Law360

Securities Litigation Trends To Watch This Year

By Todd Cosenza, Charles Cording and Amanda Payne (January 31, 2022, 6:28 PM EST)

Todd Cosenza

Charles Cording

Amanda Payne

The year 2021 saw a number of important securities rulings.

In June 2021, the U.S. Supreme Court issued its highly anticipated decision in Goldman Sachs Group Inc. v. Arkansas Teacher Retirement System, holding that the generic nature of a misrepresentation often will be important evidence of a lack of price impact, particularly in cases proceeding under the inflation-maintenance theory.

A few months later, in September 2021, the U.S. Court of Appeals for the Ninth Circuit issued a groundbreaking decision in Pirani v. Slack that departed from well-settled precedent by finding that a plaintiff has standing to sue under Section 11 of the Securities Act in a direct listing, despite the fact that the plaintiff could not meet Section 11's tracing requirement.

In 2022, we can expect to see courts grapple with these rulings and their far-reaching implications.

In addition to those important rulings, a number of decisions were handed down in 2021 in securities cases related to COVID-19; environmental, social and corporate governance issues; cybersecurity; and cryptocurrency.

While these cases differ in substance, many of these lawsuits did not make it past the motion-to-dismiss stage. Nevertheless, new legal theories continue to emerge.

For example, public companies that showed impressive growth and increased demand for their products at the outset of the pandemic are facing a new wave of cases alleging, for example, that they failed to acknowledge that such growth and demand were merely temporary effects of the COVID-19 pandemic.

In light of these cases and trends, 2022 is shaping up to be a significant year for securities litigation, especially in light of a newly filed lawsuit, Assad v. Pershing Square Tontine Holdings Ltd., in the U.S. District Court for the Southern District of New York against Pershing Square Tontine Holdings Ltd., Bill Ackman's special-purpose acquisition company, or SPAC, which provides a court with the opportunity to decide whether SPACs qualify as investment companies under the Investment Company Act.

This article highlights the hot cases and trends in securities litigation that will matter most in 2022.

Rebutting the Basic Presumption at Class Certification

On June 21, 2021, the Supreme Court issued its decision in Goldman Sachs Group Inc. v. Arkansas Teacher Retirement System.[1] Justice Amy Coney Barrett delivered the opinion of the court, which vacated the U.S. Court of Appeals for the Second Circuit's holding and remanded under an instruction that "the Second Circuit must take into account all record evidence relevant to price impact, regardless of whether that evidence overlaps with materiality or any other merits issue."[2]

Reserving on the inflation-maintenance theory, the court stressed that the generic nature of a misrepresentation often will be important evidence of a lack of price impact in cases proceeding under this theory. The Supreme Court also held that the Second Circuit correctly placed the burden of proving a lack of price impact at class certification on the defendants.[3]

On Aug. 26, the Second Circuit issued its decision on remand, vacating the U.S. District Court for the Southern District of New York's order certifying the class because it was unclear whether the district court properly considered the generic nature of Goldman's alleged misrepresentations.[4] On Dec. 8, the district court certified the class once again.[5]

Despite recognizing a discrepancy in genericness between the claimed corrective disclosures and the alleged misstatements, the court found the alleged misstatements and the corrective disclosures matched because they involved the same general subject matter. On Dec. 22, Goldman filed a Rule 23(f) petition for permission to appeal the class certification order.

The Second Circuit's decision on the petition, and other decisions that follow it, will be tremendously consequential in determining the reach of the Supreme Court's Goldman Sachs decision and, in particular, whether the guardrails established by the Supreme Court to prevent near automatic class certification in inflation-maintenance cases will be honored in practice.

The Ninth Circuit's Decision in Slack

On Sept. 20, 2021, a divided Ninth Circuit panel issued an unprecedented decision that breaks from the long-standing rule that a plaintiff must be able to trace their shares to an allegedly false or misleading registration statement in order to recover under Section 11.

In Pirani v. Slack, the Ninth Circuit held that investors have standing to sue under Section 11 and Section 12(a)(2) of the Securities Act based on purchases in a direct listing public offering, even though the investors could not trace their shares to a registration statement.[6]

In so holding, the Ninth Circuit focused on the fact that the New York Stock Exchange's rules require a company to file a registration statement to do a direct listing, and that single registration statement is what makes it possible to sell both registered and unregistered shares to the public.

