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2021 Securities Litigation Year in Review

During 2021, securities case filings fell for the second consecutive year and, for the first time since 2016, fewer than 300 federal securities class actions were filed. Despite the ongoing pandemic, the number of announced settlements of securities cases was up substantially in 2021, with 116 approved monetary class action settlements totaling $3.5 billion. The 2021 settlements include one mega-settlement of more than $1 billion and a number of other large settlements. Case filings involving COVID-19, SPACs, and cryptocurrencies continued to trend upward in 2021, and we address important developments relating to securities litigation in those sectors.

Our 2021 Securities Litigation Year in Review focuses on significant securities-related decisions from the U.S. Supreme Court and the federal appellate courts, including the much-anticipated decision by the Supreme Court in the *Goldman Sachs* case, which expands the arguments available to securities fraud defendants at class certification. There was also notable activity in the federal appellate courts on key issues involving scienter, loss causation, and opinion statements following the Supreme Court's landmark *Omnicare* decision. We have also noted select important decisions by state courts in litigation against companies and their officers and directors.

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INTRODUCTION

During 2021, the second year of the global COVID-19 pandemic, securities case filings fell for the second consecutive year, and, for the first time since 2016, fewer than 300 federal securities class actions were filed.[1] There were 210 cases filed in 2021, down substantially from the 319 cases filed in 2020 and well below the historically high level of more than 400 cases filed in each of 2017 through 2019.[2] The decline in filings was largely driven by a substantial reduction in the number of merger challenge cases. New merger objection filings declined by more than 85% between 2020 and 2021.[3] As has been the case for the last 10 years, new filings of cases alleging Rule 10b-5 claims were the vast majority of all filings in 2021. Notably, filings against non-U.S. companies also fell from the record high in 2020. Despite the intermittent disruption of federal and state courthouses as a result of the ongoing pandemic, the number of announced settlements of securities cases was up substantially in 2021, with 116 approved monetary class action settlements compared with 99 approved settlements in 2020—an increase of 17.2% year over year.[4] Likewise, total settlement amounts increased by 7.6% to $3.5 billion from $3.26 billion in 2020.[5] The 2021 settlement total includes one mega-settlement of more than $1 billion and two settlements that rank among the top 100 settlements of all times.[6]

Our 2021 Securities Litigation Year in Review focuses on significant securities-related decisions from the Supreme Court and the federal appellate courts. Perhaps the most significant decision of last year was the much-anticipated ruling by the Supreme Court in the Goldman Sachs securities case.[7] A unanimous Court held that the generic nature of an alleged misrepresentation often is important evidence of price impact that courts should consider at the class certification stage. It also held that courts should take note of all record evidence relevant to price impact even if that evidence overlaps with materiality or any other merits issue. A majority of the Court also held that the defendant bears the burden of persuasion by a preponderance of the evidence to prove a lack of price impact at class certification. The decision expands the arguments available to securities fraud defendants to challenge price impact at class certification, which has proven to be an uphill battle for defendants in most cases. There was also notable activity in the federal appellate courts on key issues involving scienter, loss causation, and opinion statements following the Supreme Court's landmark *Omnicare* decision.

Case filings involving COVID-19, SPAC, and cryptocurrency-related claims continued to trend upward in 2021. We address important developments relating to securities litigation in those sectors, including the Delaware Chancery Court's decision of first impression allowing a fiduciary-duty challenge to a de-SPAC merger to proceed. We also address developments in the cryptocurrency space, which we expect to be a continuing source of lawsuit filings in light of market volatility and increasing regulatory and enforcement focus on the sector.

We also highlight important developments relating to federal forum provisions ("FFPs") enacted by many Delaware companies following the Supreme Court's decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund*,[8] affirming the non-removability of claims under the Securities Act of 1933. This year, following the Delaware Supreme Court's decision in *Salzberg v. Blue Apron Holdings, Inc.*, which upheld the validity of FFPs under Delaware law and federal and state public policy and expressly invited other state courts to undertake their own analysis, a New York appellate court has now done so. As we discuss below, in *Hook v. Casa Systems, Inc.*, the court upheld an FFP under New York law and public policy, becoming the third state to do so.[9] As we discussed in last year's Review, a California state court exercised its discretion to dismiss a securities class action based on an FFP after concluding that it did not violate California law or policy.[10]

The widespread adoption of FFPs is likely to accelerate as a result of these developments and given the continued uncertainty whether the PSLRA's discovery-stay provisions apply to cases alleging violations of the Securities Act in state courts. Since *Cyan*, state courts have split over the applicability of the PSLRA's discovery-stay provisions, and the issue was expected to be resolved by the Supreme Court after it granted certiorari in *Pivotal Software, Inc. v. Superior Court of California* in July 2021.[11] In that case, plaintiffs filed parallel federal and state class action cases alleging violations of Section 17 of the Securities Act. After the federal complaint was dismissed for failure to state a claim, the state-court plaintiff asserted that the PSLRA's discovery stay does not apply in state court. Both the California Court of Appeal and the California Supreme Court denied defendants' request for a stay. It remains to be seen whether the U.S. Supreme Court will resolve the issue in another case or whether the continued adoption of FFPs will minimize the number of Securities Act cases in state courts.

COVID-19

As noted in last year's Review, volatility in the financial markets and the continuing economic consequences of the ongoing COVID-19 pandemic were expected to have an impact on securities filings in 2021, and they did. Eleven securities cases filed in 2021 involved claims arising out of the impact of the COVID-19 pandemic on companies.[12] The cases typically alleged misrepresentations or omissions regarding the effects of the pandemic on company operations and failure to disclose business risks associated with the pandemic. A noteworthy and not unexpected trend, however, was an uptick in the 2021 filings—a total of six cases—alleging false or exaggerated statements regarding the efficacy of COVID-19 treatments and vaccines or the capacity to manufacture such products on the timetable or scale promised by the companies.

While the on-and-off closures of courts throughout the country as a result of the pandemic has slowed resolution of the pandemic-related securities cases, of the 19 COVID-related securities cases that were filed nationwide in 2020, 10 have now seen rulings on motions to dismiss, with nine out of 10 rulings dismissing suits, at least in part, for failure to state a claim, and four outright dismissals with prejudice. In one of the earliest pandemic-related cases to reach a motion to dismiss decision, a California federal court dismissed Section 11 and Section 15 claims against a real estate finance company arising out of its IPO in early 2020. The company's disclosures touted "substantial and durable" market conditions and allegedly failed to disclose potential impacts of the pandemic on the company's business.[13] The court dismissed the claims with prejudice, finding statements about the state of the market were mere puffery and that the plaintiffs failed to allege the defendants "would or could have known the extent of the coronavirus pandemic" and its effects on the company's business outlook at the time it filed its initial public offering materials.[14] Another example of a court's refusal to entertain "fraud by hindsight" complaints was a decision by a Florida federal court dismissing Rule 10b-5 and Section 20(a) claims against a cruise line for allegedly misrepresenting the effectiveness of its COVID health and safety protocols that, although allegedly ineffective, were "based on guidance and recommendations from public health officials, such as the CDC or the WHO."[15]

While acknowledging the many unanticipated effects of the pandemic, however, one court found that the uncertainty in the market caused by the pandemic left the investing public vulnerable to "hype and speculation" and denied a motion to dismiss Rule 10b-5 claims in a case involving a vaccine developer's statements about its progress toward a COVID 19 vaccine.[16] The California federal court denied the vaccine development company's motion to dismiss securities fraud claims alleging that the company misled investors regarding its selection for Operation Warp Speed, a federal program for COVID-19 vaccine development, finding plausible allegations that the company attempted to exploit the public's uncertainty and eagerness to identify possible vaccine candidates.[17] Based on the few cases that have reached the motion to dismiss stage, it appears that courts will be skeptical of "fraud by hindsight" claims against companies that could not have foreseen the unprecedented effects of the pandemic, while allowing plaintiffs to pursue claims against companies that allegedly sought to capitalize on the vulnerabilities and confusion caused by the public health crisis.

As we predicted last year, the Biden administration has taken a more aggressive approach to both regulation and enforcement, including in the context of COVID-19. Since early in 2020, the SEC has issued a number of public statements and staff bulletins reminding companies of their disclosure obligations notwithstanding the pandemic.[18] In its fiscal year 2021, the SEC brought two COVID-related enforcement actions. The first case was against the Cheesecake Factory for alleged improper disclosures regarding the pandemic's effects on its operations. The SEC's announcement of its settlement with the company was notable because it included a statement from former SEC Chair Clayton bluntly warning that "issuers who make materially false or misleading statements regarding the pandemic's impact on their business and operations [will] be held accountable."[19] The second case was against a health sciences company and two executives based on the company's allegedly misleading press releases regarding its development of a COVID-19 screening test.[20] While many businesses have struggled to adjust to the impact of the changing pandemic, the SEC has remained vigilant in addressing false or misleading disclosures regarding the effects of COVID-19, and we expect that focus to continue as the third year of the pandemic brings continued business and economic volatility.

SPACs

A noteworthy trend in 2021 was the continued popularity of SPACs as a way to bring private companies public and a corresponding boom in securities litigation relating to SPACs. A

SPAC, or special purpose acquisition company, is an entity formed for the sole purpose of raising capital through an IPO with the objective of finding and acquiring an existing, privately owned business within a specified timeframe, typically 18 to 24 months after the IPO. The post-IPO acquisition of a private company, known as a de-SPAC transaction, requires SPAC shareholder approval and the filing of proxy materials with the SEC. SPACs serve as an alternative to a traditional IPO for a private company and their use skyrocketed last year. In 2021, there were 613 SPAC-related IPO filings that raised more than $145 billion—more than double the number of SPAC IPO filings in 2020 and a 91% increase over the funds raised in 2020.[21] Despite the ongoing pandemic-related dislocations last year, there were more than 1,000 IPOs in 2021, and SPAC-related filings represented 59% of the total.

