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In 2020, Securities Class Action Filings Likely to Continue Record Pace

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Looking ahead to a new year and decade, we see several trends in securities litigation that are likely to continue. We have every reason to believe, for instance, that federal securities class action filings will remain at elevated levels. Indeed, according to data compiled by one research firm, last year marked the third year in a row with more than 400 class action filings in federal court, and the fifth consecutive 12-month period with a year-over-year increase.

Photo: Courtesy Photo

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If last year is a guide, the composition of these suits is likely to remain stable—although there could be some incremental shifts among different categories. In 2019, for instance, there was a moderate drop-off in the number of federal merger objection suits.

This decline, though, was offset by a corresponding increase in more traditional class action cases—i.e., those seeking relief under Section 10(b) of the Securities Exchange Act of 1934 or Section 11 of the Securities Act of 1933. Even though some Securities Act suits will now be filed in state court due to Cyan, discussed below, there are few signs that the federal courts will be any less active.

Event-Driven Cases Are Likely to Remain a Focus

We expect plaintiffs firms to continue filing event-driven litigations—cases where the catalyst is the disclosure or occurrence of a significant event. These triggering events tend to reflect general risks that cut across multiple industries, such as: data breaches or other cybersecurity incidents; environmental or other accidents; natural disasters; allegations of sexual misconduct; and alleged regulatory violations. With several cases at the pleadings stage, it may soon become clearer whether event-driven lawsuits are surviving motions to dismiss and thus are gaining traction at the district court level.

This decisional law, as it develops, may bring into sharper view the viability of different theories of recovery. One typical pleading tactic, for example, is to allege on the heels of an alleged regulatory violation that the company misled investors about its compliance with an internal code of conduct or governing law.

These allegations have produced different results. For instance, the Second Circuit in Singh v. Cigna Corp. affirmed the district court's dismissal of a putative class action and, in so doing, sharply criticized plaintiffs for trying to predicate a securities fraud claim on generic statements from Cigna's code of ethics.

The Cigna decision, however, did not prevent claims from moving forward later that year against Signet Jewelers Ltd. There, following public reports of alleged sexual harassment at Signet, plaintiffs alleged that the company had violated its corporate policies barring such behavior. Taken together, these cases suggest that outcomes will depend on the strength and specificity of the plaintiff's allegations, when juxtaposed against the company's disclosures in a particular case.

The Supreme Court's Decision in Cyan Will Continue to Shape Securities Litigation

The U.S. Supreme Court's 2018 decision in Cyan v. Beaver County Employees Retirement Fund is expected to have an ongoing impact on Securities Act litigation, as federal and state courts continue to wrestle with several contentious issues. In Cyan, the Supreme Court held that the Securities Litigation Uniform Standards Act of 1998 did not authorize federal courts to remove cases brought solely under the Securities Act, thereby affirming state courts' authority to exercise jurisdiction over such cases. Some commentators opined that plaintiffs firms, emboldened by this decision, would start bringing Securities Act claims in state courts with greater frequency.

This prediction was validated in 2019: Last year, more Section 11 cases were filed in state court than in 2018, with a substantial number landing in New York. According to data from one research firm, less than one-quarter of all Section 11 cases brought during this period were filed in federal court alone. This figure stands in contrast to what occurred in the three years before Cyan, when roughly seven out of 10 Section 11 cases (or 67%) were brought in federal court on a standalone basis.

This post-Cyan migration of cases to state court has complicated efforts at case management. As an example, in 2019, nearly half (48%) of all new Securities Act matters included parallel state and federal filings (as compared to 16% in the three years before Cyan).

If these overlapping suits were confined to the federal court system, defense counsel would have the ability to consolidate or coordinate them through the Judicial Panel on Multidistrict Litigation, motions to transfer, or otherwise. But there is no procedural mechanism for consolidating—or even coordinating—overlapping federal and state suits. As a result, corporate defendants have been forced to seek discretionary stays and other alternative forms of relief.

These efforts, at least so far, have led to several inconsistent rulings at the state court level. For instance, one New York state court has twice refused to grant discretionary stays of discovery in deference to pending federal proceedings, whereas at least one Massachusetts state court has reached the opposite conclusion. State courts have also disagreed as to whether the automatic discovery stay provisions of the Private Securities Litigation Reform Act of 1995 apply to Securities Act claims brought in state court.