In other words, all of the shares sold in Slack's listing were traceable to that single registration, irrespective of whether they were registered. On Nov. 3, 2021, the Slack defendants petitioned the Ninth Circuit for a rehearing and a rehearing en banc, arguing that the decision conflicts with long-standing Supreme Court and Ninth Circuit precedent.

Before the Ninth Circuit's decision in Slack, it was assumed that Section 11's tracing requirement would be difficult to meet in the context of direct listings because shares may be sold in a direct listing without using a registration statement. If allowed to stand, the decision could have far-reaching implications for public companies, and we can expect to see an uptick in direct listing initial public offering filings.

Cases Related to COVID-19

At the outset of the pandemic in 2020, a flurry of securities class actions and derivative suits related to COVID-19 were filed in federal courts. These lawsuits were primarily focused on cruise line companies and pharmaceutical and biomedical companies. Rulings on these cases began to trickle in early in 2021, with many courts tossing the suits on motions to dismiss.

Despite these dismissals, many expected the uptick in securities filings related to COVID-19 to continue in 2021. However, that did not happen as the number of such cases filed actually waned in 2021. Additionally, plaintiffs expanded their focus from travel and health care to other industries as well.

A prime example of this is the class action pending against Tyson Foods Inc., alleging that Tyson violated the federal securities laws by making misstatements and omissions regarding its safety protocols for protecting employees in response to the coronavirus.

There are indicators that the number of securities cases related to COVID-19 will increase in 2022. In fact, some recent complaints filed against DocuSign Inc., Chegg Inc. and Citrix Systems Inc. hint at a new wave of cases. While the facts alleged in each complaint differ, they all implicate issues of the enduring impact of the pandemic on companies whose products and services were uniquely suited to the needs of the moment.

The Lawsuit Against Ackman's SPAC

In the past year, SPACs have soared in popularity. SPACs are shell companies that raise capital by means of an IPO for the purpose of identifying and merging with a target private operating company.

The U.S. Securities and Exchange Commission has never declared SPACs to be investment companies under the federal securities laws. A recently filed lawsuit has brought that issue to the forefront.

In August 2021, a shareholder derivative lawsuit was filed against hedge fund manager Bill Ackman's SPAC, Pershing Square Tontine Holdings.[7] Following PSTH's IPO, the proceeds were placed in a trust account invested in government securities and money market fund cash equivalents.

After a potential deal fell apart, investors sued, principally arguing that PSTH qualifies as an investment company under the Investment Company Act because "investing in securities is basically the only thing that PSTH has ever done." The defendants hit back in their motion to dismiss, arguing that a SPAC does not transform into an investment company by virtue of holding assets in government securities and cash equivalents while seeking operating companies or assets to purchase.

It remains dubious that courts will set aside the long-standing regulatory framework surrounding SPACs. Yet the case could have a huge impact on the SPAC market, including causing global deal uncertainty for SPACs.

Cybersecurity

Cybersecurity has increasingly become a focus for companies over the last decade. Given the threat cyberattacks pose to investors and capital markets, companies are facing heavy regulatory and shareholder scrutiny with respect to cybersecurity-related disclosures.

Consistent with this increased scrutiny, a number of cybersecurity-related securities class actions have been filed recently in federal courts. One very recent example is the consolidated class action In re: 360 DigiTech Inc. Securities Litigation filed in the U.S. District Court for the Southern District of New York.[8]

The complaint alleges that DigiTech violated the federal securities laws by making repeated misstatements and omissions to U.S. investors concerning the company's compliance with the Chinese government's data privacy and financial technology regulations.

Despite the prevalence of cybersecurity-related securities lawsuits, plaintiffs have largely failed to gain any traction. For example, In re: First American Financial Corp. Securities Litigation was dismissed in the U.S. District Court in the Central District of California in September 2021, finding that the plaintiffs failed to plead that First American had actual knowledge of the breach at issue at the time the company made the allegedly misleading disclosures surrounding its data security controls and protocols or that the disclosures were specific enough to misrepresent the current state of affairs.

Regardless of the outcome of such lawsuits, the risk of a cybersecurity attack is ever present. Moreover, regulators continue to show a focus on cybersecurity-related disclosures.[9] Accordingly, we can expect plaintiffs and regulators to continue paying close attention to such disclosures in the years to come.

