Skadden

13th Annual Securities Litigation and Regulatory Enforcement Update

This memorandum is provided by Skadden, Arps, Slate, Meagher & Flom LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum is considered advertising under applicable state laws.

One Manhattan West
New York, NY 10001
212.735.3000

On September 15, 2020, Skadden held the first program in our annual Securities Litigation and Regulatory Enforcement Update, titled "Developments and Trends in Securities Litigation: Mid-Year Update 2020." The virtual panelists were **Jay B. Kasner**, head of Skadden's nationwide Securities Litigation Group; **Scott D. Musoff**, New York litigation practice leader and co-deputy head of the nationwide Securities Litigation Group; **James R. Carroll,** head of Skadden's Boston office; **Alisha Q. Nanda**, Boston-based litigation partner; **Noelle M. Reed**, Houston litigation practice leader; and guest Kevin LaCroix, author of D&O Diary.

The webinar focused on a number of important developments in securities litigation from the first nine months of 2020, as well as the panelists' predictions on how trends will change or continue in the second half of the year when we hold another webinar focused on year-end trends. The panelists discussed (i) first-half securities litigation filing and settlement trends; (ii) recent developments involving *Omnicare* and *Cyan*; and (iii) other securities filing trends and recent district and appellate court decisions of note, including an increase in filings against non-U.S. issuers and notable decisions involving scienter and class certification.

Below are high-level takeaways on each topic.

Filing and Settlement Trends

The first half of 2020 saw a moderate decrease in securities class action filings compared to last year. This slowdown can be partly attributed to the COVID-19 pandemic, which led to widespread court closures and fewer mergers early in the year. Moreover, while more than 15 COVID-19-related securities actions have been filed so far this year, the amount of litigation generated by the pandemic remains low compared to, for instance, the volume of securities suits brought in the wake of the global financial crisis. Despite the slow start, however, filings are expected to increase as the trajectory of the pandemic improves. Indeed, while only 39 securities actions were filed in May and June of this year, 55 actions were filed in July and August. If these trends continue, it is likely that the total number of securities filings by year's end will align with those seen in recent years.

The number of securities cases settled in the first half of this year hovered at a record low compared to the last 10 years, and the dollar amount of those settlements increased to an average of $37 million — up $9 million from last year. The number of case dismissals,

© Skadden, Arps, Slate, Meagher & Flom LLP. All rights reserved.

on the other hand, has increased. If this trend remains consistent, the number of dismissed securities actions in 2020 will set a new record high for the previous 10-year period.

Recent Developments Concerning Expressions of Opinion in *Omnicare*

In *Omnicare*, Justice Elena Kagan explained that a statement of opinion is not rendered misleading by the failure to disclose "some fact cutting the other way." Rather, plaintiffs continue to face significant hurdles in stating an omissions-based fraud claim based on an opinion statement. Generally optimistic statements by a company about its performance are not likely to be actionable unless they omit "specific material facts."

For example, in recent cases, plaintiffs failed to allege an actionable statement under *Omnicare* where:

- the challenged statement simply conveyed an estimate of loss reserves;
- defendant warned that estimates could change as new information became available;
- defendants disclosed that their projections were tentative and divulged all of the information forming the basis of those projections; and
- the challenged statement omitted individual concerns about clinical studies but stated truthfully that the company was in compliance with recognized clinical standards.

On the other hand, more absolute statements presented without prefatory language may satisfy the pleading standard, especially where such statements are presented as *fact* or containing embedded facts rather than opinion. In *Abramson v. Newlink Genetics Corp.*, plaintiffs successfully alleged that the CEO and president of a pharmaceutical company misled investors by stating in absolute terms that "no major study" achieved the survival rate for pancreatic cancer that the company's clinical trials supported, when in reality, studies from competitors had achieved such survival rates. This type of absolute statement, which was directly contradicted by specific facts, could not survive defendants' *Omnicare* arguments.

