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An In-Depth Analysis of Private Federal Securities Litigation

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An Article providing an in-depth analysis of private securities litigation, specifically focusing on securities class actions and the standards created by the US Supreme Court and lower federal courts, as well as offering best practices for defending securities class actions.

Over time, the most common vehicle for private enforcement of the federal securities laws has become the shareholder class action. These cases are often triggered by a mere drop in a public company's stock price, after which shareholder plaintiffs allege that the negative change in price reflects newly public information that the company improperly concealed.

Although federal securities laws have been amended to rein in dubious shareholder suits, securities class actions remain a minefield of exposure for public companies. Indeed, the National Economics Research Associates (NERA) recently reported that the aggregate settlement amount for cases settled in 2022 was $4 billion, approximately $2 billion higher than the inflation adjusted amount in 2021. When compared to 2021, NERA reported that the average settlement value in 2022 increased by more than 70% to $38 million (NERA, Recent Trends in Securities Class Action Litigation: 2022 Full-Year Review, at 1).

As Congress and the courts try to balance the need for full disclosure against the potential for frivolous securities class actions, the legal and regulatory landscape governing securities litigation constantly changes. Counsel and companies involved in these cases must stay informed of the relevant rules and regulations, as well as the evolving jurisprudence.

This Article provides an overview of the development of securities litigation, with a particular focus on securities class actions and the latest standards created by the US Supreme Court and lower federal courts. Specifically, this Article:

- Examines sources of liability in the Securities Act of 1933, as amended (Securities Act) and the Securities Exchange Act of 1934, as amended (Exchange Act), including heightened pleading standards under Section 10(b) of the Exchange Act (see Sources of Liability: The Securities Act and The Exchange Act).
- Explains key issues in shareholder class actions for violations of the securities laws, including the Private Securities Litigation Reform Act of 1995 (PSLRA) and the Securities Litigation Uniform Standards Act (SLUSA) (see Private Enforcement: The Shareholder Class Action).
- Provides best practices for defending securities class actions (see Best Practices for Defending Securities Class Actions).

Sources of Liability: The Securities Act and The Exchange Act

The primary sources of civil liability under the federal securities laws are two New Deal-era statutes: the Securities Act and its close cousin the Exchange Act. The Securities Act regulates the offer and sale of securities, while the Exchange Act creates, among other things, ongoing reporting obligations for public companies.

Securities and Exchange Acts: Historical Backdrop

While various states had previously enacted statutes regulating the offer and sale of securities (so-called Blue Sky laws), the Securities Act was the first federal securities legislation. Although all 50 states, the District of Columbia, Guam, Puerto Rico and the Virgin Islands now have their own Blue Sky laws, federal securities laws have largely displaced these statutes.

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The Securities Act and the Exchange Act have been periodically amended during the past 90 years, but the framework they impose remains fundamentally unchanged. Rather than creating a system to ensure the soundness of marketed securities, the drafters of the Acts opted for a disclosure-based regulatory framework.

President Roosevelt articulated the basic philosophy in remarks to Congress in March 1933. He stated that the federal government "should not take any action which might be construed as approving or guaranteeing that newly issued securities are sound in the sense that their value will be maintained," but had an obligation to ensure that securities sold in interstate commerce be "accompanied by full publicity and information, and that no essentially important element ... shall be concealed from the buying public." (*President Franklin D. Roosevelt, Message to Congress on Federal Supervision of Investment Securities (Mar. 29, 1933)*.)

What is a Security?

A security is defined broadly under both statutes to include stocks, bonds, debentures, a variety of other instruments or, "in general, any interest or instrument commonly known as a security" (15 U.S.C. § 77b(a)(1); 15 U.S.C. § 78c(a)(10);*Marine Bank v. Weaver,* 455 U.S. 551, 555-56 (1982)). The Securities Act and the Exchange Act impose similar disclosure obligations, but, as discussed below, their liability provisions differ in several key respects. A private plaintiff may also bring claims under both the Securities Act and the Exchange Act (see, for example, *Herman & MacLean v. Huddleston,* 459 U.S. 375, 382-83 (1983) (the availability of a Section 11 or 12 claim under the Securities Act does not preclude a Section 10(b) claim under the Exchange Act for the same conduct)).

Courts faced the question of whether a cryptocurrency asset meets the definition of a security under federal securities law (see, *Sec. Exchange Comm'n v. LBRY*, 2022 WL 16744741, at *3-*7 (D.N.H. Nov. 7, 2022) (finding that a blockchain token was a security)).

In 2017, then-SEC Chair Jay Clayton warned cryptocurrency exchanges that many of their products likely qualified as securities and should therefore be registered under federal securities laws. In 2018, he stated that "true" cryptocurrencies like Bitcoin and Ether (that is, those that simply act as replacements for traditional currency) are commodities rather than securities.
To determine whether a digital asset is a security for purposes of the federal securities laws, the SEC considers whether the asset constitutes an "investment contract" under what has come to be known as the three-part *Howey* Test, which requires:

- The investment of money
- In a common enterprise
- A reasonable expectation of profits to be derived from the efforts of others.

(See *Sec. Exch.Comm'n v. W.J. Howey Co.*, 328 U.S. 293 (1946).)

From a procedural standpoint, courts have generally treated the question of whether a cryptocurrency asset is a security as a question of fact not to be determined at the motion to dismiss stage (see, for example, *Underwood v. Coinbase Global, Inc.*, 2023 WL 1431965 (S.D.N.Y. Feb. 1, 2023) (explaining that "whether the [crypto assets] are securities presents a question of fact more suitably litigated at summary judgment")).

For more on how courts determine whether an instrument is a security, see Practice Note, Securities Act: Jurisdictional Defenses: Identifying a Security.

For more information on the other key federal securities laws in the US, including the Sarbanes-Oxley Act of 2002, Trust Indenture Act, Investment Company Act and Investment Advisers Act, see Practice Note, US Securities Laws: Overview.

Liability under the Securities Act

The Securities Act focuses on potential misrepresentations or omissions that an issuer makes when offering securities for sale in the marketplace. The law is based on the premise that investors are capable of evaluating the merits of a securities offering only if they are provided with accurate and complete information regarding the issuer, its securities, and the offering.

The Securities Act generally imposes liability on issuers and other offering participants where publicly filed documents, used during a registered securities offering, contain material misstatements or omissions (*In re Morgan Stanley Info. Fund Sec. Litig.,* 592 F.3d 347, 358 (2d Cir. 2010)). The three primary civil liability provisions are:

- Section 11.
- Section 12(a)(1).
- Section 12(a)(2).

(15 U.S.C. § 77k; 15 U.S.C. § 77l(a).)

