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Skadden Discusses Securities Class Actions in 2024

By Susan L. Saltzstein, Tansy Woan and William J. O'Brien February 1, 2024

Comment

Plaintiffs asserted securities class actions at elevated levels in 2023 — a sign that filings will remain high in the year ahead. Based on data from Cornerstone Research through Sept. 30, 2023, plaintiffs were on pace to file approximately 216 federal and state securities class actions last year — a slight increase over the 208 suits brought in 2022 and roughly on par with the 218 suits brought in 2021.

While filing levels remained consistent from 2021 to 2023, their composition changed. Through Sept. 30, 2023, for instance, special-purpose acquisition company-related suits had fallen 37% as compared to the same period in 2022. This decline may be attributable to a significant decrease in SPAC initial public offerings and de-SPAC transactions since their peak in 2021.

Plaintiffs instead are targeting companies that allegedly have failed to anticipate supply chain disruptions, persistent inflation, rising interest rates and other macroeconomic headwinds.

For instance, in 2023, plaintiffs filed at least seven class actions against financial institutions, accusing them of downplaying liquidity and other concerns stemming from rising interest rates. Amid this ongoing period of economic uncertainty, we expect such filings to persist.

The Supreme Court will continue to shape securities law jurisprudence.

Next year, the U.S. Supreme Court is poised to decide at least two securities lawsuits that could change the landscape in both the private and regulatory arenas.

On Jan. 16, the Supreme Court will hear argument in Macquarie Infrastructure Corp. v. Moab Partners LP,[1] a closely followed case that ought to address whether a purported failure to make a disclosure required under Item 303 of U.S. Securities and Exchange Regulation S-K[2] can support a securities fraud claim under Section 10(b) of the Securities Exchange Act, even absent an otherwise misleading statement.[3]

The plaintiffs alleged that Macquarie had issued material misstatements and omissions concerning the potential impact of new international fuel regulations on the company's fuel storage business, in violation of both the Securities Act and the Exchange Act.

In support of their claims under Rule 10b-5, the plaintiffs alleged that, under Item 303, Macquire had a duty to disclose that the company's most profitable subsidiary stood to lose a significant amount of its fuel storage business as a result of impending regulations, known as IMO 2020.

The U.S. District Court for the Southern District of New York granted Macquarie's motion to dismiss, holding that the plaintiffs had failed to plead an actionable misstatement or omission, a violation of Item 303, and scienter.

In an unpublished summary order, the U.S. Court of Appeals for the Second Circuit reversed in part, holding that the plaintiffs pled adequately that Macquire made affirmative misstatements in the form of "half-truths" that required disclosure, and that Macquarie violated Item 303.

As to the latter, the panel ruled that failing to make a material disclosure required by Item 303 can serve as a predicate for a Section 10(b) claim, so long as the claim's other elements are well pled.

In the present appeal, the Supreme Court is poised to resolve a circuit split concerning whether an Item 303 violation can serve as a basis for Section 10(b) liability.

The U.S. Court of Appeals for the Ninth Circuit, contrary to the Second Circuit, has held that "Item 303 does not create a duty to disclose for purposes of Section 10(b) and Rule 10b-5."[4] The U.S. Court of Appeals for the Third Circuit and the U.S. Court of Appeals for the Eleventh Circuit have also weighed in and held that an Item 303 violation does not give rise automatically to Section 10(b) liability.[5]

Should the Supreme Court endorse the Second Circuit's framework, shareholders might explore other avenues for asserting 10b-5 claims, citing other SEC disclosure obligations.

We also await the Supreme Court's decision in SEC v. Jarkesy. While not a class action, the court has been asked to determine, among other things, whether the SEC's existing statutory and regulatory authority to initiate and adjudicate administrative enforcement proceedings seeking civil penalties violates the Seventh Amendment and the nondelegation doctrine.

The nondelegation claim would likely have consequences for other SEC rulemaking. At oral argument, however, the justices focused on the Seventh Amendment claim.