Not surprisingly, the SEC has dramatically increased its focus on SPACs. In a series of three public statements by SEC leadership and staff on a variety of SPAC-related issues, including accounting, financial reporting, and liability risks under the federal securities laws, the SEC has made clear that SPACs will receive both regulatory and enforcement scrutiny. Most recently, on December 9, 2021, SEC Chair Gary Gensler announced he "believe[s] the investing public may not be getting like protections between traditional IPOs and SPACs," and that he favors new rules bringing the legal treatment of SPACs in line with other IPOs with respect to investor protections.[22]

Last year also brought the first SEC enforcement action against a SPAC, its target company, and their CEOs, alleging the defendants misrepresented the success of the target, a space transportation company, in-space testing, and the extent to which national security concerns could prevent the company's acquisition of necessary licenses.[23] Private investors also brought a follow-on suit in the Central District of California, alleging violations of Sections 10(b) and 20(a) based on the same alleged misrepresentations.[24] In another noteworthy case, the SEC agreed to a settlement with a post-SPAC music streaming service, alleged to have misled investors regarding its user base and revenue, which resulted in disgorgement of $38.8 million to be directed to settlement agreements with investors in related private class action suits.[25] As we discussed in the context of COVID-related securities class actions that followed the filing of an SEC enforcement action, we expect to see a similar increase in SPAC-related private securities litigation following a likely uptick in SEC enforcement actions in 2022, especially in light of the SEC identifying the SPAC space as an "emerging threat."[26]

Consistent with the substantial increase in SPAC activity, securities-related litigation involving SPACs also increased substantially in 2021, with 32 securities class actions filed relating to SPACs, compared to 13 SPAC-related filings over the prior two years.[27] The majority of these complaints alleged violations of Section 10(b) of the Exchange Act and Rule 10b-5 and involved companies in the consumer sectors. Nearly all of the complaints were brought by shareholders alleging that SPAC sponsors made misleading material statements or omissions about the prospects of the target companies before the de-SPAC transaction to garner shareholder approval. Three-quarters of the SPAC-related suits were filed in either New York or California federal courts, with the Southern District of New York being the most popular venue. As a result of the intermittent shutdowns and slowdowns as courts across the country struggle to address the pandemic, there have not been any notable decisions in these recently filed cases, but we expect to see guidance from the courts on how SPAC-related suits will fare as the cases move toward the motion-to-dismiss stage in 2022.

As we discuss in more detail below, the Delaware Chancery Court recently issued a first-of-its-kind decision in *MultiPlan Corp. Stockholders Litig.* allowing claims for breach of fiduciary duty to proceed against the directors, sponsor, and controlling shareholder of a SPAC for allegedly concealing material information about the SPAC's target company, thereby impairing shareholders' redemption rights.[28] Of particular note, the Chancery Court applied the onerous "entire fairness" standard rather than the more deferential business judgment rule standard because of the "inherent conflicts" between the SPAC fiduciaries and public stockholders. It remains to be seen whether the *MultiPlan* case will result in the filing of additional suits in Delaware Chancery Court seeking to vindicate shareholder redemption rights where stock prices declined below redemption prices after a de-SPAC transaction. We expect that SPAC-related litigation will likely increase in tandem with the continuing popularity of SPAC transactions.

Cryptocurrency

Cryptocurrencies experienced unprecedented growth in 2021.[29] Their widespread use as a medium of exchange grew,[30] while both retail and institutional investors flocked to the asset class.[31] Markets in the United States found new ways to accommodate investor demand for cryptocurrencies by offering the first Bitcoin-linked exchange traded fund.[32] And total market capitalization for all cryptocurrencies grew to $2.2 trillion—an increase of 185% from 2020.[33] Not surprisingly, this explosive growth and extensive media coverage brought with it greater scrutiny from regulators and increased litigation.

Under the Biden administration, the SEC repeatedly asserted its intent to take a more aggressive stance on cryptocurrencies and bring the asset class under its regulatory authority in 2021. In August, Chairman Gensler stated: "Make no mistake: It doesn't matter whether it's a stock token, a stable value token backed by securities, or any other virtual product that provides synthetic exposure to underlying securities. [Cryptocurrencies] are subject to the securities laws and must work within our securities regime."[34] Moreover, the SEC Chair raised the alarm about cryptocurrencies as "highly speculative stores of value" and noted that "[t]his asset class is rife with fraud, scams and abuse in certain applications."[35] Although Chair Gensler noted that the SEC has prioritized token-related cases involving fraud or other significant harm to investors, he has made clear that the SEC has its regulatory and enforcement sights on crypto-trading platforms, lending platforms, decentralized finance or so-called "DeFi" platforms, and crypto-custody arrangements by broker-dealers. Calling for additional regulatory authority and more resources from Congress "to protect investors in this growing and volatile sector," he emphasized that the SEC "[has] taken and will continue to take our authorities as far as they go."[36] Likewise, Director of Enforcement Gurbir Grewal has touted his division's "proactive efforts" to police cryptocurrencies through robust enforcement efforts.[37]

The SEC's actions have matched the aggressive comments from its leadership regarding the cryptocurrency space. In 2021, the Commission brought 20 enforcement actions involving cryptocurrency, including 14 lawsuits and six administrative proceedings.[38] Thirteen of these actions included allegations of fraud under Section 17(a) of the Securities Act and/or Section 10(b) and Rule 10b-5 of the Exchange Act.[39] The SEC also pursued first-of-their-kind actions in the cryptocurrency space. For example, the Enforcement Division brought the first action involving decentralized finance against two individuals using the technology to facilitate fraudulent offerings[40] and began cracking down on platforms that were allegedly functioning as unregistered digital asset exchanges.[41] The primary focus of the enforcement actions filed in the cryptocurrency sector alleged unregistered securities offering violations under Sections 5(a) and 5(c) of the Securities Act with such allegations raised in 80% of the cases filed in 2021.[42]

The SEC has argued vigorously that many types of cryptocurrencies fall under the *Howey*[43] definition of an "investment contract," thus requiring them to be registered and brought under its regulatory authority.[44] Thus far, the courts that have considered the issue have come down on both sides. For example, in a case of first impression, a federal jury found that cryptocurrency products, including a cryptographic token, were not securities, marking the first time a jury decided such a question.[45] Conversely, as we discuss elsewhere in this year's Review, the Eleventh Circuit in *Fedance v. Harris* held that the cryptographic tokens at issue in that case easily met the requirements of an investment contract under the *Howey* test and were thus subject to the federal securities laws.[46] Notably, the Eleventh Circuit rejected the argument that cryptographic tokens were not investment contracts because they had some potential future utility. As the SEC continues to aggressively assert cryptocurrencies are securities for the purposes of regulation[47] and civil litigation surrounding the issue increases, we expect the issue of whether cryptocurrencies are securities under the federal securities laws to be hotly litigated in 2022.

While SEC enforcement actions in the cryptocurrency sector accelerated last year, private actions remained stable. Plaintiffs filed 11 securities class actions related to cryptocurrency in federal courts in 2021, consistent with the 12 securities class actions related to cryptocurrency filed in 2020. In a majority of the cases filed, plaintiffs alleged that defendants made misleading material statements or omissions about their cryptocurrency operations.[48] Notably, private plaintiffs in one case channeled the SEC's position that cryptocurrencies are securities and claimed a defendant offered and sold unregistered securities in violation of federal law when it conducted an unregistered initial coin offering.[49] More venues also saw securities class actions related to cryptocurrency than in years prior. Although plaintiffs filed all such actions in the Southern District of New York in 2020, federal district courts in five states saw securities class actions related to cryptocurrency in 2021.[50]

The high number of securities class actions related to cryptocurrency presented unique issues to courts. For example, in a nonprecedential summary order, the Second Circuit considered the applicability of domestic securities laws to cryptocurrency-related claims when a foreign plaintiff sought recovery from a foreign defendant for losses on a foreign-issued cryptocurrency.[51] The court applied the *Morrison* framework and held that although it is well-settled, the framework does not automatically apply when a complaint contains state statutory and common-law causes of action, as opposed to federal claims.[52] As the market capitalization of cryptocurrencies grows and they become a more widely adopted medium of exchange, we expect the courts to continue grappling with how existing securities laws apply to this burgeoning technology in 2022.

FALSE AND MISLEADING STATEMENTS

Ninth Circuit Affirms Protection for Forward-Looking Statements and Holds That Defendants Can Defeat Loss Causation at Pleading Stage by Pointing to a Rapid Stock Price Recovery Following a Corrective Disclosure

In *Wochos v. Tesla, Inc.*, the Ninth Circuit affirmed the dismissal of a complaint alleging that Tesla, its CEO Elon Musk, and a former CFO misled investors with statements about the company's progress in building production capacity for its new Model 3 vehicle in violation of section 10(b) of the Securities Exchange Act and Rule 10b-5.[53] The court concluded that because the complaint did not specifically allege that the defendants knew Tesla's stated production goal was impossible, plaintiffs failed to plead falsity as to any of the challenged statements. The court also held that the plaintiffs failed to plead sufficient facts to avoid the safe harbor provision for forward-looking statements under the PSLRA. Noting that Tesla's statements about its objectives for future production capacity were accompanied by "meaningful cautionary statements,"[54] the court rejected plaintiffs' claim that the challenged statements contained "embedded assertions concerning present facts"[55] that would be actionable. Following *Wochos*, companies and executives may continue to make forward-looking predictions and projections as long as the speaker does not know the statements to be false and if its accompanying cautionary statements are appropriately detailed and specific. In addition, the court held that the plaintiffs failed to adequately plead loss causation based on alleged misstatements by the company because a "quick and sustained" stock price recovery after a corrective disclosure refutes the inference that the defendants' alleged concealment caused the stock drop in the first place.