Securities Act Litigation Post-*Cyan*

In *Cyan*, the U.S. Supreme Court held that state and federal courts have concurrent jurisdiction over class action claims under the Securities Act of 1933 ('33 Act), and that such claims are not removable to federal court. While *Cyan* led to a significant increase in state court '33 Act filings in recent years, that trend was reversed in the first half of this year, with state court '33 Act filings decreasing for the first time since *Cyan* was decided. That decline can be partially attributed to the sharp drop in '33 Act cases filed in California, where only one such case was brought in the first half of this year, compared to 10 cases filed in the second half of 2019. The decline also is due in part to fewer offerings during the relevant timeframe, with a particular lack of activity in the technology sector impacting California disproportionately. The existing cases have progressed so that parties litigating parallel state and federal securities actions have continued to experience difficulties coordinating the separate lawsuits, a problem exacerbated by the refusal of many state courts to stay securities cases in favor of parallel proceedings in federal court.

While state courts have historically been more hesitant to dismiss securities actions than their federal counterparts, post-*Cyan* results in state court have been more mixed. So far this year, defendants have recorded several notable victories by arguing that an issuer's disclosures adequately warned investors of the risks. In *In re Sundial Growers Inc.*, plaintiffs alleged that a Canadian cannabis producer misled investors as to the quality of its products. The court dismissed the complaint, holding that the company's "robust" risk disclosures adequately alerted investors of any potential quality concerns. Similarly, the court in *In re Altice USA, Inc. Sec. Litig.*, dismissed a securities claim based in part on the strength of the company's disclosed risk factors. On the other hand, state courts have recently sustained or partially sustained several securities actions where the plaintiffs identified specific and concrete statements in the companies' filings that were allegedly false or misleading.[1]

Additional takeaways from recent post-*Cyan* litigation include:

- New York state trial courts have split on whether '33 Act claims are subject to CPLR §3016(b), New York's heightened pleading standard. The Appellate Division has yet to rule on this issue.
- In *In re Sw. Energy Co.*, the Supreme Court of Texas may rule on two key issues impacting securities litigation in that state: (1) whether Texas state courts should be guided by federal securities precedent when analyzing '33 Act claims at the motion to dismiss stage; and (2) the application of the '33 Act's statute of limitations and statute of repose provisions in Texas state court.

[1] *See, e.g.*, *In re Netshoes Sec. Litig. v. XXX*, No. 157435/2018, 2020 WL 2893433 (N.Y. Sup. Ct. June 2, 2020); *PPDAI Grp. Sec. Litig. v. XXX*, 66 Misc. 3d 1226(A), 125 N.Y.S.3d 533 (N.Y. Sup. Ct. N.Y. Cnty. 2020); *Uxin Ltd. Sec. Litig. v. XXX*, 66 Misc. 3d 1232(A), 125 N.Y.S.3d 537 (N.Y. Sup. Ct. N.Y. Cnty. 2020); *Kirkland v. Wideopenwest, Inc.*, No. 653248/2018, 2020 WL 2526982 (N.Y. Sup. Ct. May 18, 2020).

Furthermore, in a highly anticipated ruling, the Delaware Supreme Court held in *Sciabacucchi v. Salzberg* (*Blue Apron*) that Delaware corporations may include provisions in their certificates of incorporation requiring '33 Act claims to be brought in federal court. This decision is significant due to the increasing prevalence of such provisions in corporate charters, which allow corporations to avoid the duplicative litigation of securities claims that has proliferated in the wake of *Cyan*. However, while the Delaware Supreme Court upheld the facial validity of these provisions, whether other states will enforce them is a separate question that will depend on the specific circumstances in each case. In *Wong v. Restoration Robotics, et al*., for instance, a California state court recently held that such a provision in a Delaware corporation's charter was enforceable under California state law. The court dismissed the securities action against the company and its officers and directors based on the charter provision, but declined to dismiss claims against the company's underwriters because they were not signatories to the company's charter. This nuance highlights the unique challenge these provisions pose for underwriters and other non-issuers facing '33 Act claims.