If the court rules in Jarkesy's favor on his Seventh Amendment claim, the SEC may be required to bring certain civil penalty actions for securities violations in federal court.

The ramifications of this decision could be significant, as the SEC often uses its in-house courts to seek monetary penalties, and studies reveal that the SEC wins cases it brings in its in-house courts at a much higher rate than those it tries in federal court.[6]

We also should expect plaintiffs to attempt to maneuver in light of the Supreme Court's decision in Slack Technologies LLC v. Pirani.[7]

Decided last term, the court in Slack unanimously rejected the Ninth Circuit's holding that under Section 11 of the Securities Act, plaintiffs may recover even when shares owned are not traceable to a defective registration statement.[8] Or as Pirani argued, when the shares "bear some sort of minimal relationship" to a defective registration statement.[9]

Instead, a plaintiff must plead and prove that the securities held are traceable to the particular registration statement alleged to be false or misleading.[10]

Courts will continue to assess short-seller reports underlying securities complaints.

As 2023 confirmed, short-seller reports are increasingly being used by the plaintiffs bar to form the basis of securities complaints.[11] It is estimated that short-seller reports have underpinned at least 75 securities class actions filed against public companies in roughly the last three years.

Given the recent proliferation of these suits, a body of law has developed around the extent to which allegations derived from such reports should be credited on a motion to dismiss.

The better-reasoned opinions discount allegations where they lack independent corroboration or verification citing a short-seller's motivation to drive down the target's stock price. Accordingly, these courts equate short-sellers to confidential witnesses and apply the Private Securities Litigation Reform Act's heightened pleading standard.[12]

In January 2023, in In re: DraftKings Inc., for example, the Southern District of New York analyzed the credibility of a short-seller report and concluded that the plaintiffs' reliance on the allegations in the report — which were largely unsourced or anonymously sourced — was "a global deficiency" spanning the complaint that mandated dismissal.[13]

Similarly, in Hershewe v. Joyy Inc. last year, the Ninth Circuit discredited a short-seller report because it lacked "indicia of reliability" and "failed to substantiate [plaintiffs] allegations of falsity."[14]

Separately, courts have also held that shareholders cannot rely on short-seller reports as corrective disclosures if they are based on public information because a corrective disclosure "must by definition reveal new information to the market that has not yet been incorporated into the price."[15]

We note that some courts have credited short-seller reports under particular circumstances at the pleading stage.[16] This line of cases often cites older decisions, which rejected the premise that short-sellers are the functional equivalent of confidential witnesses and must be evaluated under the PSLRA's pleading standard for confidential sources.

According to these older decisions, short-seller reports do "not implicate the same skepticism as a 'traditional' anonymous source."[17]

Defendants have introduced a roadmap for challenging price impact at class certification.

In 2023, the Second Circuit was called upon — yet again — to adjudicate the plaintiffs' multiyear quest for class certification in Arkansas Teacher Retirement System v. Goldman Sachs Group Inc.

This time, the Second Circuit reversed the trial court and denied class certification.[18] In so holding, the court determined that the defendants had rebutted the basic presumption of reliance because there was an "insufficient link between the alleged misrepresentations and corrective disclosures" in the Section 10(b) claim.[19]

While the alleged misstatements were generic — for example, "integrity and honesty are at the heart of our business"[20] — the corrective disclosures were specific, such as an SEC enforcement action against the defendant company for purportedly failing to disclose a conflict of interest.[21]

The Second Circuit determined that the Southern District of New York had failed to apply the Supreme Court's guidance — that when there is a gap in generality between the front- and back-end disclosures, the Vivendi back-end-front-end price inflation inference starts to "break down."[22]

Rather than ask what would have happened if the company had spoken truthfully, at an "equally generic level," the district court allowed the "details and severity … of the corrective disclosure to do the work of proving front-end price impact."[23]

This violated Supreme Court precedent because "utilizing a back-end price drop as a proxy for [a] front end misrepresentation's price impact works only if, at the front end, the misrepresentation is propping up the price."[24] Thus, the proper inquiry is "whether the disclosure as written is specific enough to evoke investor reliance."[25]