The complaint alleged that in 2016, Tesla announced plans for the Model 3—its first mass-market electric vehicle.[56] With a much lower price than its previous models, the company anticipated selling hundreds of thousands of the cars by 2018. To support this endeavor, Tesla began developing a fully automated assembly facility in California and a complementary battery production facility, "Gigafactory 1," in Nevada, with the stated goal of producing 5,000 Model 3s per week before the end of 2017.[57]

According to the complaint, between May and November 2017, Musk and Tesla made numerous statements about the company's production goals that the plaintiffs alleged to be false or misleading.[58] For example, in a Form 8-K filed in May 2017, Tesla stated that "preparations at our production facilities are on track to support the ramp of Model 3 production to 5,000 per week at some point in 2017."[59] In an earnings call on the same day, Musk allegedly stated that he did not "know of anything that would prevent us from . . . exceeding 5,000 units [per week] by the end of the year," and that "as far as we know, there are no issues."[60] The complaint also alleged that Tesla had not completed a fully automated production line and that problems at the Gigafactory precluded even partial automation of the production process. The complaint further alleged that the challenged statements were false because long before May 2017, Tesla employees told Musk that the production goal of 5,000 Model 3 vehicles per week was not possible by the end of 2017. On October 6, 2017, *The Wall Street Journal* reported that "[u]nknown to analysts, investors and hundreds of thousands of customers who had signed up to buy it," major portions of the Model 3 were being produced by hand as recently as September 2017.[61] Tesla's stock dropped 3.9% on the next trading day. On November 1, 2017, Tesla confirmed in an 8-K filing that it would not make its year-end production goal.[62] The district court dismissed the action with prejudice and without leave to amend after concluding that plaintiffs had failed to plead any material misrepresentations that were not protected by the PSLRA's safe harbor for forward-looking statements.

On appeal, the Ninth Circuit affirmed and held that the plaintiffs' failure to plead falsity was dispositive of their 10b-5 claims. The court noted that plaintiffs asserting 10b-5 claims may rely on either an affirmative misrepresentation theory or an omission theory but that both theories require falsity to be pleaded with respect to a material fact. Citing the Supreme Court's decision in *Omnicare, Inc. v. Laborers Dist. Council Constr.*, the court noted that there are also "substantial limits in applying such theories to a pure statement of opinion."[63] In *Omnicare*, the Supreme Court held that a statement of opinion is false under the securities laws only if the speaker does not genuinely believe it to be true or if they omit information that in context would cause the statement to materially mislead a reasonable investor. Applying this standard, the court concluded that plaintiffs failed to allege sufficient facts to establish falsity as to any of the challenged statements.

Furthermore, the court held that even if the challenged statements were otherwise actionable, they were protected by the PSLRA's safe harbor for forward-looking statements. The court explained that the safe harbor provision is intended to protect companies and their officials when they fall short of their own "optimistic projections,"[64] including "statement[s] of plans and objectives of management for future operations" and "statement[s] of the assumptions underlying or relating to" such plans or objectives.[65] Under the heightened PSLRA pleading standard, a plaintiff must show that a forward-looking statement of a goal or objective contains non-forward-looking features, such as express or implied "concrete assertions of specific current or past facts," in order for the statement to be actionable.[66] Further, for an issuer to take advantage of the safe harbor provision, the forward-looking statement must have been made without actual knowledge that it was false, the statement must be immaterial, or the statement must be accompanied by "meaningful cautionary statements."[67]

The court rejected plaintiffs' argument that statements that Tesla was "on track" to achieve its production goal, or that Tesla knew of "no issues" that "would prevent" its goals, contained assertions of fact that certain events would occur—namely that the stated production goal was achievable—and therefore held the challenged statements contained no non-forward-looking features.[68] To accept plaintiffs' argument, the court reasoned, would completely erode the safe harbor provision's protections because "any announced 'objective' for 'future operations' *necessarily* reflects an implicit assertion that the goal is achievable based on current circumstances."[69] Despite allegations that employees had warned Musk that his stated production goals were impossible, the court held that plaintiffs failed to allege that Musk ever accepted the same "conservative timelines" that his more-pessimistic employees had adopted.[70]

In other words, to succeed in showing Musk knew his statements to be false, the plaintiffs would have had to plead that Musk or Tesla affirmatively knew the production timelines to be impossible to achieve. Additionally, the court emphasized that Tesla's forward-looking statements were accompanied by "meaningful cautionary statements" that were "detailed and specific" and were not challenged by plaintiffs. Since the challenged statements did not include concrete factual assertions but rather only implicit assertions that the production goals were achievable, the court found them to be forward-looking only, and thus protected by the PSLRA's safe harbor provision.[71]

The Ninth Circuit also held that the district court properly denied leave to amend the complaint because plaintiffs could not allege loss causation. The court explained that loss causation is a variant of proximate cause and the ultimate issue is "whether the defendant's misstatement, as opposed to some other fact, foreseeably caused the plaintiffs' loss."[72] Plaintiffs sought to amend the complaint by adding an alleged misrepresentation by the company in August 2017 that automated production of the Model 3 had begun "on schedule" in July 2017. The court noted that the October 6 *Wall Street Journal* article disclosed the same facts that plaintiffs sought to add to the complaint and resulted in a drop of only $13.94 in Tesla's stock price on the next trading day. However, during the following week, Tesla's stock price rebounded to between $350 and $360 per share. The court concluded that the "quick and sustained price recovery after the October 9 drop in stock price refutes the inference that the alleged concealment caused any material drop in stock price."[73] Because plaintiffs failed to show they could adequately plead loss causation even if the additional statement was included in the complaint, the court held that further amendment would be futile. The holding that a defendant can defeat loss causation at the pleading stage by pointing to a rapid stock price recovery soon after a purported corrective disclosure will provide defendants with a significant tool to obtain early dismissal in cases with similar stock price recoveries.

Ninth Circuit Holds That *Omnicare* Pleading Standards for Statements of Opinion Apply to Proxy-Related Claims

In *Golub v. Gigamon, Inc.*,[74] the Ninth Circuit addressed an issue of first impression: whether the standards for pleading the falsity of a statement of opinion under Section 11 of the Securities Act of 1933, as enunciated by the Supreme Court in *Omnicare, Inc. v. Laborers Dist. Council Constr. Industry Pension Fund*,[75] also govern whether a plaintiff has sufficiently alleged the falsity of a statement of opinion in a proxy statement in violation of Section 14(a) and Rule 14a-9. The court concluded that they do. Noting that the Ninth Circuit had previously held that the *Omnicare* standards apply to Rule 10b-5 claims because Rule 10b-5 and Section 11 contain an "identical limitation of liability to 'untrue statement[s]' and omissions of 'fact,'" the court held that the same reasoning applies in the proxy context since Rule 14a-9 contains a virtually identical limitation of liability and "[l]ike its siblings, then, Rule 14a-9 is concerned primarily with questions of 'fact.'"[76] Applying the *Omnicare* standards in an accompanying unpublished memorandum, the court affirmed dismissal of the complaint.[77]

The complaint alleged that Gigamon filed a proxy statement in 2019 urging its shareholders to approve a proposed sale of the company. The proxy statement described the terms of the proposed sale, the company's current and projected finances, and the process by which the board approved the sale and recommended approval of the sale by shareholders. The complaint further alleged that the company's officers and directors had deliberately agreed to sell Gigamon at an undervalued price and filed a "materially false and misleading Proxy Statement in order to secure shareholder support."[78]

The complaint alleged five factual misrepresentations and two factual omissions that purportedly rendered certain statements of opinion false and misleading in violation of Section 14(a) of the Exchange Act and Rule 14a-9. The district court dismissed the complaint on the grounds that the plaintiff failed to plead any actionably false misrepresentations and could not overcome the safe harbor provisions of the PSLRA. However, the district court "hesitated to extend *Omnicare*'s discussion of how *omissions* can render a statement of opinion false or misleading to the Rule 14a-9 context without [the Ninth Circuit's] express approval," given that the Supreme Court's decision in "*Virginia Bankshares* was largely silent about such a theory of liability, and *Omnicare* was not a section 14(a) or Rule 14a-9 case."[79]

The Ninth Circuit affirmed the dismissal. As a preliminary matter, the court noted that while Rule 14a-9 prohibits statements in proxy materials that are false or misleading with respect to any material "fact," courts have "long permitted a plaintiff to plead and prove false the 'statements of reasons, opinions, or beliefs' of a company's directors that are placed in a proxy statement to urge shareholders to vote in a particular manner."[80] The court cited the Supreme Court's explanation that such statements of opinion "are factual in two senses: as statements that the directors do act for the reasons given or hold the belief stated and as statements about the subject matter of the reason or belief expressed."[81] Given the parallels between Rule 14a-9 and Section 11, the court concluded that *Omnicare*'s elucidation of what "facts" a statement of opinion conveys, and how they can be pled to be false or misleading, should apply in the Rule 14a-9 context also.[82]

"Disclosure Is Not an Act of Confession": Second Circuit Affirms Dismissal Based on Plaintiffs' Failure to Plead Facts Sufficient to Transform Corporate Mismanagement Into Securities Fraud