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- Counsel defending against claims brought under Section 11 or 12 have several statutory defenses at their disposal, but should be aware of certain nuances that ease a plaintiff's burden in establishing these claims, including: In section 11:
  - the traceability requirement (Section 11: Traceability); and
  - opinion statement liability (Section 11: Opinion Statements Liability Under Section 11).
- In section 12: the definition of seller (see Section 12: Defining a Seller).

For more information on the liability provisions of the Securities Act, see Securities Act and Securities Exchange Act Liability Provisions: Overview: Securities Act of 1933.

Section 11: Traceability

Section 11 allows any person that acquired a security to seek to recover damages from a broad range of defendants, including issuers and underwriters, for material misstatements or omissions in registration documents (15 U.S.C. § 77k(a)). The right to bring an action is limited to plaintiffs that either bought the security directly in the offering or can otherwise trace their purchase back to the relevant offering, also known as the traceability requirement.

Courts have generally interpreted the traceability requirement strictly, requiring plaintiffs to plead that they acquired a security issued under a particular registration statement (see, for example, *In re Ariad Pharmaceuticals, Inc. Sec. Lit.*, 842 F.3d 744, 755-56 (1st Cir. 2016); *Barnes v. Osofsky*, 373 F.2d 269 (2d Cir. 1967)).

The Supreme Court recently affirmed the traceability requirement in *Slack Technologies, Inc. v. Pirani*, holding that Section 11 plaintiffs must plead and prove that they purchased securities under a materially misleading registration statement to have standing to bring a claim under Section 11 (143 S. Ct. 1433 (2023)). In doing so, the Supreme Court vacated a Ninth Circuit decision analyzing this traceablity requirement in the context of a direct listing, where both registered and unregistered shares were publicly traded at the same time. Specifically, the Ninth Circuit held that both registered and unregistered shares in a company's direct listing were sufficiently traceable to the company's registration statement to sustain a Section 11 claim. The Ninth Circuit reached this conclusion even though the plaintiff did not please that the shares he purchased could be traced back to the registration statement that contained the alleged misstatement. (See, *Pirani v. Slack Technologies, Inc*. 13 F.4th 940 (9th Cir. 2021)). The Ninth Circuit reasoned that because no shares in the direct listing could be sold until the issuer filed its registration statement and prospectus, all shares (whether registered or unregistered) were sufficiently traceable to the offering documents that contained the alleged misstatement.

The Supreme Court rejected that reasoning and focused on the text of the statute, explaining that the phrase **such security** in Section 11 only encompasses shares issued pursuant to a registration statement that contained the alleged misstatement or omission and not any security that "bear[s] some sort of minimal relationship" to the registration statement (*Slack,* 143 S. Ct. at 1441). Under that framework, the case was remanded to the Ninth Circuit to determine whether Pirani's pleadings sufficiently allege that his shares are traceable to the challenged registration statement.

Scope of Section 11 Liability

Section 11 imposes potential liability on a broad range of actors, including:

- The company itself, which is the issuer of the security.
- Every person signing the issuer's registration statement.
- Directors of or partners in the issuer at the time the statement was filed.
- The underwriter.
- Accountants and other professionals named as having prepared or certified any part of the registration statement or any report or valuation used in connection with the registration statement regarding the portion the professional purportedly prepared or certified.

(15 U.S.C. § 77k(a).)

Section 11: Opinion Statements

In *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*, the Supreme Court addressed the issue of when a statement of opinion constitutes a false or misleading opinion statement that may render an issuer liable under Section 11, such as an issuer's statement that "we believe that our pharmacy practices are in compliance with applicable federal and state laws" (575 U.S. 175 (2015)). The Court held that for a statement of opinion to render an issuer liable under Section 11:

- The speaker must not have honestly held the stated opinion.
- A fact supplied in support of the stated opinion was false.

(*Omnicare*, 575 U.S., at 185-86).

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The Court also held that an opinion statement can be misleading under Section 11 when the registration statement omits material facts about the issuer's inquiry into or knowledge about the opinion statement and those facts "conflict with what a reasonable investor would take from the statement itself" (*Omnicare*, 575 U.S., at 189). The Court clarified that whether an omission of material fact renders an opinion statement misleading "always depends on context" (*Omnicare*, 575 U.S., at 190).

Courts have applied the *Omnicare* standards for pleading actionable opinion statements to claims outside of the Securities Act as well (see, for example, *City of Dearborn Heights Act 345 Police & Fire Ret. Sys. v. Align Tech., Inc.*, 856 F.3d 605, 610 (9th Cir. 2017) (holding that the *Omnicare's* standards for pleading actionable opinion statements apply to Section 10(b) and Rule 10b-5 claims under the Exchange Act)).

Section 12: Defining a Seller

Section 12 permits buyers of a security to rescind a purchase or sue for damages if they have already sold the security.

Section 12(a)(1) imposes absolute liability on any person offering or selling a security in violation of the registration requirements of Section 5 of the Securities Act (15 U.S.C. § 77l(a)(1)). Under Section 12(a)(1), a seller is any person who successfully solicits a purchase of securities on the basis of a desire to serve the person's own financial interests or those of the owner of the security (*Pinter v. Dahl*, 486 U.S. 622, 646-47 (1988); *In re Morgan Stanley*, 592 F.3d at 359 (applying the statutory seller definition to claims brought under Section 12(a)(2))).

A seller can be held strictly liable to any purchaser of securities able to prove that they purchased securities that were sold by the seller that should have been registered under Section 5 of the Securities Act but were not. Effectively, Section 12(a)(1) holds underwriters, broker-dealers, selling agents, and others directly involved in the selling process liable for any violation of the registration requirements.

Section 12(a)(2) supplements Section 11 and creates liability by permitting rescission where someone offers or sells a security "by means of a prospectus or oral communication" that contains a material misstatement or omission (15 U.S.C. § 77l(a)(2)).

To show that a defendant is a seller under Section 12, the Second and Third Circuit Courts of Appeal have required direct solicitation (see, for example, *Capri v. Murphy*, 856 F.2d 473, 478-79 (2d Cir. 1988) (holding that a plaintiff must demonstrate that the defendant actually solicited the plaintiff's specific investment for the defendant to qualify as a seller under Section 12); *Underwood v. Coinbase Global, Inc.*, 2023 WL 1431965, at *9 (S.D.N.Y. Feb. 1, 2023) (similar); see also *Craftmatic Sec. Litig. v. Kraftsow*, 890 F.2d 628, 636 (3d Cir. 1989) (holding that a defendant must engage in "direct and active participation in the solicitation of the immediate sale" to qualify as a Section 12 seller)).