We will be watching to see if the business community can replicate elsewhere the defendants' hard-earned victory in Arkansas Teacher.[26] At minimum, the plaintiffs cannot demonstrate price impact merely by showing a subject-matter match between a front-end misstatement and back-end corrective statements where, as in Arkansas Teacher, there was a significant mismatch in specificity.[27]

"Materialization of Risk" Will Remain in Focus After the Ninth Circuit's Decisions in Facebook and Glazer Capital Management

We anticipate plaintiffs will continue to press securities fraud claims under a materialization of risk theory — in which plaintiffs allege that defendants have framed a risk in purely hypothetical terms when in fact it has already occurred.

Two recent Ninth Circuit decisions have brought this topic into sharper view. In In re: Facebook Inc. Securities Litigation, the Ninth Circuit, in a split decision, revived Exchange Act and Rule 10b-5 claims, holding that because "Facebook was aware of Cambridge Analytica's misconduct [before it filed its 10-K], … Facebook's statements about risk management 'directly contradict[ed] what the company knew when it filed its [10-K].'"[28]

The Ninth Circuit credited the plaintiffs' allegation that Facebook's 10-K had described a particular risk — specifically, third-party misuse of Facebook users' personal data — as one that could harm the company if it materialized, when in fact the alleged misuse had already transpired. Accordingly, the Ninth Circuit concluded that the district court had "overlook[ed] the reality of what Facebook knew."[29]

Earlier in 2023, the Ninth Circuit addressed a similar issue in Glazer Capital Management LP v. Forescout Technologies.[30] In Glazer, the plaintiffs alleged that Forescout had made materially false or misleading statements relating to the likelihood of its merger closing, in violation of the Exchange Act and Rule 10b-5.[31]

In particular, they claimed that Forescout was in possession of information that its counterparty was considering not closing the merger, yet stated it "look[ed] forward to completing our pending transaction."[32]

Although Forescout provided risk disclosures about the transaction, "including that the timing of the closing was uncertain and closing conditions might impact the deal's course," the Ninth Circuit reversed the district court's dismissal, holding that a company "cannot rely on boilerplate language describing hypothetical risks to avoid liability for the failure to disclose … [when] the company already had information suggesting the merger might not ensue."[33]

This holding may conflict with other circuits, which hold that the disclosure of facts is necessary under the securities laws only when the risk has materialized or where there is a "near certainty" of its occurrence.[34] That said, after Glazer, we expect the plaintiffs in the Ninth Circuit to pursue materialization of risk cases even where the risk has not yet occurred.

As 2024 continues, all signs indicate that plaintiffs will continue bringing securities class actions at elevated levels consistent with what we have seen in the past several years. What the filing data suggests is that the securities plaintiffs bar has proven adept at shifting theories and areas of focus when circumstances warrant.

We saw this in 2020 and 2021, when plaintiffs brought an onslaught of COVID-focused suits in response to the coronavirus pandemic; or more recently, in 2021 and 2022, when plaintiffs reacted to the rise in SPACs by filing scores of SPAC-focused securities suits.

Now, as we begin a new year, we expect plaintiffs will continue following the headlines — whether they be based on legal decisions, legislative amendments, macroeconomic developments or world events. And although the theories might change, the end result will be the same: numerous newly filed securities class actions targeting public companies.

ENDNOTES

[1] Macquarie Infrastructure Corp. v. Moab Partners, L.P. , No. 22-1165 (2023).

[2] Item 303 obligates a company to describe in its SEC filings "any known trends or uncertainties that have had or that are reasonably likely to have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations." 17 C.F.R. §229.303. At the time of the alleged violation in this case, Item 303 obligated a company's SEC filings to "[d]escribe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations." SEC Final Rule Release No. 33-10890, Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information. The SEC explained that the purpose of the amendment from "reasonably expects" to "reasonably likely to have" was to provide "specific guidance" and "a tailored and meaningful framework" for issuers to "objectively analyze whether forward looking information is required" where the likelihood of "known events or uncertainties" cannot be determined. Id.