In *Plumbers & Steamfitters Local 773 Pension Fund et al. v. Danske Bank*,[83] the Second Circuit affirmed dismissal of a putative securities class action alleging that Danske Bank, the largest financial institution in Denmark, and several of its corporate officers made materially misleading statements and omissions about the nature and scope of a money laundering scandal involving the bank's Estonian branch.[84] The court concluded that allegations of Danske's failure to supervise the Estonian Branch, failure to react once it became aware of money laundering issues there, and material misstatements and omissions about the scandal after it was publicly disclosed did not move the claims "outside the realm of corporate mismanagement and into the realm of securities fraud."[85] In particular, the court rejected the plaintiffs' theory that the bank was at fault for its nondisclosure of "uncharged, unadjudicated wrongdoing" and affirmed the district court's dismissal of the case with prejudice.[86] The court also held that the plaintiffs' reliance on general allegations of money laundering at the Estonian branch and failure to plead specific acts constituting the alleged scheme to defraud under Rule 10b-5(a) and (c) did not satisfy the heightened pleading requirements of Rule 9(b). The decision is also an important reminder that timing matters: In addressing several alleged misstatements or omissions because they occurred more than three years before the plaintiffs' first purchase of the bank's securities or after its last purchase, the court noted that such statements "cannot reasonably be said to have significantly altered the mix of information available to reasonable investors" at the later or earlier dates of purchase.[87]

The complaint alleged that between 2007 and 2015, the failure to follow anti-money laundering protocols in the Estonian branch allowed suspicious transactions ultimately totaling $230 billion to flow through the bank. The complaint further alleged that in 2016, news of the scandal broke when the Danish Financial Supervisory Authority reprimanded and fined the bank for failure to identify material money laundering risk at the Estonian branch or to implement adequate risk-mitigation measures. The complaint alleged that negative public coverage about the money laundering problems at the branch prompted further governmental scrutiny from Danish and French regulators. In 2018, Danske voluntarily promised to renounce its profits from all illegal transactions at the branch and stated publicly that it did not expect "the dialogue with public authorities to have any material effect on its financial position."[88] Later that year, the bank released a report of an internal investigation that indicated that the scandal was much larger than anticipated and reported for the first time that more than $200 billion of transactions were suspicious. The price of Danske's securities sank as the negative news about the money laundering problems at the Estonian branch accumulated.[89] After allowing amendments to the complaint, the district court granted the defendants' motion to dismiss with prejudice because the complaint failed to allege any materially misleading statement or omission.

On appeal, the Second Circuit affirmed and held that the 144-page complaint detailing all that went wrong at the Estonian branch over eight years nevertheless failed to adequately allege any actionable misstatement or omission and thus failed to plead the first element of a claim under Section 10(b) or Rule 10b-5. First, the court rejected the plaintiffs' theory that the bank's financial statements were materially misleading because they did not disclose the money laundering issues in Estonia. Noting that Danske was under no obligation to self-report its growing suspicions about the Estonian branch, the court held that disclosure of accurate historical data is not a basis for a securities fraud claim simply because some wrongdoing may have contributed to a company's financial performance.

Second, the court rejected the plaintiffs' claim that the bank's financial statements were rendered "per se misleading" because of noncompliance with international accounting and financial reporting standards relating to revenues derived from transactions structured to facilitate money laundering.[90] Applying settled precedent that a securities fraud claim premised on a violation of law or accounting standards must be pled with particularity, the court concluded that the complaint failed to identify any specific law or contractual provisions related to the underlying transactions that rendered them illegal or unenforceable and thus failed to meet the applicable heightened pleading requirement.

Third, the court rejected the plaintiffs' claim that a $1.4 billion goodwill write-down of bank assets in Estonia and other countries was materially misleading because the bank described it as "purely technical" rather than related to the money laundering issues in Estonia.[91] Since the write-down occurred more than 39 months after the plaintiffs first purchased Danske securities and after multiple disclosures about the money laundering issues at the Estonian branch, the court found it "implausible that the fine points of a technical accounting exercise" in 2014 significantly altered the total mix of information available to investors in 2018 notwithstanding that the alleged class period began in 2014.[92] For the same reason, the court disagreed that a 2015 Corporate Responsibility report omitted material information about the handling of a whistleblower claim three years before the named plaintiffs' first purchase of bank securities amounted to an actionable omission.[93]

Likewise, the court held that certain "generic statements" about the bank's goal to conduct its business in accordance with international principles in the area of anticorruption were not actionable. As a preliminary matter, the court concluded that no investor would take such statements seriously in assessing an investment because all banks make the same statements. In addition, the court noted that general declarations about the importance of acting lawfully and with integrity are inactionable puffery. The court held that no reasonable investor, including the named plaintiffs who first purchased Danske securities more than three years after those reports, and after many intervening disclosures about the money laundering issues in Estonia, would weigh such generic statements in its investment calculus.[94] Finally, the court rejected the plaintiffs' claim that a misleading statement in a footnote in the bank's 2018 financial statements could be actionable because it was made *after* the plaintiffs' last purchase of securities and thus could not have influenced the price of a purchase that had already been made.[95]

The Second Circuit also affirmed the district court's dismissal of plaintiffs' "scheme liability" claims under Rule 10b-5(a) and (c) that the defendants carried out a scheme to deceive the investing public about money laundering at its Estonian branch in order to artificially inflate its stock price. The court concluded that the complaint's general allegations of money laundering and failure to enumerate any specific acts that constituted the alleged fraudulent scheme did not satisfy the heightened pleading requirement of Rule 9(b).[96]

Notably, the court declined to reexamine its precedents requiring that scheme liability claims be based on acts that are distinct from the misstatements or omissions that are the basis for claims brought under Rule 10b-5(b) in light of the Supreme Court's decision in *Lorenzo v. SEC*.[97] In *Lorenzo*, the Supreme Court held that those who disseminate false or misleading information to the investing public with the intent to defraud can be held liable under Rule 10b-5(a) and (c) even if the disseminator did not "make" the statement and rejected the argument that scheme liability claims are viable only when conduct other than misstatements or omissions are involved. Although the court acknowledged a split among district courts in the Second Circuit following *Lorenzo*, it declined to address its prior cases because the complaint in *Danske* was held to be deficient for "a more fundamental reason."[98] In another post-*Lorenzo* decision, the Ninth Circuit recently held that alleged dissemination of false statements that were the basis of a claim under Rule 10b-5(b) could also "run afoul" of Rule 10b-5(a) and (c) and support a scheme liability claim under those subsections.

Seventh Circuit Affirms Dismissal of Proxy Challenge

In *Kuebler v. Vectren Corp.*, the Seventh Circuit affirmed dismissal of a proxy challenge because the plaintiff failed to allege adequately both the materiality of purportedly omitted financial metrics and resulting economic loss.[99] In the absence of allegations that the proposed merger was marred by bad faith, disloyalty, or disregard for shareholder value and where the company's board conducted a competitive sale, the court held that there was no plausible claim of hidden and unappreciated value of Vectren shares. The decision is an important reminder that shareholders are not entitled to the disclosure of every financial input used by a financial advisor so they may "double-check" every aspect of the advisor's math and judgment.[100] Nor does Section 14(a) operate as "a license for shareholders to acquire all the information needed to act as a sort of super-appraiser; appraising the appraiser's appraisal after the fact."[101]

The complaint alleged that CenterPoint Energy, Inc. acquired all of Vectren Corporation's stock for $72 per share. Merrill Lynch, the financial advisor to Vectren, reviewed the transaction and provided a fairness opinion that, subject to various assumptions and limitations, ultimately deemed the $72 price to be fair. The plaintiffs were shareholders who alleged that the proxy statement was misleadingly incomplete because it omitted two categories of financial information, unlevered cash flow projections and business segment projections for the company's three lines of business, in violation of Section 14(a) and Rule 14a-9 of the Exchange Act. Plaintiffs alleged that without those two categories of financial metrics, shareholders could not independently assess the Merrill Lynch analysis and reach their own opinions on whether $72 per share was a fair price. The district court dismissed the complaint for failure to allege adequately materiality and loss causation.

On appeal, the court affirmed the district court's ruling that the omitted unlevered cash flow projections were immaterial as a matter of law. Noting the voluminous financial information in the proxy statement, the court rejected the plaintiffs' conclusory argument that unlevered cash flow is a superior measure of intrinsic value because "superiority is not synonymous with materiality."[102] "The materiality standard requires courts to assess the value of the omitted information in light of all the information made available to shareholders."[103] Thus, the "fundamental defect in plaintiffs' allegations of materiality" is their "failure to offer a plausible theory" for treating the unlevered cash flow projections as material in light of all the other information provided to shareholders.[104]

The court also affirmed the district court's rejection of plaintiffs' argument that the omitted business segment projections were material because they were allegedly a "key input" in Merrill Lynch's discounted cash flow analysis. The court rejected that argument because CenterPoint was offering to acquire

Vectren as a whole enterprise, not as individual segments. Nor did the proposed merger give shareholders the option of selling separate interests in separate business lines. Accordingly, the court held that the plaintiffs had failed to allege a substantial likelihood that a reasonable investor would have viewed the business segment projections as significantly altering the total mix of available information on whether to vote for or against the merger.[105]

The court also held that the plaintiffs' failure to adequately allege loss causation warranted dismissal of the complaint. As a preliminary matter, the court concluded that the plaintiffs had confused transaction causation with loss causation, and thus their heavy reliance on the Supreme Court's decision in *Mills v. Electro Auto-Lite Co.* was misplaced.[106] Citing its precedents that "transaction causation is nothing but proof that a knowledgeable investor would not have made the investment in question had she known all the facts," the court noted that both loss causation and transaction causation must be proven in the context of a claim asserted under Section 14 and Rule 14a-9 of the Exchange Act.[107]