The Ninth and Eleventh Circuits recently endorsed a broader definition of a statutory seller, in ruling that even mass communication efforts promoting an unregistered security, including on social media posts not directed at any particular individual, may qualify as impermissible solicitation under Section 12 of the Securities Act (see, for example, *Wildes v. BitConnect Int'l PLC*, 25 F.4th 1341 (11th Cir. 2022) (ruling that online videos by defendant online marketers and "influencers" to promote cryptocurrencies may qualify as solicitation under Section 12(a)(1) of the Securities Act), cert. denied sub nom. *Arcaro v. Parks*, 143 S. Ct. 427 (2022); *Pino v. Cardone Capital*, 55 F.4th 1253 (9th Cir. 2022) (ruling that Instagram posts and YouTube videos could qualify as solicitation under Section 12 of the Securities Act)).

Until the Supreme Court resolves this issue, the question of what constitutes impermissible solicitation rendering a defendant a seller under Section 12 may vary depending on the jurisdiction where the plaintiff files the complaint.

Defending Section 11 and 12 Claims

Counsel defending against Section 11 or 12 claims may consider asserting a series of defenses, including:

- **Plaintiff's knowledge.** Defendants may assert that the plaintiff had knowledge of the untruth or omission at the time the plaintiff purchased the security (15 U.S.C. § 77k(a); 15 U.S.C. § 77l(a)).
- **Negative causation.** The defendant's alleged misstatements or omissions did not cause the security's decline in value, which was instead attributable to a general decline in the market (15 U.S.C. § 77k(e); 15 U.S.C. §§ 77l(a),(b)).
- **Due diligence.** The non-issuer defendant, after conducting a reasonable investigation, reasonably believed that the registration statement was accurate and complete (known as the due diligence defense) (see 15 U.S.C. §§ 77k(a)(4)-(5), (b)(3); 15 U.S.C. § 77l(a)(2)).

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There are several aspects of these rules that may make establishing a Section 11 or 12 claim easier for a plaintiff. For example:

- **Reliance.** A plaintiff does not need to demonstrate reliance on the defendant's alleged misstatements, unless it is a Section 11 claim and the plaintiff purchased the security after the defendant issued an earnings statement covering a period of at least one year beginning after the effective date of the registration statement (see 15 U.S.C. §77k(a)).
- **Heightened pleading standard.** A plaintiff generally does not need to make a particularized showing of fraud under Federal Rule of Civil Procedure (FRCP 9(b), except where the plaintiff's claims "sound in fraud" (see *Rombach v. Chang*, 355 F.3d 164, 170-71 (2d Cir. 2004)).
- **Scienter.** A plaintiff does not need to make a showing of the defendant's mental state, in contrast to Section 10(b) of the Exchange Act (see Scienter). However, where a claim sounds in fraud, some courts have applied *Rombach* to dismiss Securities Act claims that fail to plead scienter (see, for example, *In re Chembio Diagnostics, Inc. Sec. Litig.*, 2022 WL 2872671, at *7 (E.D.N.Y. July 21, 2022); *Caiafa v. Sea Containers Ltd.*, 2008 WL 11516813, at *5-*6 (S.D.N.Y. May 15, 2008)).

For more information on elements and defenses of Sections 11 and 12, see Practice Notes, Securities Act: Section 11 Elements and Defenses; Securities Act: Section 12(a)(1) Elements and Defenses; and Securities Act: Section 12(a)(2) Elements and Defenses.

For more on the due diligence defense and information on other aspects of Section 11 and 12 claims, such as control person liability, fraud under Section 17, and the damages and equitable relief available under the Securities Act, see Practice Note, Liability Provisions: Securities Offerings.

The Exchange Act: Liability under Section 10(b) and Rule 10b-5

While the Securities Act applies to misstatements or omissions in the initial registration and offering of securities, the Exchange Act creates liability to private plaintiffs for any misstatements or omissions relating to the purchase or sale of securities. It therefore renders any allegedly materially misleading public statement a potential source of liability, including those in SEC filings, on earnings calls or in press releases.

The best-known and most often invoked Exchange Act provision is Section 10(b). This catch-all antifraud provision makes it unlawful to "use or employ, in connection with the purchase or sale of any security" a "manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe" (15 U.S.C. § 78j(b)).

The SEC's implementing regulation, Rule 10b-5, further defines the scope of the statutory language. The rule renders it unlawful, in connection with the purchase or sale of any security, to:

- Employ any device, scheme, or artifice to defraud.
- Make any untrue statement of a material fact or omit to state a material fact necessary to make the statements made not misleading.
- Engage in any act, practice, or course of business that operates or would operate as a fraud or deceit on any person.

(17 C.F.R. § 240.10b-5.)

For a collection of resources on asserting claims under Section 10(b), see Exchange Act: Section 10(b) Asserting Securities Fraud Toolkit. For resources on defending against Section 10(b) claims, see Exchange Act: Section 10(b) Defense Toolkit.

Section 10(b): Elements of Claim

While Section 10(b) is broader in scope than Section 11 or 12 of the Securities Act, a plaintiff carries a heavier burden in proving a Section 10(b) claim. Specifically, to establish liability under Section 10(b), a plaintiff must show that:

- The defendant made a material misstatement or omission (see Misstatement or Omission and Materiality).
- The misstatement or omission was made with an intent to deceive, manipulate or defraud (that is, with scienter) (see Scienter).
- There is a connection between the misstatement or omission and the plaintiff's purchase or sale of a security (see In Connection With a Purchase or Sale).
- The plaintiff relied on the misstatement or omission (see Reliance).
- The plaintiff suffered economic loss that is causally connected to the misstatement or omission (see Loss Causation).

(*Dura Pharms., Inc. v. Broudo,* 544 U.S. 336, 341-42 (2005).)

Given the frequency of Section 10(b) lawsuits, each of these elements is constantly being tested as courts calibrate the appropriate scope of liability in light of the broad statutory language and the judicially-created nature of the action.

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Misstatement or Omission

Section 10(b) requires a defendant to have made a misstatement or omission. An omission may only give rise to liability if it was necessary to render another statement not misleading or if the defendant had a duty to disclose (see, *Basic Inc.,* 485 U.S. at 239 n.17 (silence, absent a duty to disclose, is not misleading)).

In a seminal decision, *Janus Capital Group, Inc. v. First Derivative Traders*, the Supreme Court addressed what it means to "make" an untrue statement under Rule 10(b)-5(b) (131 S. Ct. 2296 (2011)). The Court found that a mutual fund investment adviser cannot be held liable for false statements in its clients' prospectuses, as it did not "make" the statements at issue. Rejecting the argument that liability can be extended to the person providing the false information, the Court held that "the maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it." (*Janus,* 131 S. Ct., at 2300-02.) For more on the *Janus* decision and its implications, see Practice Note, Liability Provisions: Securities Offerings: Limitation of Liability Under Rule 10b-5 to Those Who Actually Make Misstatements.