[3] The Court granted certiorari on this exact question in 2017 in Leidos Inc. v. Ind. Public Retirement Sys. , No. 16-581 (2017), but the case settled before argument. In Macquarie, the government filed an amicus curiae brief in support of Moab, requested divided argument, and reframed the question presented as "[w]hether an issuer's submission of a Form 10-K or Form 10-Q that discloses some but not all of the known trends or uncertainties the issuer was required to disclose under Item 303 . . . can give rise to liability under Section 10(b) . . . and SEC Rule 10b-5." Macquarie Infrastructure Corp. v. Moab Partners, L.P., No. 22-1154 (2023) (Brief for the United States as Amicus Curiae Supporting Respondent Moab Partners, L.P., at (I)).

[4] In re NVIDIA Corp. Sec. Litig. , 768 F.3d 1046, 1056 (9th Cir. 2014).

[5] See Oran v. Stafford, 226 F.3d 275, 288 (3d Cir. 2000) (Item 303 violation "does not automatically give rise to a material omission under Rule 10b-5"); Carvelli v. Ocwen Fin. Corp. , 934 F.3d 1307, 1331 (11th Cir. 2019) (Item 303 violation "does not ipso facto indicate a violation of the latter").

[6] See Jean Eaglesham, SEC Wins With In-House Judges, The Wall Street Journal, May 6, 2015, https://www.wsj.com/articles/sec-wins-with-in-house-judges-1430965803.

[7] Slack Techs., LLC v. Pirani , 598 U.S. 759 (2023).

[8] Id. at 762.

[9] Id. at 768.

[10] Id. at 1442.

[11] In addition to their impact on falsity and scienter, short-seller reports may also bear on loss causation if their allegations are drawn from publicly available (i.e., previously disclosed) facts.

[12] See Leacock v. IonQ, Inc. , No. 22-1306, at *22 (D. Md. Sep. 28, 2023) (granting motion to dismiss because of plaintiffs' reliance on short-seller report with unsourced allegations) (citing Tchrs.' Ret. Sys. of La. v. Hunter , 477 F.3d 162, 174(4th Cir. 2007) ("Under the PSLRA, '[w]hen the complaint chooses to rely on facts provided by confidential sources, it must describe the sources with sufficient particularity.'")).

[13] In re DraftKings Inc. Sec. Litig ., 2023 WL 145591, at *18 (S.D.N.Y. Jan. 10, 2023).

[14] Hershewe v. Joyy, Inc. , 2023 WL 3316328, at *1 (9th Cir. 2023).

[15] In re Bolf Holding, Inc. Secs. Litig. , 977 F.3d 781, 794 (9th Cir. 2020); see also Macphee v. MiMedx Grp. , 73 F4th 1220, 1245 (11 Cir. 2023) ("[T]he mere repackaging of already-public information by an analyst or short-seller is simply insufficient to constitute a corrective disclosure." (citing Meyer v. Greene , 710 F.3d 1189, 1199 (11th Cir. 2013))). However, in a footnote, the Meyer court left open the possibility that a short-seller opinion could constitute a corrective disclosure if it reveals "to the market something previously hidden or actively." See id. n.10; see also Bishins v. CleanSpark, Inc. , 2023 WL 112558, at *13 (S.D.N.Y. 2023) (rejecting that third party analysis of already-public financial information cannot contribute new information and holding that plaintiffs can plead a short-seller report containing such analysis as a corrective disclosure); In re Chi. Bridge & Iron Co.

N.V. Sec. Litig. , 2020 WL 1329354, at *8 (S.D.N.Y. 2020) (holding short-seller report could constitute a corrective disclosure because it provided several new pieces of information to the market although it otherwise consisted of public information).

[16] See, e.g., In re Cassava Scis., Inc. Sec. Litig. , 2023 WL 3442087, at *8 (W.D. Tex. May 11, 2023); Handal v. Tenet Fintech Grp. Inc. , 2023 WL 6214109, at *12 (E.D.N.Y. Sept. 25, 2023) (accepting as true factual allegations contained in the short-seller reports because "the truth or accuracy" of the short-seller reports "are factual disputes not appropriate for resolution at this stage").