The court concluded that the plaintiffs' failure to plead economic harm was "fatal" to their Section 14(a) claim and declined to address whether the complaint adequately alleged transaction causation.[108] The court summarily rejected the plaintiffs' argument that Merrill Lynch's use of a flawed discount rate impeded them from realizing the scope of supposed economic harm. "Plaintiffs are debating the merits of Merrill Lynch's choice of a discount rate and its judgment about the fair value of Vectren shares. That is a debate about the merger terms, not whether the Proxy Statement was misleading."[109] The court likewise rejected as speculation the plaintiffs' allegation that if the omitted metrics regarding the discount rate had been disclosed, shareholders would have been able to determine that the value of their shares exceeded the price of two bidders who had submitted indications of interest but ultimately did not make offers. "Here plaintiffs do not even allege the existence of a viable superior offer, making their allegations of economic loss even weaker than those in *Beck v. Dobrowski*, in which [the court] described the allegations of economic loss as 'heavy on hindsight and speculation, [and] light on verifiable fact.'"[110]

Second Circuit Holds CEO's Statements About Inventory Levels Actionable

In *IWA Forest Indus. Pension Plan v. Textron Inc.*, a divided panel of the Second Circuit vacated in part the dismissal of a putative securities class action alleging that Textron made materially misleading statements about excessive inventory levels at a recently acquired business, while affirming dismissal of other alleged misrepresentations related to the acquired company's integration, expected performance, and potential goodwill impairment.[111] The majority held that the complaint sufficiently alleged that the company's CEO made misleading statements about the status of inventories. The majority also held that the alternative interpretation of the challenged statements by the district court, while not unreasonable, was nevertheless erroneous because it effectively imposed an impermissible pleading requirement. The decision is a reminder that in determining whether a complaint has met the heightened pleading standard of the PSLRA and Rule 9(b), a court must accept all factual claims in the complaint as true and draw all reasonable inferences in the plaintiff's favor. The decision also highlights the need for companies to carefully vet public statements by senior management to confirm that they are consistent with the actual facts on the ground.

The complaint alleged that in 2017, Textron Inc., an aerospace and defense product manufacturer,[112] acquired Arctic Cat Inc., a manufacturer of snowmobiles and off-road vehicles,[113] and planned to integrate the company into its Specialized Vehicles business unit. When the acquisition was announced, Textron's CEO acknowledged that Arctic Cat had "inventory issues" as a result of a build-up in inventory over the preceding few years and that the excess inventory was weighing on sales of new vehicles.[114] To address the excess inventory problems after the acquisition closed, the company started a rebate program designed to encourage sales of older inventory.

The case focused on three statements by the CEO about inventory levels. In the company's January 2018 earnings call, the CEO stated that he saw "improved demand in the snow retail channel, allowing dealers to clear older inventory and drive 2018 model sales."[115] In an April 2018 earnings call, the CEO stated that "through the course of the year," there had been "pretty significant reductions in the aged inventory."[116] In response to an analyst's question during a July 2018 earnings call, the CEO said that although he did not "have [the] numbers at [his] fingertips," "older inventory ha[d] been moved off [dealers'] books," and "last year was great, in terms of burning down a lot of the inventory."[117] The complaint alleged that these statements about Arctic Cat's inventory issues were false because from early 2017 through the summer of 2018, the company had maintained a backlog of approximately 22,000–25,000 units from product years 2015–2017. The complaint also included information from a "cadre" of confidential informants who stated that current-year models were "stacked up for miles" at the company's headquarters and that the rebate program continued to fill dealerships "back up with more aged inventory from 2015–2017."[118]

In October 2018, Textron announced it had fallen short of revenue projections for the third quarter, largely due to a "precipitous decline" in the business unit that included Arctic Cat.[119] Textron's stock price dropped by 11% after the announcement. According to the complaint, a leading analyst blamed the stock decline on the rebate program for moving older products and asserted that it cost the company $40–50 million in the third quarter of 2018 alone. The plaintiffs sued, alleging that Textron and its top executives made four sets of material misstatements relating to Arctic Cat's business: its inventory levels; its integration into the Specialized Vehicles business unit of Textron; its expected financial performance; and a possible goodwill impairment charge relating to the acquisition.[120] The district court dismissed the complaint in its entirety for failure to allege any actionable misstatements.[121]

On appeal, a split panel of the Second Circuit reversed the district court's ruling as to the actionability of the CEO's statements regarding Arctic Cat's inventory levels while affirming the dismissal as to the other alleged misrepresentations.[122] In addressing whether the statements by the CEO in 2018 were actionable under the heightened pleading standards of the PSLRA and Rule 9(b), the majority noted that a challenged statement must be misleading, "evaluated not only by literal truth, but by context and the manner of presentation."[123] As a preliminary matter, the majority rejected the defendants' argument that the CEO's references in 2018 to "older vehicles" related only to products from model years 2016 and earlier, not 2017 models.[124] The majority held that the complaint plausibly alleged that a reasonable investor would have understood a reference to "older inventory" to include 2017 model vehicles as distinguished from the 2018 model year products launched just a few months earlier."[125] The majority also held that the plaintiff was justified in treating the vehicles from 2015–2017 as interchangeable because the CEO's inventory-related statements treated them in the same way. For example, the majority pointed to the CEO's statements in April and July 2018 contrasting "older vehicles" with "exciting new stuff" being shipped to dealers that plainly referred to all model years before 2018.[126]

The majority explained that even if the defendants' contrary and competing explanation of the meaning of the CEO's statements was not unreasonable, it was entitled to little weight at the pleading stage, when the court must draw all reasonable inferences in the plaintiff's favor."[127] The court also concluded that reasonable investors would have understood from Textron's prior statements that it needed a net reduction in aged inventory to drive current model year sales and that the CEO's statements about inventory in 2018 suggested that such a reduction had occurred. Finally, the court concluded that the CEO's statements about the easing of the inventory backlog conflicted directly with the complaint's allegations that Textron maintained in inventory at least 22,000 vehicles from model years 2015–2017 from early January through summer 2018 and the statements by the cadre of confidential informants about the backlog. For those reasons, the court concluded that the plaintiff had sufficiently alleged materially misleading statements by the company's CEO in 2018 about inventory issues at Arctic Cat.

In dissent, Judge Kaplan opined that the plaintiffs had failed to meet their burden under the heightened pleading standards of the PSLRA and Rule 9(b).[128] The dissent contended that the complaint merely "cherry-picked" the CEO's statements about inventory at Arctic Cat without reference to the context in which they were made and without making particularized factual allegations to support them.[129] The dissent also took issue with the majority's conclusion that the district court had erred in finding that the CEO's statements about "old inventory" excluded the 2017 model year and had improperly "required" the plaintiffs to show that their reading of his statements as false was superior to the district court's "own benign reading."[130] The dissent asserted that the district court only "correctly required" the plaintiffs to plead factual allegations from which its proposed reading of the CEO's statements could reasonably be inferred.[131]

Second Circuit Addresses Interplay Between "Scheme Liability" and "Misstatement Liability" Theories Under Rule 10b-5

In *In re Hain Celestial Group, Inc. Securities Litigation*, the Second Circuit held that the district court erred in dismissing a complaint alleging that defendants failed to disclose a "channel stuffing scheme." The court vacated the dismissal based on the lower court's erroneous assumption that the plaintiffs' Rule 10b-5(b) claim was contingent on their successful pleading of a fraudulent business scheme or practice in violation of Rule 10b-5(a) and (c) where no such requirement exists. The court also held that the district court further erred in failing to consider the cumulative weight of the scienter allegations. As we discuss elsewhere in this year's Review,[132] this was another decision of note in 2021 addressing the interplay and differences between pleading a claim under Rule 10b-5(b) and Rule 10b-5(a) and (c). It also highlights the need for district courts to address the total weight of circumstantial scienter allegations together with allegations of motive and opportunity to commit fraud.

Hain purportedly offered sales incentives to its largest distributors near the end of several financial quarters, including cash incentive payments, product discounts, favorable payment terms, and an "absolute right to return unsold product," to induce those customers to purchase more product than needed so that Hain could meet its sales goals and financial projections.[133] Notably, the incentives were not included in any customer contracts and were not documented or reflected in the company's books and records. The complaint also alleged that the defendants made repeated public statements attributing its growing sales to "organic" factors and "strong consistent consumer demand," without any mention of the channel stuffing scheme.[134]

In 2016, after certain large distributors refused to take more inventory, Hain commenced an internal investigation into its financial reporting and whether it had properly accounted for revenues. Its outside auditors commenced an independent audit, and the company announced it would delay filing its financial statements. Hain's stock price fell by more than 26% upon these disclosures. In early 2017, on the final day of the class period, Hain announced it had expanded the scope of the internal investigation to encompass its historical financial results and that the SEC had launched an investigation. As a result, Hain's stock price dropped an additional eight percent. Later, Hain filed its Form 10-K for 2016 and identified material weaknesses in internal controls over its financial reporting and its policies for revenue recognition. The company also announced restated lower financial results for fiscal years 2014 and 2015 and for the nine months ending on March 31, 2016.

The complaint alleged that multiple public statements to the effect that Hain's sales were based on strong consumer demand were materially misleading because they omitted any mention of the channel stuffing scheme, in violation of Section 10(b) of the 1934 Act and Rule 10b-5(b).[135] The complaint also alleged that, separate from the purportedly misleading statements, the channel stuffing constituted an unlawful scheme to defraud investors under Rule 10b-5(a) and (c). Hain moved to dismiss for failure to state a claim and the district court analyzed the complaint with respect to the three separate clauses of Rule 10b-5: clause (a), which prohibits the "employ[ment of] any device, scheme, or artifice to defraud"; clause (b), which "renders it unlawful '[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made . . . not misleading'"; and clause (c), which "prohibits 'engag[ing] in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.'"[136]

The district court dismissed the complaint with prejudice as to all three clauses of Rule 10b-5, reasoning that because the practice of channel stuffing was not inherently fraudulent and thus not in violation of Rule 10b-5(a) and (c), the claim under Rule 10b-5(b) failed because "its predicate is the illegitimacy of the channel stuffing practices the [c]ourt already found to be legitimate."[137] The district court also found the scienter allegations to be insufficient. The plaintiffs appealed only the district court's ruling on their claim under Section 10(b) and Rule 10b-5(b)—for misstatement liability.