As these examples suggest, the law surrounding Cyan remains unsettled. With multiple Securities Act cases pending in New York, California, and elsewhere, the new year may provide more clarity into how state courts are resolving these procedural issues. Equally important, we hope to learn more in 2020 about how different state courts are applying the substantive elements of Securities Act claims at the motion to dismiss stage. In 2019, defendants won several important victories in this regard. Rulings this year may provide more insight into whether trends are developing within or among the states.

The Supreme Court May Address Whether Plaintiffs Can Use ERISA Stock-Drop Suits to Plead Around the Securities Laws

Later this year, we expect the U.S. Supreme Court to issue a decision in issue a decision in Retirement Plans Committee of IBM v. Jander, a closely-watched case that may give the justices a chance to address whether plaintiffs can effectively use ERISA to plead around the federal securities laws. In Jander, plaintiffs accused plan administrators, all of whom were company insiders, of violating ERISA by failing to disclose allegedly negative information about IBM's microelectronics business.

Plaintiffs claimed that during the relevant time period, plan administrators should have understood that the disclosure of this nonpublic information (along with a corresponding drop in the price of IBM stock) was inevitable. As a result, plaintiffs alleged, any prudent fiduciary would have concluded that silence—that is, waiting to reveal the adverse information—would do more harm than good.

In reversing the dismissal of plaintiffs' complaint, the Second Circuit largely agreed with this framing of the "more harm than good" standard first enunciated by the Supreme Court in Fifth Third Bancorp v. Dudenhoeffer.

The Supreme Court is now poised to decide if the Second Circuit properly applied this test. The IBM fiduciaries have argued, in a position supported by the U.S. Solicitor General, that when ERISA fiduciaries learn of inside information that may negatively affect the company's stock price, courts must evaluate a duty to disclose that information by looking solely to the federal securities laws.

Reasoning from this premise, IBM has claimed that the Second Circuit's "inevitable disclosure" standard sweeps far more broadly—and is appreciably more lenient from a pleading perspective—than Dudenhoeffer permits. Indeed, IBM has argued that the Second Circuit's test could, in some cases, require disclosure in situations where the federal securities laws do not. At oral argument last fall, at least three justices—Gorsuch, Kavanaugh, and Alito—expressed concern about such a potential conflict between the two statutory regimes.

This tension speaks to Jander's potential significance. Although much will depend on the court's opinion, if the Second Circuit's test remains intact, plaintiffs may argue that lawsuits involving the same alleged frauds and the same inside information can fail as securities claims but survive as ERISA claims—as was the case in Jander, which saw the dismissal of the underlying securities litigation. This, in turn, could theoretically lead to a proliferation of ERISA stock-drop class actions.

Other Issues to Look Out For in 2020

Finally, we anticipate district and appellate courts will have an opportunity to consider two of the Supreme Court's more notable securities matters from 2019: Lorenzo v. SEC and Emulex Corp. v. Varjabedian.

In Lorenzo, the court held that Lorenzo, an investment banker, was liable under subsections (a) and (b) of Rule 10b-5 for emailing clients a false and misleading investment solicitation that had been prepared by someone else—Lorenzo's boss.

The court's decision meant, in practical terms, that Lorenzo could be held responsible as a primary violator of Section 10(b) despite not having "made" the underlying statement. In 2020, Lorenzo may lead to an increase in private securities claims against disseminators and other non-makers of false and misleading statements, based on the theory that these defendants participated in a scheme to defraud investors.

We also will be tracking any fallout from Emulex, a merger objection suit that was dismissed by the court after oral argument and, crucially, before any decision was issued. The complaint had asserted violations of Section 14(e) of the Exchange Act, a provision that is routinely invoked by private plaintiffs in challenging the accuracy of tender offer materials.

This long-recognized private right of action, however, may be in jeopardy: During oral argument, several justices questioned whether it was even appropriate for a private plaintiff to proceed under Section 14(e). Taking their cues from the Supreme Court, defendants in Section 14(e) suits are likely to challenge the very right of private investors to sue under this section of the Exchange Act. If one of these cases survives long enough, it may well serve as a vehicle for the Court to revisit whether a private right of action exists under Section 14(e).

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