More recently, in *Lorenzo v. Securities Exchange Commission*, the Supreme Court addressed liability under Rules 10b-5(a) and (c) (the "scheme liability" provisions) (139 S. Ct. 1094 (2019)). The question before the Court in *Lorenzo* was whether an investment banker may be liable under Rule 10b-5(b), when his boss directed him to send an email to investors that contained false statements. *Lorenzo*, 139 S. Ct., at 1099-1100. The Court held that although the defendant was not the maker of the allegedly false or misleading statement under subsection (b), he was liable under subsections (a) and (c) for "disseminat[ing] false or misleading statements to potential investors with the intent to defraud." (*Lorenzo*, 139 S.Ct. at 1099-1100).)

Since *Lorenzo*, the SEC has invoked 10b-5(a) and (c) to target behind-the-scene actors alleging that they engaged in a scheme to disseminate false information (see, for example, *Malouf v. Sec. Exch. Comm'n*, 933 F.3d 1248, 1261 (10th Cir. 2019) (defendant's knowledge "that a conflict existed" and "that [an investment advisor] was telling its clients that he was independent," combined with his failure to correct the advisor's statements constituted an unlawful fraudulent scheme)). Scheme liability, however, still requires conduct beyond misstatements and omissions. For example, in *Securities Exchange Commission v. Rio Tinto*, the court held that the SEC's Rule 10b-5(b) claims only identified misstatements and omissions under 10b-5(b), not "actions" or "conduct" actionable under 10b-5(a) or (c) (2019 WL 1244933, at *15-16 (S.D.N.Y. Mar. 18, 2019)). In affirming the district court's denial of a rehearing, the Second Circuit observed:

> "For now [*Lentell v. Merrill Lynch & Co.*, 396 F.3d 161 (2d Cir. 2005)] tells us that misstatements or omissions alone are not enough for scheme liability, and Lorenzo tells us that dissemination is one example of something extra that makes a violation a scheme."

(*Sec. Exch. Comm'n v. Rio Tinto*, 41 F.4th 47, 57 (2d Cir. 2022).)

The Supreme Court has declined to imply a private cause of action for aiding and abetting liability under Section 10(b), in part because the express liability provisions of the Securities and Exchange Acts do not allow for it (see *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.,* 511 U.S. 164, 176-77, 179-80, 191 (1994)). The SEC is not bound by this limitation (see 15 U.S.C. § 78t(e);*Sec. Exch. Comm'n v. U.S. Envtl., Inc.,* 155 F.3d 107, 113 (2d Cir. 1998)).

For tips and strategies on pleading and proving misstatements or omissions, see Practice Note, Exchange Act: Section 10(b) Pleading & Proving Materiality. For more on defending against these claims, see Practice Note, Exchange Act: Section 10(b) Defenses Against Materiality Claims. For more on scheme liability, see Practice Note, Exchange Act: Section 10(b) Scheme Liability and Market Manipulation.

Materiality

Only a material misstatement or omission can give rise to liability under Section 10(b) and Rule 10b-5 (17 C.F.R. § 240.10b-5). A fact is material if "there is a substantial likelihood that a reasonable shareholder would consider it important" in making his investment decision. The misstatement or omission is not viewed in a vacuum. The question is instead whether disclosure "significantly altered the "total mix" of available information." (*Basic,* 485 U.S. at 231-32 (quoting *TSC Indus., Inc. v. Northway, Inc.,* 426 U.S. 438, 449 (1976)).)

Materiality generally is a mixed question of law and fact and is decided as a matter of law only when "reasonable minds could not differ on" the statement's importance (see, *Litwin v. Blackstone Grp., L.P.,* 634 F.3d 706, 717 (2d Cir. 2011)). However, there are cases where this standard is met and alleged misstatements or omissions are deemed immaterial as a matter of law. For example, certain statements may be considered mere "puffery" when they

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are too general to induce a reasonable investor's reliance on them (see, for example, *City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG,* 752 F. 3d 173, 186-86 (2d Cir. 2014) (explaining that to be material under Section 10(b), the alleged misstatement "must be sufficiently specific for an investor to reasonably rely on that statement as a guarantee of some concrete fact or outcome")).

The Supreme Court addressed materiality in *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309 (2011). In *Matrixx*, it considered whether a pharmaceutical company's failure to disclose adverse event reports associated with one of its products was material, where the reports did not disclose a "significant number of adverse events." (*Matrixx*, 131 S. Ct., at 1313.)

The Court held that the plaintiffs had adequately pled materiality given the quality of the reports, the commencement of related product liability lawsuits, previous studies which lent credibility to the reports and the fact that the product in question allegedly accounted for 70% of the defendant's sales. Because these facts suggested "a significant risk to the commercial viability of [the defendant's] leading product," it was "substantially likely that a reasonable investor would have viewed this information as having significantly altered the total mix of information" (*Matrixx,* 131 S. Ct. at 1313-14, 1323 (internal quotations omitted)). For more on the *Matrixx* decision, see Legal Update, US Supreme Court Rejects Bright-line Materiality Standard for Section 10(b) and Rule 10b-5 Claims.

For tips and strategies on pleading and proving materiality, see Practice Note, Exchange Act: Section 10(b) Pleading & Proving Materiality. For more on defending against these claims, see Practice Note, Exchange Act: Section 10(b) Defenses Against Materiality Claims.

Scienter

A plaintiff pursuing a Section 10(b) claim must demonstrate that the defendant acted with scienter or the intent to deceive, manipulate, or defraud. Although negligent conduct is insufficient to create liability, reckless conduct may satisfy this requirement and the necessary degree of recklessness varies. (*Tellabs, Inc. v. Makor Issues & Rights, Ltd.,* 551 U.S. 308, 319 & n.3 (2007);*Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 193, 214 (1976).)

The PSLRA requires a plaintiff to state with particularity facts giving rise to a strong inference that the defendant acted with the requisite state of mind (see *Tellabs, Inc.,* 551 U.S. at 321; see also PSLRA). When evaluating whether a plaintiff has met this standard, a court "must consider plausible, nonculpable explanations for the defendant's conduct, as well as inferences favoring the plaintiff." A complaint survives only where a reasonable person can deem the inference of scienter "cogent and at least as compelling as any opposing inference" that may be drawn from the facts alleged. (See, *Tellabs, Inc.,* 551 U.S. at 323-24.)

The formulation of the scienter standard adopted by the US Court of Appeals for the Second Circuit is illustrative. Under that standard, a plaintiff may sufficiently plead scienter by alleging facts showing either:

- The defendant had both motive and opportunity to commit fraud.
- Strong circumstantial evidence of conscious misbehavior or recklessness.