On appeal, the Second Circuit vacated the district court's ruling on the grounds that it reflected both a misunderstanding of the requirements of pleading a Rule 10b-5(b) claim as well as of the plaintiffs' theory of the case. Regarding the pleading requirements, the court held that "the district court mistakenly imported the requirements of clauses (a) and (c) of a fraudulent scheme or practice into clause (b), which includes no such requirement."[138] The court explained that unlike a fraudulent scheme or practice that is required for a claim under Rule 10b-5(a) and (c), Rule 10b-5(b) is concerned with statements—"whether something said was materially misleading"[139]—and held that "the success of such a complaint in alleging a violation of clause (b) does not depend on whether the . . . practices themselves were fraudulent or otherwise illegal."[140]

The court concluded that the theory of the complaint in reference to the alleged violation of Rule 10b-5(b) was that the defendants made statements attributing Hain's high sales volume to strong consumer demand, while omitting to state that increased competition had weakened consumer demand and that Hain's high sales volume had been achieved in significant part by unsustainable channel stuffing. The court concluded that the success of the Rule 10b-5(b) claim based on misstatements about channel stuffing did not depend on whether the alleged channel stuffing itself was fraudulent or otherwise illegal.

The Second Circuit also took issue with the district court's scienter findings, noting that the district court's "mistaken understanding" of the substance of the alleged offense "inevitably affected" its view of whether it was done with scienter.[141] The court also faulted the district court's failure to weigh the scienter allegations "as a whole," including the defendants' knowledge of the channel stuffing practices, the company's inadequate internal controls and inaccurate financial reporting, and suspicious terminations, resignations, and demotions of senior employees who questioned the channel stuffing practices.[142] While acknowledging that the district court had considered the defendants' motive and opportunity to commit fraud—including high-volume insider trading by two defendants during the class period—the court held that the district court's failure to assess the total weight of the circumstantial allegations "together with" the allegations of motive and opportunity amounted to error.[143] On remand, the Second Circuit instructed the district court to reassess the scienter allegations and "consider afresh whether the Complaint adequately stated a claim under Rule 10b-5(b)."[144]

This decision is the second highlighted in this year's Review in which courts parsed the interplay between alleged "scheme liability" claims under Rule 10b-5(a) and (c) and alleged material misrepresentations or omissions under Rule 10b-5(b) following the Supreme Court's decision in *Lorenzo v. SEC*.[145] In *Lorenzo*, the Supreme Court held that those who disseminate false or misleading information to the investing public with the intent to defraud can be held liable under Rule 10b-5(a) and (c) even if the disseminator did not "make" the statement and also rejected the argument that scheme liability claims are viable only when conduct other than misstatements or omissions are involved.[146] In *In re Alphabet Securities Litigation*, the Ninth Circuit held that alleged dissemination of a material misstatement "may run afoul" of Rule 10b-5(a) and (c) even in the absence of any other alleged conduct.[147] In *Plumbers & Steamfitters Local 773 Pension Fund v. Danske Bank*, the Second Circuit declined to reexamine its precedents requiring that scheme liability claims be based on acts that are distinct from the alleged misstatements or omissions that are the basis for claims under Rule 10b-5(b), notwithstanding a split among district courts in the Second Circuit following *Lorenzo*.[148]

"It Does Not Require a Ph.D. to Know That a Product Cannot Be 'Super Strong' If It Has Never Once Done What It Is Supposed to Do": First Circuit Reverses Dismissal of Complaint Alleging Misrepresentations About Defective Data Protection Product

In *Construction Industry and Laborers Joint Pension Trust v. Carbonite, Inc., et al.*,[149] the First Circuit upheld a complaint alleging that Carbonite, Inc. and certain senior executives made misleading and materially false statements about a data protection product that did not work. The court held that the plaintiffs adequately alleged falsity, materiality, and scienter and reversed the district court's dismissal of the complaint for failure to state a claim under Sections 10(b) and 20(a) of the Exchange Act. The court held that the professed importance of a product can support an inference that corporate executives paid close attention to its status and would have known of internal corporate information showing that it could not perform as the company represented publicly. This decision is an important reminder of the need for companies to carefully choose the language they use to describe products to the investing public and to review the adequacy of their prior disclosures as information about the functionality of product changes.

Carbonite is a software company that offers cloud-based backup and data protection products. The complaint alleged that in October 2018, the company launched a new data backup product called Server VM Edition ("VME"). After the product was released, the company and senior executives promoted it publicly. For example, on November 1, 2018, Carbonite's CEO told investors that VME "significantly improves our performance for backing up virtual environments and makes us extremely competitive going after that market."[150] The CFO likewise touted VME at an investors' conference, describing it as a "super strong product" and telling investors "[VME is] a really important product for us, and I think it will help us address a pretty big segment of the market."[151] Contrary to the company's positive public statements about VME, the complaint alleged that the product never worked. During a pre-launch trial, the complaint alleged that several customers tested VME and "there was not one successful customer data backup before the product was released."[152] Carbonite employees also allegedly reported internally that the product was not ready for release. The company allegedly created an internal "tiger team" to try to fix the product and ultimately put out a "large patch" and "hundreds of bug fixes."[153]

By early summer 2019, the company had decided to stop selling VME. On July 25, 2019, Carbonite publicly announced that it was withdrawing VME from the market and that its CEO was resigning effective immediately. It also announced a substantial reduction in its quarterly earnings and projected annual revenue as a result of the VME withdrawal. Investors reacted negatively to these disclosures, and the company's stock price dropped by more than 24%.[154] Pointing to 12 statements that were "materially false and misleading," the complaint alleged that the company and current and former executives misled investors by touting VME despite knowing it did not work, in violation of Section 10(b) and Rule 10b-5.[155] The district court dismissed the complaint with prejudice on the grounds that the plaintiff insufficiently pleaded scienter and declined to reach the alternative argument that the complaint alleged no actionable misrepresentations or omissions.[156]

The First Circuit reversed,[157] holding that the complaint adequately stated with the particularity required by the PSLRA that company executives made material misstatements about VME as well as facts giving rise to a strong inference that those executives acted with scienter. Applying the standards for pleading the falsity of a statement of opinion enunciated by the Supreme Court in *Omnicare, Inc. v. Laborers Dist. Council Constr. Industry Pension Fund*,[158] the court rejected the defendants' argument that the statements by its executives were not actionable because they were opinions, not statements of fact. The court held that the CEO's statement that VME "improves our performance for backing up virtual environments and makes us really competitive" could be reasonably construed as a statement of fact that would be false in light of the allegation that VME could not back up in virtual environments at the time the statement was made.[159] Likewise, the court concluded that a statement by the CFO that "we have put something out that we think is just completely competitive and just a super strong product"[160] plausibly conveyed three facts that were false in light of the complaint's description of the nonfunctional state of VME when the statements were made.

First, the statement conveyed that the CFO actually believed VME to be "completely competitive" and "super strong."[161] Second, the statement conveyed that the CFO's opinion "fairly aligned with the information he possessed at the time."[162] Third, the CFO's statement plausibly conveyed that his opinion was based on the type of "reasonable inquiry" that an investor in context "would expect to have been made."[163] The court therefore "[had] no trouble" finding that the statements by the executives were material because they "would have been viewed by investors as a significant part of the total mix of information in valuing Carbonite" as an investment.[164]

The complaint advanced two theories to establish scienter. First, by touting the importance of VME to the company, the executives implied that they followed the product closely and thus were aware of its serious shortcomings. Alternatively, if the executives did not know about VME's performance problems, then they acted with a high degree of recklessness by promoting the product publicly without first ensuring that it actually worked.[165] The court held that the complaint adequately alleged facts giving rise to a strong inference of both alternative inferences that was "more than merely plausible or reasonable," cogent, and "at least as compelling as any opposing inference of nonfraudulent intent."[166]

Pointing to its precedents holding that "the importance of a particular item to a defendant can support an inference that the defendant is 'paying close attention' to that item,"[167] the court concluded that the fact that the company thought VME important enough to warrant two specific plugs from top management created a "very strong inference" that the executives would have paid at least some attention to the product's status.[168] Moreover, it concluded that "it does not require a PhD to know that a product cannot be 'super strong' if it has never once done what it is supposed to do."[169]

The court also rejected the argument that management "was somehow in the dark about VME's true status" given the allegations that Carbonite employees internally reported before launch that the product was not ready for market and that during the trial runs, VME had produced "not one successful backup."[170] Finally, the court rejected the defendants' invitation to find a competing, nonculpable inference from the company's efforts to fix the problems with VME, noting that the executives' statements touting the product as "completely competitive" and "super strong" were framed in the present tense and were "flat-out claims about the product as it then stood" and could not be plausibly construed as "projections of hoped-for performance."[171]

SCIENTER

Fourth Circuit Holds That Internal Disagreement Over Business Strategy Does Not Support Strong Inference of Scienter

In *KBC Asset Mgt. NV v. DXC Tech. Co.*, the Fourth Circuit affirmed dismissal of a $2 billion securities fraud suit accusing DXC and its senior executives of making misleading statements about revenue.[172] The court agreed that the complaint, viewed as a whole, did not contain factual allegations sufficient to give rise to a "strong inference" of scienter.[173] The court held that multiple prior disclosures of risks and "newly discovered" weaknesses, including a significant revenue decline, cut against an inference of scienter.[174] The decision is an important reminder for companies to continually and timely review and update their disclosures to reflect ongoing changes in business conditions.