Securities Filings Against Non-U.S. Issuers

While the total number of securities filings is down this year, the number of filings against foreign issuers is up 19% from last year. This is likely due to a number of companies facing accounting issues, a significant uptick in litigation against China-based companies that have entered the U.S. capital markets and the volatility of the Canadian cannabis industry. Indeed, foreign issuers are being sued at a much higher rate than their U.S. counterparts. For example, only 16-17% of U.S.-listed companies are foreign, but they have accounted for 30% of the securities filings this year.

This trend signals a heightened risk for non-U.S. companies and correspondingly higher insurance premiums and retentions being faced by all companies.

Developments Related to Scienter

Scienter remains one of the most successful grounds for dismissal of securities fraud litigation. Courts continue to harbor suspicions about confidential witness statements, which increasingly form the basis of plaintiffs' scienter allegations.

The so-called "corporate scienter" theory is often the last refuge for plaintiffs who have failed to allege factual allegations of scienter against individual defendants. Corporate scienter remains (appropriately) difficult to allege, however, particularly in event-driven litigation where plaintiffs often attempt to impute the knowledge of employees at a far-flung, sometimes foreign, division or subsidiary to the corporation itself. In responding to such allegations, defendants should consider the connection — or lack thereof — between the individuals alleged to have knowledge and the control group.

In *Setzer v. Omega Healthcare Inv'rs, Inc.*, the U.S. Court of Appeals for the Second Circuit held that plaintiffs adequately alleged facts supporting an inference of "conscious recklessness" on the part of the defendant-REIT because it issued statements about its second-largest tenant's financial well-being without disclosing that it had made a $15 million loan to that same tenant, who used that loan to pay the defendant rent. This specific contradictory information supported a "conscious recklessness" theory of fraud-by-omission because plaintiffs showed that a defendant had knowledge of specific, undisclosed information that was inadequate.

On the other hand, in *Hou Liu v. Intercept Pharm, Inc.*, plaintiffs failed to plead "conscious recklessness" because their allegations were based on the vague conclusion that defendants "must have known" adverse information solely because of their positions, even though plaintiffs did not identify specific information in those reports that was directly contradictory to defendants' public statements. There, the U.S. District Court for the Southern District of New York emphasized that plaintiffs failed to plead "motive and opportunity" on the part of defendants and that the generalized motive to avoid adverse effects on the market was not pled with particularity.

Thus, in order to support a theory of corporate scienter — especially on the basis of "conscious recklessness" — plaintiffs must (1) identify *specific facts* that directly contradict the defendants' statements and (2) establish that defendants had access to, or knowledge of, such facts.

Notable Decisions Involving Class Certification

The Second Circuit confirmed in *Arkansas Teacher Retirement Sy v. Goldman Sachs Group, Inc.* (*Arkansas Teachers*) that statements may be actionable when they merely "maintain" a stock price that is inflated for nonfraudulent reasons. In *Arkansas Teachers*, defendant touted its client service capabilities and its protocols for addressing conflicts of interest, but when defendant's numerous conflicts of interest were revealed to the market, its stock price fell. Plaintiffs were successful in arguing that although the misleading statements did not cause the drop in stock price, they maintained an inflated price until the truth was revealed. This "price maintenance" theory may serve as a useful tool for plaintiffs at the class certification stage, as the court rejected many of defendants' arguments regarding materiality.