(See *Novak v. Kasaks,* 216 F.3d 300, 307-308 (2d Cir. 2000) (noting that only an "extreme departure from the standards of ordinary care … to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it" may constitute recklessness severe enough to give rise to liability) (internal quotations omitted).)

For example, courts have found scienter to be insufficiently pled where:

- The plaintiffs alleged that the defendant attempted to inflate its stock price to, among other things, reduce the cost of acquiring another financial institution and that the individual defendants were motivated to increase their compensation and bonuses (see *ECA & Local 134 IBEW Joint Pension Tr. of Chicago v. JP Morgan Chase Co.,* 553 F.3d 187, 200-201 (2d Cir. 2009)).
- The plaintiffs' confidential witness allegations asserted that various managers at a subsidiary had knowledge of undisclosed customs violations and that high-level officers of the defendant meets with the subsidiary's management (see *Rahman v. Kid Brands, Inc.,* 736 F.3d 237, 243-44 (3d Cir. 2013)).
- The plaintiffs' allegations that a medical device manufacturer misleadingly stated that its product was to be approved by the FDA despite allegedly knowing it was not to be approved due to unresolvable device migration problems, because the "notion that a company would promise FDA approval that it knew would not materialize" does not, without more, "make a whole lot of sense" (*Nguyen v. Endologix, Inc.*, 962 F.3d 405, 415-16 (9th Cir. 2020)).

For tips and strategies on pleading and proving scienter, see Practice Note, Exchange Act: Section 10(b) Pleading & Proving Scienter. For information about defending

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against these claims, see Practice Note, Exchange Act: Section 10(b) Defenses Against Scienter Claims.

In Connection With a Purchase or Sale

Section 10(b) prohibits certain acts "in connection with the purchase or sale of any security" (15 U.S.C. § 78j(b)). It is well-settled that a private action under Section 10(b) can be brought only by a buyer or seller of the security. Therefore, a potential buyer dissuaded from purchasing as a result of a fraudulent misstatement or an investor holding a security and, in reliance on the alleged misstatement, did not sell it, cannot bring suit (see *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit,* 547 U.S. 71, 79-80 (2006)*; Blue Chip Stamps,* 421 U.S. at 730-31, 737-38).

The Second Circuit recently declined to broaden this purchaser-seller rule when it rejected a plaintiffs' proposed direct relationship test, under which a Section 10(b) claimant was able to demonstrate standing by making a sufficiently direct link between one company's misstatements and another company's stock price (*Menora Mivtachim Ins. Ltd. v. Frutarom Indus. Ltd.*, 54 F.4th 82, 87 (2d Cir. 2022)). In *Menora*, plaintiffs, investors in a company (acquiror) that later acquired another company (target), alleged that the target company violated Section10(b) by engaging in bribery before the acquisition.

The Second Circuit held that plaintiffs lacked standing to sue under Section 10(b) as investors in the acquiror (not the target) because standing "does not depend on the significance or directness of the relationship between the two companies, but whether the plaintiff bought or sold the securities about which the misstatements were made" (*Menora*, 54 F.4th,. at 88-89). This decision reaffirmed the widespread acceptance of the purchaser-seller rule adopted by the Supreme Court in *Blue Chip Stamps*.

While the courts have narrowed plaintiff classes to buyers and sellers, the in connection with requirement is read broadly in other respects. For example, in *Securities Exchange Commission v. Zandford*, the Supreme Court rejected the proposition that the in connection with language was limited to violations in connection with "market integrity or investor understanding" (535 U.S. 813, 818 (2002)). It instead held that conduct was in connection with a securities transaction where a broker "made a series of transactions that enabled him to convert the proceeds of the sales of [his clients'] securities to his own use," regardless of whether his conduct influenced his clients' trading decisions (*Zandford*, 535 U.S. at 820-21).

Courts have also focused on the in connection with requirement in determining the scope of SLUSA, which precludes certain state law class actions that allege a misrepresentation or an omission of a material fact in connection with the purchase or sale of a covered security (see *Chadbourne & Parke LLP v. Troice,* 134 S. Ct. 1058, 1064 (2014);*Dabit,* 547 U.S. at 84; see also SLUSA).

For tips and strategies on meeting the in connection with requirement, see Practice Note, Exchange Act: Section 10(b) Pleading and Proving a Connection with the Purchase or Sale of a Security. For defenses, see Practice Note, Exchange Act: Section 10(b) Defenses Against an Alleged Connection with the Purchase or Sale of a Security.

Reliance

Reliance, sometimes called transaction causation, provides the requisite causal connection between an alleged misstatement or omission and the plaintiff's injury (*Basic Inc.,* 485 U.S. at 243).

In cases involving affirmative misstatements, the most direct way to demonstrate reliance is to show that the plaintiff was aware of a company's statement and engaged in the relevant transaction based on that specific misrepresentation (*Erica P. John Fund, Inc. v. Halliburton Co.,* 131 S. Ct. 2179, 2185 (2011)).

Where omissions are at issue, reliance may be presumed under certain circumstances. In *Affiliated Ute Citizens of Utah v. United States*, the Supreme Court held that where a plaintiff alleged that the defendant breached an affirmative duty to disclose certain information, the plaintiff did not need to show proof of reliance on the purported omission (406 U.S. 128 (1972)). Instead, it was enough to show that the withheld facts were material or important to a reasonable investor (*Affiliated Ute,* 406 U.S., at 153-54). Under the *Affiliated Ute* presumption, lack of reliance remains a viable defense in omission cases, effectively shifting the burden to the defendant to demonstrate that the plaintiff did not rely on the misstatement or omission.

The most common use of a reliance presumption is based on the fairly controversial fraud on the market theory. Under this theory, plaintiffs are afforded a presumption that the prices of shares traded in an efficient market reflect any material misrepresentations. Therefore, the typical investor buying or selling stock at the market price does so relying on the belief that the price reflects all public, material information. (*Halliburton,* 134 S. Ct. at 2408 (citing *Basic,* 485 U.S. at 247).) This presumption permits class action plaintiffs to avoid individualized issues of reliance when moving to certify a class (see Fraud on the Market Presumption).

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In *Goldman Sachs v. Arkansas Teachers Retirement System*, the Supreme Court addressed this reliance presumption at the class certification stage (141 S. Ct. 1951 (2021)). In *Goldman*, the Court held that at the class certification stage, courts may consider the generic nature of an alleged misrepresentation as evidence of the lack of price impact in determining whether a defendant has rebutted the presumption of classwide reliance recognized in *Basic Inc. v. Levinson*. The Court held in *Goldman* that in assessing price impact at class certification, courts should be open to all probative evidence on that question, regardless of whether the evidence is also relevant to a merits question like materiality. The Court further held that defendants seeking to rebut the *Basic* presumption bear not only the burden of production, but also the ultimate burden of persuasion to prove lack of price impact by a preponderance of the evidence.

