. Securities law practitioners and public companies should continue to monitor closely cases currently pending in the federal courts, especially those arising out of the COVID-19 pandemic or that are ESG-related.

Moreover, with cert petitions filed in both Arkansas Teacher Retirement System v. Goldman Sachs Group, Inc. and M&T Bank Corp. v. David Jaroslawicz, the Supreme Court may provide needed guidance on disclosure duties under Item 105 of Regulation S-K and rebutting the Basic presumption at class certification.

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Disclosure: Willkie represents a group of former SEC officials and law professors who filed an amicus brief in support of Goldman Sachs' petition for a writ of certiorari in Arkansas Teacher Retirement System v. Goldman Sachs Group Inc. The firm also represents the underwriter defendants in In re: Uber Technologies Inc. Securities Litigation, which is currently on appeal.

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[1] Douglas v. Norwegian Cruise Lines, et al., No. 1:20-cv-21107 (S.D. Fla. Mar. 12, 2020). Douglas was consolidated with Atachbarian v. Norwegian Cruise Lines, No. 1:20-cv-21386 (S.D. Fla. Mar. 31, 2020).

[2] Service Lamp Corporation Profit Sharing Plan v. Carnival Corp., et al., No. 1:20-cv-22202 (S.D. Fla. May 27, 2020).

[3] City of Riviera Beach General Employees Retirement System v. Royal Caribbean Cruises Ltd. et al., No. 1:20-cv-24111-KMW (S.D. Fla. Oct. 7, 2020).

[4] Drieu v. Zoom Video Commc'ns, Inc., No. 3:20-cv-02353 (N.D. Cal. Apr. 7, 2020).

[5] McDermid v. Inovio Pharm., Inc., No. 2:20-cv-01402 (E.D. Pa. Mar. 12, 2020).

[6] Wasa Med. Holdings v. Sorrento Therapeutics, Inc., No. 20-cv-00966 (S.D. Cal. May 26, 2020).

[7] Ocegueda v. Zuckerberg, et al., No. 3:20-cv-04444 (N.D. Cal. July 2, 2020).

[8] Kiger v. Mollenkopf, et al., No. 3:20-cv-01355 (S.D. Cal. July 17, 2020). This case was later consolidated with Nelson v. Mollenkopf, No. 3:20-cv-01417 (S.D. Cal. July 23, 2020).

[9] Esa v. NortonLifeLock Incorporated, et al., No. 3:20-cv-05410 (N.D. Cal. Aug. 5, 2020).

[10] Klein v. Ellison, No. 3:20-cv-04439 (N.D. Cal. July 2, 2020).

[11] Lee v. Fisher, et al., No. 3:20-cv-06163 (N.D. Cal. Sept. 1, 2020).

[12] M&T Bank Corporation, et al. v. David Jaroslawicz, et al., No. 20-678 (3d Cir. 2020).

[13] 17 C.F.R. § 229.105.

[14] Jaroslawicz v. M&T Bank Corp. , 962 F.3d 701, at 716 (3d Cir. 2020).