DXC was an information technology company formed as a result of a merger in 2017. It initially succeeded in meeting its strategic financial goals by instituting cost-cutting measures. On February 8, 2018, the company publicly announced its continued financial success. By November 6, 2018, however, the company revised its projected revenue guidance downward by an estimated $800 million. The company's stock price fell as a result. The plaintiff filed suit alleging that the defendants knew that the cost-cutting measures implemented in 2018 would undermine the company's ability to generate revenue, contrary to the defendants' public disclosures in violation of the Section 10(b) and Rule 10b-5 of the Exchange Act. The district court dismissed the complaint because the challenged statements were either forward-looking statements protected by the PSLRA safe harbor or non-actionable puffery.

On appeal, the Fourth Circuit concluded that the five categories of allegations that the plaintiff claimed demonstrated scienter—including allegations by a former executive and former employees, massive stock sales by senior executives during the class period, and the temporal proximity between the company's positive statements and its ultimate admission that it had been overly optimistic—did not give rise to an inference of scienter as compelling as a nonfraudulent inference. Instead, the court held that "the far more plausible inference" was that a disagreement within the company over the proper course forward and the management's ultimate decision to make cuts that some employees found questionable did not support a strong inference of scienter.[175] In addition, the court noted that because the defendants disclosed risks and newly discovered weakness, that "counts against an inference of scienter."[176]

"Mere Negligence—Even Head-Scratching Mistakes—Does Not Amount to Fraud": Ninth Circuit Holds That Plausibility Matters in Analyzing Scienter Allegations

In *Prodanova v. H.C. Wainwright & Co.*, the Ninth Circuit affirmed dismissal of a securities fraud action against an investment bank and certain of its employees who had allegedly published an analyst report about a biopharmaceuticals company to inflate the stock price of the company without disclosing the bank's role in an impending offering on behalf of the same company.[177] Because the complaint did not offer a plausible motive for fraud or compelling and particularized allegations about scienter, the court concluded that it did not support a strong inference that the defendants made intentional misstatements or acted with deliberate recklessness. Rather, the court concluded that the more plausible inference was of nonculpable negligent conduct. The decision is an important reminder that if a complaint fails to plead a plausible motive for fraud, the plaintiff will face a substantial hurdle in establishing scienter for a claim under Rule 10b-5.

The complaint alleged that on October 10, 2017, an investment analyst at H.C. Wainwright & Co. ("HCW" or "bank") published a report about MannKind Corporation, a publicly traded biopharmaceuticals company that produced an insulin drug that had recently received a positive labeling change from the FDA. The HCW report set a $7 "buy" target price for the company's shares, and the stock price jumped 26% the day the report was issued to $6.71. Later on the same day, MannKind announced a registered direct offering of 10,166,600 shares of common stock at $6 per share. The announcement stated that HCW would be serving as the exclusive placement agent for the offering. The next day, MannKind's stock price declined 18% to a closing price of $5.47.

Based on these events, plaintiff brought a putative class action alleging that HCW, certain senior executives, and the author of the report had fraudulently sought to inflate the price of MannKind shares before the offering by issuing the report. The district court initially granted a motion to dismiss the complaint without prejudice for failing to adequately plead scienter. The plaintiff filed a second amended complaint, which sought to bolster the scienter allegations by adding evidence from an industry expert who explained that it was "industry custom" for investment banks to maintain compliance departments that track prospective client relationships and place those names on a "watch list" to ensure that when analysts draft research reports about a company on a watch list, the reports are flagged for potential conflicts of interest. The second amended complaint also included evidence from a confidential witness who had previously worked in HCW's research department who alleged that the bank had a compliance department that generally complied with industry custom regarding conflicts of interest. The district court granted HCW's renewed motion to dismiss based on the failure to adequately allege scienter.

On appeal, the Ninth Circuit affirmed the district court's dismissal, concluding that neither of the plaintiff's theories of defendants' motives were persuasive or plausible as both were "divorced from common experience."[178] Plaintiff first claimed that HCW published the report without disclosing its role in the upcoming offering in order to drive up MannKind's stock price, which would in turn increase HCW's compensation from the offering. The court rejected this theory because the bank's compensation was entirely based on the offering's gross proceeds and the complaint did not explain how a higher share price would increase the gross proceeds.

Plaintiff's second motive theory was that HCW published the report to generate interest in MannKind stock, so that as many shares as possible would be sold in the offering, which would lead to greater compensation for HCW. The court rejected this claim because the complaint did not allege any facts to show that the offering would not have sold out but for the publication of the report. Noting that "we expect that a financial motive for securities fraud will be clear," the court concluded that neither of the plaintiff's theories provided a clear financial incentive and thus failed to allege a plausible motive.[179] The court held that since the bank stood to lose more than it could gain from its allegedly fraudulent actions, including harm to its reputation and potential damage to its relationship with a longtime client, the more plausible explanation was that the bank simply erred in letting "a glaring conflict pass by."[180] The court held that an error—even an embarrassing or inexplicable one—does not establish fraudulent intent, especially in the absence of a plausible motive for fraud.

Noting that a plaintiff who could not plead a plausible motive for allegedly fraudulent actions "face[d] a substantial hurdle in establishing scienter," the court acknowledged that the plaintiff could still meet the burden of pleading a strong inference of scienter by alleging "compelling and particularized facts showing fraudulent intent or deliberate recklessness."[181] While the complaint alleged that the bank acted with scienter based on the imputed intent or deliberate recklessness of the individual defendants—including the report's author, the CEO, the COO, and the bank's compliance department—the court held that the complaint failed to allege with sufficient particularity that any of those parties acted with intent or deliberate recklessness to satisfy the heightened burden for pleading scienter under the PSLRA. Instead, reviewing all the allegations holistically, the court concluded that the more plausible inference to be drawn from the complaint was one of nonculpable, merely negligent conduct. Because the innocent explanation for defendants' alleged conduct was more plausible, the district court properly dismissed the complaint for failing to adequately allege scienter.

The court also rejected the plaintiff's reliance on the "core operations theory," which posits that "corporate officers have knowledge of the critical core operation of their companies."[182] Because the complaint failed to allege specific admissions by company executives that they were involved in the details of the operation or witness statements that the executives were specifically involved in producing false reports, the complaint did not adequately allege the first two formulations of the core operations theory. Nor did the complaint allege that the conflict between the report and the offering was a fact of such prominence that it would be "absurd" to suggest that management did not know about it. Finally, the court also rejected the plaintiff's argument that the bank's failure to correct the report promptly to disclose the conflict of interest supported an inference of intentional or deliberately reckless conduct because neither the Ninth Circuit nor the Supreme Court has recognized such a duty, and the panel declined to do so in this case.

Second Circuit Revives Market Manipulation Claims and Holds Disclosure of Investment Risks May Be Insufficient When Risks Have "Materialized in the Past" and Are "Virtually Certain to Materialize Again"

In *Set Capital LLC v. Credit Suisse Group AG*,[183] the Second Circuit held that the plaintiffs in a securities class action adequately alleged market manipulation and misstatements and omissions in offering documents related to an alleged scheme to collapse the market for a derivative financial product offered by Credit Suisse. The court also held that the complaint alleged circumstantial evidence of conscious misbehavior or recklessness that, when viewed holistically and together with allegations of motive and opportunity, gave rise to a strong inference of scienter. The decision is noteworthy because the court revived market manipulation claims against an issuer arising from open market hedging activities based in part on the structure of the underlying derivative product, which provided both a motive and opportunity to manipulate the market. It is also an important reminder that even explicit disclosure of risk from hedging activities may be insufficient to avoid liability where an issuer fails to timely update its disclosures to reflect actual risk based on past experiences that are "virtually certain to materialize again."[184]

The complaint alleged that a derivative product issued by Credit Suisse, the VelocityShares Daily Inverse VIX Short Term Exchange Traded Notes ("XIV Notes"), were priced based on the inverse of a stock market volatility index that tracked futures on the Chicago Board of Exchange ("VIX"). The price of XIV Notes increased in times of market stability and decreased during times of market volatility, thereby enabling investors to bet against the VIX index based on their expectations of future market volatility. Between 2010 and 2018, the market experienced three spikes in volatility that caused the value of XIV Notes to drop substantially. During those periods, Credit Suisse continuously hedged its exposure to the XIV Notes and rapidly adjusted those hedges by purchasing VIX futures contracts, which were increasing in value when volatility spiked, in order to offset potential losses on the XIV Notes. According to the complaint, the upshot of this hedging activity was insufficient liquidity in the VIX futures market that in turn created a "liquidity squeeze," resulting in the price of VIX futures contracts spiking even higher and the value of XIV Notes plummeting even further.