For tips and strategies on showing reliance, see Practice Note, Exchange Act: Section 10(b) Pleading & Proving Reliance. For defenses, see Practice Note, Exchange Act: Section 10(b) Defenses Against Reliance Claims.

Loss Causation

Under Section 10(b), a plaintiff must also demonstrate loss causation or a link between a misstatement or omission and the damages sought. Put differently, the misrepresented or concealed information must have negatively affected the stock price (*Dura Pharms.,* 544 U.S. at 346).

A plaintiff often makes this showing by pointing to a later disclosure that seeks to correct the alleged misstatement or omission and triggers a negative response from the market, commonly known as a corrective disclosure. However, to estasblish loss causation, the plaintiff must show that the alleged corrective disclosure disclosed **new** information (see, for example, *In re Omnicom Grp., Inc. Sec. Litig.,* 597 F.3d 501, 511 (2d Cir. 2010) (holding that negative news that caused a stock price decline cannot give rise to liability under Section 10(b) if the news did not disclose new information)).

Recently, the Ninth Circuit Court of Appeals held that allegations in a separate civil lawsuit may constitute a "corrective disclosure" in a securities fraud action (see *In re Bofl Holding, Inc. Sec. Litig.*, 977 F.3d 781 (9th Cir. 2020)). The Ninth Circuit rejected the lower court's holding that loss causation had not been adequately pled because the claims in the civil lawsuit were merely unconfirmed allegations of fraud and instead held that the plaintiffs need not establish the allegations as true, but only that the market reasonably perceived them as true.

For tips and strategies on showing loss causation and economic loss claims, see Practice Notes, Exchange Act: Section 10(b) Pleading and Proving Loss Causation and Exchange Act: Section 10(b) Pleading and Proving Economic Loss. For defenses, see Practice Notes, Exchange Act: Section 10(b) Defenses Against Loss Causation Claims and Exchange Act: Section 10(b) Defenses Against Economic Loss Claims.

Defenses Against Section 10(b) Claims

In addition to challenging a plaintiff's complaint for failure to adequately plead or prove the required elements of a Section 10(b) claim, defendants commonly defend against these claims on other grounds, including that the plaintiff's claim:

- Involves securities not listed on a US exchange or purchased or sold within the US (see Extraterritoriality).
- Was not brought within the applicable statutory period (see Timeliness).

For more on the extraterritoriality issue, see Practice Note, Exchange Act: Section 10(b) Jurisdictional Defenses: Identifying a Domestic Transaction. For more on timeliness, see Practice Note, Exchange Act: Section 10(b) Elements and Defenses: Timeliness. For more on other threshold defenses to claims under section 10(b), see Practice Note, Exchange Act: Section 10(b) Elements and Defenses: Threshold Defenses in Securities Fraud Cases.

Extraterritoriality

The Supreme Court has interpreted Section 10(b) to apply only to securities listed on domestic exchanges or domestic transactions in other securities (see *Morrison v. Nat'l Austl. Bank Ltd.,* 561 U.S. 247, 273 (2010)). Therefore, private claims under Section 10(b) are not actionable if the relevant securities were not listed on a US exchange and the purchase or sale did not occur within the US.

Since the *Morrison* decision, courts have struggled to define the appropriate scope of the domestic transaction requirement, as highlighted by a disagreement between the Second and Ninth Circuits on this question. For example, in *Parkcentral Global Hub Ltd. v. Porsche Automotive Holdings SE*, the Second Circuit declined to extend the second prong of *Morrison* to domestic securities transactions where "foreign elements" dominated (763 F.3d 198 (2d Cir. 2014); see also, *Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60, 67 (2d Cir. 2012) (articulating a test that looks to whether "irrevocable liability is incurred or title passes within the United States" for determining whether a transaction

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involving securities that are not listed on a U.S. exchange may be deemed domestic under *Morrison*)).

However, the Ninth Circuit disagreed, finding the decision in *Parkcentral* contrary to Section 10(b) and *Morrison* (see *Stoyas v. Toshiba Corp*., 896 F.3d 933, 950 (9th Cir. 2018) (holding that the purchase of unsponsored foreign American Depositary Receipts from a domestic investment manager and broker was a domestic transaction)). Accordingly, it remains unclear whether the Exchange Act applies to all domestic transactions or only those where foreign elements are not predominate.

For more on the *Morrison* decision, see Article, In Dispute: Morrison/National Australia Bank.

Timeliness

A plaintiff's ability to bring claims under Section 10(b) faces two temporal limitations, which must both be satisfied:

- Claims must be brought within two years of "discovery of the facts constituting the violation."
- Claims cannot be brought more than five years after the alleged violation.

(28 U.S.C. § 1658(b).)

The two-year limitations period is triggered once the plaintiff discovers or with reasonable diligence should have discovered the facts constituting the violation, whichever comes first (see *Merck & Co. v. Reynolds,* 559 U.S. 633, 653 (2010)).

In other words, where the plaintiff never actually learned of the alleged fraud, the limitations period commences when "a reasonable investor conducting … a timely investigation would have uncovered the facts constituting a violation" (*City of Pontiac Gen. Employees' Ret. Sys. v. MBIA, Inc.,* 637 F.3d 169, 174-75 (2d Cir. 2011) (a fact is sufficiently discovered when "a reasonably diligent plaintiff would have sufficient information about that fact to adequately plead it in a complaint")).

Private Enforcement: The Shareholder Class Action

Because of its broad applicability, Section 10(b) of the Exchange Act is the most common vehicle for shareholders of a public company to bring securities law claims, often by filing a class action. To curb frivolous securities fraud claims by plaintiffs brought with the intent of extracting settlement (known as strike suits), Congress enacted the PSLRA and SLUSA, imposing additional requirements for securities fraud class actions that do not apply to other types of class actions.

Although a securities class action must meet the same certification requirements as any other federal class action and is typically brought under FRCP 23(b)(3), several judicially created requirements have also emerged that afford securities class action plaintiffs favorable presumptions in the class certification process.

For information on federal class actions, including an overview of class action prerequisites and types and the certification process, see Practice Notes, Class Actions: Overview and Class Actions: Certification.

Preventing Abuse by Legislation: PSLRA and SLUSA

Securities class actions brought under Section 10(b) are often triggered by any drop in a public company's stock price, after which shareholder plaintiffs allege that the negative change in price reflects newly public information that the company failed to disclose. A company's changing economic realities may make it vulnerable to these types of allegations, with a potential for large monetary exposure.