Another significant class certification opinion recently came from the U.S. District Court for the Eastern District of Virginia in *In re Willis Towers Watson*, where the court rejected defendants' arguments based on the Supreme Court's Comcast decision. In Comcast, the Court held that plaintiffs' damages model could not establish a measurement of loss across the entire class for purposes of Rule 23(b)(3) because it did not connect its measure of damages to plaintiffs' only surviving theory of liability. Defendants in *Willis Towers Watson* argued that plaintiffs' model was similarly flawed because it was based on speculative assumptions and involved inspecting each individual plaintiffs' stockholdings. But the court held that these merits-based arguments were inappropriate at the class certification phase. Plaintiffs' model pertained to an objective question common to all members of the class: the loss in value that they experienced as the result of approval and announcement of a merger. Thus, the model purported to measure loss across the entire class and the court found that certification was warranted. *Willis Towers Watson* clarifies that *Comcast* may not be as useful in defeating class certification as once thought. It appears that in order to meet Rule 23's predominance requirement, plaintiffs merely have to show that their damages model purports to measure the loss across the entire class and that that loss is connected to their theory of liability.

Confidential Witness Allegations and Falsity

As demonstrated by several recent cases, courts in the Second Circuit continue to reject confidential witness allegations that lack specificity as to reliability and substance. In *Woolgar v. Kingstone Companies, Inc*., the District Court rejected as insufficiently detailed confidential witness allegations that defendant company received reports indicating its assets were undervalued, because the plaintiffs did not identify specific information contained in such reports or explain how such information contradicted the defendants' public statements. Similarly, in *In re Adient plc Sec. Litig.*, the District Court discounted confidential witness statements alleging that the defendants must have known about certain undisclosed facts because those facts were purportedly "common knowledge" at the company, finding that the confidential witnesses failed to establish any "specific contradictory information" known by the defendants. Finally, in *Altimeo Asset Management v. Qihoo 360 Technology Co. Ltd. et al.*, the District Court discounted confidential witness allegations that lacked particularized indicia of reliability, including the witnesses' job descriptions. These cases highlight the Second Circuit's willingness to subject confidential witness allegations — which are growing in popularity — to careful scrutiny at the motion to dismiss phase.

Evaluating Disclosures in Their Entirety

In another notable win for defendants, FedEx Corporation recently succeeded in dismissing a disclosure-based derivative suit against its officers and directors. In *FedEx Corp. Derivative Litigation*, the plaintiffs alleged that the defendants had failed to fully disclose the negative impact of a cyberattack on different facets of the company's business, including its operational capacity, customer retention efforts and integration of a major acquisition. In holding that the plaintiffs failed to identify material misstatements or omissions, the Delaware District Court performed a searching inquiry of all disclosures made by the defendants during the relevant time period and concluded that, taken together, their disclosures adequately informed the company's investors of the cyberattack's impact. This case demonstrates the importance of companies not only making specific, as opposed to general, risk disclosures, but also the benefits of keeping those disclosures updated to reflect new events or circumstances.

Loss Causation

Two recent decisions suggest that loss causation may be a particularly useful tool for defendants at the summary judgment stage. *In Loreley Financing (Jersey) No. 3 Ltd. v. Lynch*, the New York Supreme Court for New York County held that "a damages calculation [is] not a proof of proximate cause or loss causation." Plaintiffs alleged that they "overpaid" for certain collateralized debt obligations but did not explain how that overpayment was caused by defendant's actions. Similarly, in *Atlantica Holdings, Inc. v. Sovereign Wealth Fund Samruk-Kazyn*, the Southern District of New York rejected plaintiff's theory that defendant's nondisclosure of a transaction caused plaintiffs' loss because the defendant-bank's financial decline was due to factors other than that transaction. As facts become available at the summary judgment stage, defendants might find success in arguing for dismissal on the basis of a lack of loss causation, especially where plaintiff's allegations lack detail or factual support.

Key Takeaways
13th Annual Securities Litigation and Regulatory Enforcement Update

Contacts

James R. Carroll
Partner / Boston
617.573.4801
james.carroll@skadden.com

Jay B. Kasner
Partner / New York
212.735.2628
jay.kasner@skadden.com

Scott D. Musoff
Partner / New York
212.735.7852
scott.musoff@skadden.com

Alisha Q. Nanda
Partner / Boston
617.573.4804
alisha.nanda@skadden.com

Noelle M. Reed
Partner / Houston
713.655.5122
noelle.reed@skadden.com