[17] See McIntire v. China MediaExpress Holdings. , 927 F. Supp. 2d 105, 124 (S.D.N.Y. 2013) (citation omitted); accord In re Hebron Tech. Co. , 2021 WL 4341500, at *13 (S.D.N.Y. 2021); see also In re Cassava Scis., Inc. Sec. Litig. , 2023 WL 3442087, at *8 ("Other courts have found it permissible to rely on short-seller reports to allege falsity at the motion to dismiss stage" (citing McIntire, 927 F. Supp. 2d at 123-24)).

[18] Ark. Tchr. Ret. Sys. v. Goldman Sachs Grp., Inc. , 77 F.4th 74 (2d Cir. 2023).

[19] Id. at 105.

[20] Id. at 94.

[21] Id. at 83.

[22] Id. at 81 (citing Goldman Sachs Grp., Inc. v. Ark. Tchr. Ret. Sys. , 141 S. Ct. 1951 (2021)).

[23] Id. at 99.

[24] Id. at 100.

[25] Id. at 101.

[26] Jessica Corso, Goldman's 2nd Circ. Win Opens Path to Class Action Defense, Law360, Aug. 14, 2023, https://www.law360.com/articles/1710686/goldman-s-2nd-circ-win-opens-path-to-class-action-defense ("[I]t's up for debate whether other corporations can replicate the fact pattern the investment bank used to win its appeal."). The challenged statements at issue in Arkansas Teacher were "highly generic" and being able to point to 36 media reports discussing the alleged conflicts of interest before the SEC settlement helped demonstrate the disclosures had no impact on the company's stock price. See id.

[27] In another decision this year, the Second Circuit further clarified its interpretation of Omnicare. See New Eng. Carpenters Guaranteed Annuity & Pension Funds v. DeCarlo , 80 F.4th 158 (2d Cir. 2023). There, the court considered whether defendant company's historical financial statements, which reflected discretionary decisions, were actionable under the securities laws. The Second Circuit reversed the district court's ruling and held that a statement of opinion that reflects some subjective judgment can nevertheless be actionable under the securities laws if it misleads investors into thinking that the issuer had historical or factual support for the judgment made. See id. at 176. According to the court, because the challenged statements incorrectly presupposed the existence of historical evidence for a chosen accounting treatment and implied an "erroneous fact" that payment of discretionary bonuses was not "probable," plaintiffs could proceed with their claim. See id. at 172-76.

[28] In re Facebook, Inc. Sec. Litig. , 84 F.4th 844, 867 (9th Cir. 2023), opinion amended and superseded on denial of reh'g, 2023 WL 8365362 (9th Cir. Dec. 4, 2023).

[29] Id. at 858. The SEC is likewise focused on similar issues. It has promulgated and proposed risk disclosure obligations in cybersecurity and climate change, respectively. And it recently brought an enforcement action against a company and its CISO, alleging that they defrauded investors by, among other issues, understating or failing to disclose known risks.

[30] Glazer Cap. Mgmt. L.P. v. Forescout Techs., Inc. , 63 F.4th 747 (9th Cir. 2023).

[31] Id. at 781.

[32] Id. at 780.

[33] Id. at 779 (emphasis added). That said, the decision also stated that "Forescout was aware of a significant likelihood that the risk would materialize." Id. at 781.

[34] See, e.g., Mia. Firefighters & Police Officers' Ret. Tr. v. CBS Health Corp. , 46 F.4th 22, 35 (1st Cir. 2022) (speaker only has a duty to disclose facts affecting the likelihood of that risk when the alleged risk had a "near certainty" of occurring or when the warned-of-risk had begun to materialize); Ind.

Pub. Ret. Sys. v. Pluralsight, Inc. , 45 F.4th 1236, 1254-57 (10th Cir. 2022) (materially misleading risk factors exist where "the risk had materialized or was virtually certain to occur").

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