This may be true even when the change in stock price results from circumstances beyond the company's control and the underlying misrepresentation claims ultimately are meritless because public companies often prefer to settle even frivolous claims than suffer from a negative media exposure and letting unsympathetic juries decide these claims (see *Dura Pharms.,* 544 U.S. at 342-43 (noting that there may be many reasons why a stock trades at a lower price, other than earlier misrepresentations)).

As the Supreme Court acknowledged almost 50 years ago, "litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general" (*Blue Chip Stamps,* 421 U.S. at 739-40). One concern is that even a meritless case has a "settlement value to the plaintiff out of any proportion to its prospect of success at trial" (*Blue Chip Stamps,* 421 U.S. at 740). Not only is defending these types of cases extremely costly, but the mere pendency of the case may impact the company's business, creating a particular danger of strike suits (see *Halliburton,* 134 S. Ct. at 2413).

Possible abuse of the liberal discovery rules also "may likewise exist in this type of case to a greater extent than … in other litigation" because these cases often involve depositions of corporate officers and extensive

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document productions (*Blue Chip Stamps,* 421 U.S. at 741). This concern has heightened resonance, of course, in the age of electronic discovery.

In response to these concerns, Congress enacted two legislations:

- The Private Securities Litigation Reform Act (PSLRA).
- The Securities Litigation Uniform Standard Act (SLUSA).

The Private Securities Litigation Reform Act (PSLRA)

Enacted in 1995, PSLRA was designed to improve the efficiency of capital markets and foster economic growth by deterring frivolous and burdensome securities litigation suits that were seemingly filed every time an issuer's stock price experienced a significant change. (*Dabit,* 547 U.S. at 81 (citing H.R. Conf. Rep. No. 104-369, at 31 (1995)).)

The PSLRA amended both the Securities Act and the Exchange Act. It contains several procedural reforms for federal securities class actions based on fraud allegations, including, among other things:

- A heightened pleading standard that requires Section 10(b) plaintiffs to:
  - identify each allegedly fraudulent statement;
  - explain why each statement purportedly is fraudulent;
  - state with particularity facts giving rise to a strong inference that the defendant acted with scienter; and
  - plead and prove that the alleged misconduct caused the purported loss.

  (15 U.S.C. §§ 78u-4(b)(1)-(2), (4); see also*Tellabs, Inc.,* 551 U.S. at 313-14*; Dura Pharms.,* 544 U.S. at 341-42.)
- An automatic stay of discovery during the pendency of a motion to dismiss, absent a finding "that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to [either] party" (15 U.S.C. § 77z-1(b)(1); 15 U.S.C. § 78u-4(b)(3)(B)).
- A safe harbor for forward-looking statements that were accompanied by meaningful cautionary language or were not knowingly false when made (15 U.S.C. § 77z-2(c)(1); 15 U.S.C. § 78u-5(c)(1); see also *Slayton v. Am. Express Co.,* 604 F.3d 758, 765-66 (2d Cir. 2010)).
- A cap on damages under the Exchange Act that is limited to the difference between the price a plaintiff paid for a security and that the security's mean trading price during the 90 days after corrective information was released to the market (15 U.S.C. § 78u-4(e)(1)).
- New procedures relating to the appointment of class action plaintiffs and counsel, meant to ensure that the lead plaintiff has a significant stake in the litigation (15 U.S.C. § 77z-1(a)(3); 15 U.S.C. § 78u-4(a)(3)).

Because of the restrictions on who may be the lead plaintiff in a securities class action, lead plaintiffs are now usually institutional investors, typically holding a larger financial stake in the company than individual shareholders.

For more on PSLRA's requirements for class actions, see Practice Notes, Securities Litigation Involving the Private Securities Litigation Reform Act (PSLRA) and Challenging Standing in Securities Class Actions: PSLRA Lead Plaintiff Standing.

The Securities Litigation Uniform Standards Act (SLUSA)

Despite the explicit intentions behind enacting the PSLRA, securities class action plaintiffs and their counsel began filing cases involving securities traded on national exchanges in state courts, a rare tactic at the time, to avoid the new federal statutory requirements. To curtail this practice and prevent certain state securities class actions alleging fraud from being used to frustrate the objectives of the PSLRA, in 1998, Congress passed SLUSA, which gives federal courts exclusive jurisdiction over certain securities class actions (15 U.S.C. § 77p(b)).

Specifically, SLUSA provides that no covered class action may be brought under state law by a private party alleging, among other things, "a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security" (15 U.S.C. § 78bb(f)(1)(A)). If a class action that meets this description is brought in state court, it may be removed to federal court and dismissed on preemption grounds (15 U.S.C. §§ 77p(b)-(c); 15 U.S.C. §§ 78bb(f)(1)-(2)).

The statute defines covered class action as any lawsuit or group of lawsuits, not including derivative suits, involving common questions of law or fact "in which damages are sought on behalf of more than 50 persons or prospective class members" (15 U.S.C. § 77p(f)(2); 15 U.S.C. § 78bb(f)(5)). The three causes of action that are expressly excluded from SLUSA's reach and may be brought in state court include:

- State law claims arising in the proxy solicitation or tender offer context relating to an equity holder's decision on how to vote or in exercising dissenters' rights or appraisal rights, commonly known as the Delaware carve-out (15 U.S.C. § 78bb(f)(3)(A)(ii)).

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- Securities suits brought by a state, political subdivision of a state or state pension plan (15 U.S.C. § 78bb(f)(3)(B)).
- Actions under contractual agreements between issuers and indenture trustees to enforce conditions of the indenture (15 U.S.C. § 78bb(f)(3)(C)).

The Supreme Court has addressed a variety of issues involving the SLUSA since its enactment. In *Dabit*, the Supreme Court held that SLUSA's preemption of state securities suits encompassed claims by plaintiffs alleged to have held (rather than sold) securities in reliance on a misrepresentation. The Supreme Court reached this conclusion despite the fact that these **holder** plaintiffs also cannot bring a Section 10(b) action under *Blue Chips Stamps*, resulting in complete preclusion of these class actions in either forum. The PSLRA and SLUSA were motivated by many of the same policy considerations regarding vexatious litigation that anchored the *Blue Chip Stamps* decision and a narrow reading of the statutes undercuts this purpose. The Supreme Court further reasoned that congressional use of Section 10(b)'s in connection with the purchase or sale requirement in SLUSA suggested its intent to give the language its settled judicial interpretation. (*Dabit*, 547 U.S. at 85-86.)