Cryptocurrency

There's been an explosion of interest in cryptocurrency in recent years as investors seek to further diversify their portfolios and maximize returns. Unsurprisingly, this interest has been accompanied by a proliferation of cryptocurrency securities fraud class actions by investors seeking to recover their losses.

These actions can include allegations that the defendants offered or sold unregistered securities in violation of the federal securities laws. Given the broad range in types of cryptocurrencies, the issue of whether a particular cryptocurrency is a security has been front and center in many of these lawsuits. In 2021, this question was answered for the first time by a federal jury.

On Nov. 2, 2021, a jury in the U.S. District Court for the District of Connecticut in Audet v. Fraser found that four cryptocurrency-related products were not securities under the Securities Exchange Act. In Audet, the plaintiffs filed a class action against GAW Miners LLC and ZenMiner LLC, two cryptocurrency mining entities, and their owners, Homero Joshua Garza and Stuart Fraser, for violations of the federal securities laws, alleging that defendants engaged in an evolving scheme to defraud investors.

The purported scheme began by offering hashlet contracts, whereby the purchaser bought computing power in exchange for a return on the profits defendants earned by using that power to mine for virtual currencies, and culminated in hashstakers, a digital wallet.

After the case went to trial, a threshold issue for the jury was whether defendants' cryptocurrency-related products were securities. Because the plaintiffs alleged that those products were investment contracts, and therefore securities, the court instructed the jury on the application of the test the Supreme Court laid out in its 1946 decision in SEC v.

Howey. The jury ultimately determined that none of the products were investment contracts.

The verdict is significant because it directly contradicts the SEC's position that the hashlets are investment contracts. Notwithstanding the verdict, we expect to see a continued increase in cryptocurrency-related securities class actions as more and more investors dip their toes into the crypto market.

ESG-Based Derivative Lawsuits

In 2021, a number of decisions were handed down by courts in ESG-related shareholder derivative suits and class actions filed against a wide range of companies. These lawsuits sought to hold directors and officers accountable for alleged misrepresentations related to a company's commitment to diversity and inclusion. Thus far, defendants largely prevailed on motions to dismiss. Indeed, nearly all of these dismissals turned on a finding that the plaintiff failed to clear the high bar for pleading demand futility.

Even though defendants have had some recent successes with respect to ESG-related securities lawsuits, both investors and the SEC continue to closely monitor ESG-related disclosures. As ESG matters continue to increase in importance, so too must companies continue to be mindful of their ESG-related disclosures.

Conclusion

In light of these notable cases and trends, 2022 promises to be a significant year for securities litigation. Securities law practitioners and public companies should continue to monitor closely cases currently pending in the federal courts, especially if the Second Circuit declines to grant Goldman Sachs' petition to appeal and the Ninth Circuit fails to rehear the Slack decision.

Moreover, we can expect this year to shed more light on the viability of securities lawsuits arising out of disclosures related to things like COVID-19, crypto and ESG.

Todd G. Cosenza is a partner and co-chair of the securities litigation practice group at Willkie Farr & Gallagher LLP.

Charles Cording is a partner at the firm.

Amanda M. Payne is an associate at the firm.

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 and petition to appeal in Goldman Sachs Group Inc. v. Arkansas Teacher Retirement System.

[1] Goldman Sachs Grp., Inc. v. Arkansas Tchr. Ret. Sys., 141 S. Ct. 1951 (2021).

[2] Id. at 9.

[3] Id. at 1962-63.

[4] Arkansas Tchr. Ret. Sys. v. Goldman Sachs Grp., Inc., 11 F.4th 138, 140 (2d Cir. 2021).

[5] In re Goldman Sachs Grp., Inc. Sec. Litig., No. 10 CIV. 3461 (PAC), 2021 WL 5826285 (S.D.N.Y. Dec. 8, 2021).

[6] Pirani v. Slack Techs., Inc., 13 F.4th 940 (9th Cir. 2021).

[7] Assad v. Pershing Square Tontine Holdings, Ltd., Case No. 1:21-cv-06907-AT-BCM (S.D.N.Y. Aug. 17, 2021).

[8] In re 360 DigiTech, Inc. Securities Litigation, Case No. 1:21-cv-06013-AKH (S.D.N.Y. Jan. 14, 2022).

[9] See, e.g., Press Release, SEC Announces Three Actions Charging Deficient Cybersecurity Procedures (Aug. 30, 2021), available at https://www.sec.gov/news/press-release/2021-169.