However, in *Chadbourne & Parke LLP v. Troice*, the Supreme Court interpreted SLUSA preemption more narrowly (134 S. Ct. 1058 (2014)). Again addressing the in connection with the purchase or sale language, the Court held that SLUSA did not preempt state law fraud claims involving the purchase of certificates of deposit, which were noncovered securities. Because SLUSA's primary focus is on transactions in covered securities, the Court reasoned, SLUSA preemption applies only to matters "where the misrepresentation makes a significant difference to someone's decision to purchase or sell a covered security." (*Chadbourne & Park LLP,* 134 S. Ct., at 1065-66.) For more on the *Chadbourne & Parke LLP* decision, see Legal Update, Supreme Court Decision Allows More State Law Securities Class Actions.

More recently in *Cyan Inc. v. Beaver Cnty. Emps. Ret. Fund*, the Supreme Court held in a unanimous decision that state and federal courts have concurrent jurisdiction over class actions based only on claims brought under the Securities Act and that these claims are not removable to federal court (138 S. Ct. 1061 (2018)). This decision brought an end to an almost two-decades-long split among federal district courts over the jurisdictional provisions of SLUSA. Accordingly, in the wake of *Cyan*, plaintiffs seeking to represent nationwide classes alleging Securities Act claims often file competing complaints in both state and federal courts alike. This has raised a host of procedural issues for courts to address, as reflected in the recent divide among state courts on whether the automatic discovery stay under the PSLRA applies to actions pending before them. For more on the impact of *Cyan*, see Expert Q&A: Securities Act Claims and SLUSA After Cyan.

For more on SLUSA, see Practice Note, Navigating the Securities Litigation Uniform Standards Act of 1998 (SLUSA).

Preventing Abuse by Judicially-created Requirements

In addition to the unique statutory requirements governing securities fraud class actions, two key judicially-created class certification standards apply only to these types of cases, placing additional burdens on securities class plaintiffs.

Loss Causation Standard

The loss causation inquiry examines whether the misrepresentation or omission directly caused the economic loss. The Supreme Court has held that a plaintiff does not need to prove loss causation to achieve class certification. Reviewing an opinion from the US Court of Appeals for the Fifth Circuit affirming denial of class certification on the grounds that the plaintiffs had failed to establish loss causation, the Supreme Court emphasized the distinction between showing that the deceptive conduct caused the alleged economic loss and establishing that each plaintiff relied on the misstatements and omissions. (*Erica P. John Fund, Inc.,* 131 S. Ct. at 2183-85.)

For more information on challenging loss causation, see Practice Note, Exchange Act: Section 10(b) Defenses Against Loss Causation Claims: Challenging Loss Causation at Class Certification.

Fraud on the Market Presumption: Pre-Certification Rebuttal

Class certification in a securities class action is often only possible by using a presumption to satisfy Section 10(b)'s reliance requirement. Unlike loss causation, a presumption of reliance must be established at the certification stage because without it, common questions likely do not predominate (*Halliburton,* 134 S. Ct., at 2406).

More than 35 years ago, in *Basic Inc.*, the Supreme Court held that plaintiffs can rely on a "fraud on the market" theory at the certification stage to create a rebuttable presumption of reliance on the alleged misrepresentation (485 U.S., at 245-50). This theory posits that in an efficient securities market, any material misinformation

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is incorporated into the stock price. Therefore, a plaintiff purchasing stock at that price arguably does so in reliance on the misstatement. In the litigation context, plaintiffs may employ this theory to create a rebuttable presumption that anyone trading in the defendant's shares during a certain period of time did so in reliance on material misstatements made to the market generally.

To invoke the presumption, the plaintiffs must show that the:

- Misrepresentations were public.
- Misrepresentations were material.
- Securities traded in an efficient market.
- Plaintiffs traded between when the misstatements were made and when the truth was disclosed.

(*Halliburton,* 134 S. Ct., at 2413-14.)

In *Halliburton*, the Supreme Court declined to overrule *Basic's* fraud on the market presumption. The Supreme Court clarified, however, that defendants can introduce price impact evidence before class certification to defeat the presumption, showing that an alleged misrepresentation did not actually affect the stock price. If defendants are successful in rebutting the *Basic* presumption, the plaintiffs cannot establish the commonality requirement for class certification. (*Halliburton,* 134 S. Ct. at 2414). As the Supreme Court later clarified in *Goldman*, defendants seeking to rebut the *Basic* presumption bear not only the burden of production, but also the ultimate burden of persuasion to prove lack of price impact by a preponderance of the evidence. (See, *Goldman Sachs*, 141 S. Ct., at 1962-63).

For more on challenging plaintiff's class certification based on these requirements, see Practice Note, Exchange Act: Section 10(b) Defenses Against Loss Causation Claims: Challenging Loss Causation at Class Certification and Exchange Act: Section 10(b) Opposing Class Certification Checklist: Challenging the Applicability of the Fraud-on-the-Market Presumption.

Best Practices for Defending Securities Class Actions

Because securities class actions pose substantial financial and reputational risk for many public companies, counsel should take steps early to assess the merits of the case and map out a strong defensive strategy. These steps may include:

- **Moving to dismiss.** The PSLRA successfully raised the pleading standard and courts have not hesitated to dismiss cases if the allegations are inadequate. According to a recent report by NERA on securities cases filed and resolved between 2013 and 2022, courts granted 61% of the motions to dismiss entirely (with or without prejudice) and granted in part another 19% (NERA, Recent Trends in Securities Class Action Litigation: 2022 Full-Year Review, at 11, available at nera.com).
- **Narrowing the plaintiff class whenever possible.** Certain groups of plaintiffs, for various reasons, may not have standing to bring a claim. For example, a group of plaintiffs may seek to certify a class of plaintiffs who do not meet the domestic transaction requirements established by the *Morrison* decision. Defense counsel should move to exclude these putative plaintiffs from a shareholder class.
- **Evaluating the merits of the case with a critical eye.** Securities class actions rarely go to trial and the question of settlement is one of risk allocation and timing. From the matter's inception, knowledge of the strengths and weaknesses of the case is critical to these strategic decisions.

For more resources on defending a securities fraud lawsuit under the Exchange Act, see Exchange Act: Section 10(b) Defense Toolkit. For defending the Securities Act claims, see Securities Act: Federal Private Lawsuit Defense Toolkit. For a collection of resources on handling the certification stage of securities class actions see Securities Litigation: Class Certification Toolkit. For resources on settling securities class actions, see Federal Securities Class Action Settlement Toolkit.

Mr. Kasner represented parties in some of the cases cited in this Article, including the petitioner, Merrill Lynch, in Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71 (2006). The views expressed in this Article are those of the authors and not necessarily those of Skadden, Arps, Slate, Meagher & Flom LLP or its clients.

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