In July 2016, following the third liquidity squeeze, Credit Suisse announced that all future sales of XIV Notes would be conditioned on the buyer's agreement to sell Credit Suisse hedging instruments consistent with its hedging strategy. The complaint also alleged that shortly after that announcement, Credit Suisse began issuing millions of additional XIV Notes into the market, including an additional 16,275,000 XIV Notes on January 29, 2018, alone, with knowledge that future hedging activity relating to the volume of newly issued XIV Notes would cause the price of VIX futures contracts to spike in the event of another liquidity squeeze and also cause the price of XIV Notes to crater. The offering documents included several warnings about the risks of an investment in XIV Notes but notably stated that while Credit Suisse's hedging activity "could" or "may" adversely impact the value of XIV Notes, the issuer had "no reason to believe" that would occur.[185]

On February 5, 2018, the market experienced a sudden and nearly unprecedented increase in volatility and the S&P 500 dropped 4.1 percent. The volatility drove up the VIX, increased the cost of VIX futures contracts, and caused a corresponding drop in the price of XIV Notes. The complaint alleged that Credit Suisse's substantial hedging activity on that day contributed to a liquidity squeeze that resulted in the price of XIV Notes falling to $4, an approximately 96% decrease from the prior day's closing value. In addition, the complaint alleged that because the current value of XIV Notes ("Flatline Value"), which was supposed to be updated every 15 seconds throughout the day, was not updated between 4:09 p.m. and 5:09 p.m., investors purchased more than 700 million in XIV Notes at inflated prices.

On February 6, 2018, Credit Suisse announced that an "acceleration event" had occurred—namely, that the value of the XIV Notes fell to a level less than or equal to 20% of the prior day's closing value, and it would permanently stop issuing the notes. Credit Suisse ultimately terminated all XIV Notes and paid each investor $5.99 per note. The complaint alleged that investors lost approximately $1.8 billion while Credit Suisse reported that its equity sales and trading division earned approximately $490 million for its own account in the first quarter of 2018 "due to more favorable trading conditions, particularly higher levels of volatility which benefitted our derivatives business."[186]

The complaint alleged that the defendants engaged in a complex fraud to collapse the market for XIV Notes to earn substantial profits at investors' expense, and failed to correct the Flatline Value of the notes during after-hours trading on February 5, 2018, all in violation of Sections 9(a) and 10(b) of the Exchange Act. It also alleged that the defendants misleadingly warned about "risks" in the offering documents for XIV Notes that they knew would occur, in violation of Section 10(b) and 11 of the Securities Act. The district court dismissed the complaint on the grounds that: (i) the plaintiffs failed to allege any actionable misstatement or omission in the offering documents; and (ii) although the complaint did allege acts of market manipulation and misrepresentations regarding the Flatline Value, it failed to show a strong inference of scienter.

On appeal, the Second Circuit affirmed in part and reversed in part, holding that the complaint raised a strong inference of scienter regarding the market manipulation claim and identified actionable misstatements or omissions in the offering documents. However, the court upheld the district court's ruling that the complaint did not support a strong inference that the defendants acted with scienter in failing to update the Flatline Value on February 5, 2018.

Noting Supreme Court precedent that defines a "manipulative act" as an activity that sends an "artificial" or "false" price to the market with an intent to mislead investors, the court acknowledged that hedging activity that affects price "is not, by itself, manipulative."[187] Likewise, the court stated that open-market transactions "are not inherently manipulative," but "they may constitute manipulative activity when accompanied by manipulative intent."[188] The court concluded that the complaint adequately alleged manipulative intent by alleging that Credit Suisse intentionally flooded the market with millions of additional XIV Notes as part of a scheme to enhance the impact of its hedging activity for a particular purpose: to trigger a liquidity squeeze that would destroy the value of the XIV Notes while enabling Credit Suisse to profit. "In some cases, as here, scienter is the only factor that distinguishes legitimate trading from improper manipulation."[189]

Turning to the element of scienter, the court focused on three points supporting its conclusion that the allegations regarding Credit Suisse's intent were "at least as compelling" as Credit Suisse's proffered competing inferences.

First, the complaint plausibly alleged that Credit Suisse knew that its hedging trades would cause a spike in the price for VIX futures contracts and a corresponding drop in the price for XIV Notes, based on the hedging actions it took in response to three prior price spikes resulting from market volatility and its July 2016 announcement conditioning the sale of new XIV Notes on the buyer's agreement to sell Credit Suisse additional hedging instruments.

Second, the complaint plausibly alleged that Credit Suisse exacerbated the liquidity squeeze in the VIX futures market that cratered the value of the notes by dramatically increasing the number of XIV Notes outstanding in the run up to February 5, 2018. According to the court, a reasonable juror could conclude that Credit Suisse sold these millions of new XIV Notes either knowingly or recklessly disregarding a substantial risk that, at the next period of market volatility, Credit Suisse's hedging trades "would have an even greater negative impact on the value of XIV Notes than they had before."[190] Third, the complaint included supporting evidence of conscious misbehavior or recklessness, including statements in the offering documents for the notes that minimized the expected impact of the hedging activities and that did not account for experiences during the prior liquidity squeezes.

The court also pointed to evidence supporting Credit Suisse's motive and opportunity to engage in the manipulative scheme, including the structure of the XIV Notes themselves, which would allow the issuer to profit even if the value of the notes collapsed. Accordingly, the court concluded that the complaint supported a strong inference of scienter and, as required by the PLSRA's heightened pleading standard, a reasonable person could find the allegations that Credit Suisse knowingly and intentionally caused the collapse of its own XIV Notes equally as compelling as the nonfraudulent alternative accepted by the district court.

Finally, the court had no trouble finding that the offering documents misrepresented Credit Suisse's knowledge of the impact of its hedging activity and failed to disclose its plan to increase the volume of XIV Notes in the market before triggering an Acceleration Event. While the offering documents contained warnings about the extensive risks related to purchases of XIV Notes and disclosed Credit Suisse's intention to hedge its exposure, the documents did not adequately disclose the likely impact of that hedging strategy. Instead, the offering documents stated that hedging activities "could" or "may" impact the price of the notes but Credit Suisse had "no reason to believe" that it would.[191] The court reasoned that such "cautionary words" are not enough to insulate an issuer from liability for failure to disclose risks that have "materialized in the past" and are "virtually certain to materialize again."[192] In addition, the court noted that Credit Suisse's warnings had remained unchanged for nearly a decade despite the three prior episodes of extreme market volatility that resulted in liquidity squeezes and loss of value of the notes. Likewise, the court found that the offering documents omitted material facts when they disclosed that the hedging trades "may present" a conflict of interest when the market structure for the notes ensured that Credit Suisse would profit at its own investors' expense when the next volatility spike occurred. The court concluded that these misrepresentations and omissions, if proven at trial, would materially alter the mix of information available to a reasonable investor.[193]

Honest Debate About the Merits of a Business Judgment Is Insufficient to Show Scienter or Recklessness, Fourth Circuit Holds

In *In re Triangle Capital Corp. Securities Litigation*,[194] the Fourth Circuit affirmed the dismissal of a complaint with prejudice because allegations that the defendants failed to heed advice to change investment strategies did not raise a strong inference of scienter. The court concluded that the much-stronger inference was that the defendants had an honest debate about the merits of a business judgment and "in hindsight, simply made the wrong choice with some investments."[195] The court quoted extensively from the company's disclosures warning that investments in it might not be suitable for someone with a lower risk tolerance and of the highly competitive nature of its market that might cause a substantial risk of capital loss. The court concluded that these robust and detailed disclosures helped contextualize other more optimistic statements about the company's investment opportunities and supported a conclusion that the proffered inference of scienter was not as strong as the inference of innocence. This decision is an important reminder of the need for companies to provide robust and detailed risk disclosures that adequately track changing risks in the underlying business.

The complaint alleged that Triangle was a business development company that provided customized financing to lower-middle-market companies. Unlike traditional lenders, Triangle offered its clients "mezzanine financing," a hybrid of debt and equity that provided the lender with the ability to convert to an ownership or equity interest in the borrower in the event of default after senior lenders were paid. This form of financing was inherently riskier because the lender received a lower-priority security interest in the borrower's assets even as it received higher interest rates.

The complaint alleged that by 2014, mezzanine financing lenders in the lower middle market began to experience increased competition from so-called "unitranche lenders."[196] Unitranche lending combined senior and subordinated debt into one package with a blended interest rate that both lowered a borrower's costs and presented other benefits that mezzanine lending did not. The crux of the fraud claim was that while Triangle's financial advisors recommended that the company begin moving away from mezzanine structures and into unitranche structures in 2014 and 2015, the defendants decided to continue with an investment strategy focused primarily on mezzanine deals. In its public statements, Triangle's senior executives emphasized that the company was focusing on "quality over quantity" and lauded its "robust investment pipeline."[197]

In 2016, the company announced that its CEO would be replaced by the CFO, and it unveiled a new plan to transition to a greater emphasis on unitranche financing. It also closed a public offering of stock that netted $120 million. By 2017, the company's investment portfolio began to falter, and in a call with investors, the new CEO acknowledged that as a result of the prior decision to continue to lead with a mezzanine strategy, the company "added incremental exposure to a number of riskier credits, many of which are now underperforming."[198] Shortly thereafter, Triangle's stock declined by $2.57 per share, or 21%.

The plaintiff sued under Section 10(b) and Rule 10b-5 of the Exchange Act, asserting four types of false statements and omissions. The district court initially dismissed an amended complaint on the grounds that it failed to adequately allege that any particular statement or omission was actually false or misleading. After granting the plaintiff leave to file a second amended complaint, the district court dismissed that complaint with prejudice and denied leave to amend as futile because the fraud allegations were "not cogent and compelling [as] compared to the alternative explanation—that [D]efendants were aware that the [BDC] market was changing, but they continued to believe that high-quality investment opportunities remained in the marketplace."[199]

On appeal, the plaintiff's scienter allegations fared no better. The Fourth Circuit noted the plaintiff's heavy reliance on the allegation that Triangle had been advised that the mezzanine lending market was contracting but failed to specify "when this advice was given, how firm in their conviction these investment advisers were in recommending that Triangle should avoid mezzanine deals moving forward, or what a mix of mezzanine and unitranche investments should look like."[200]

The court also was unpersuaded that the CEO's departure and his successor's changes to the company's investment strategy evidenced fraud. "The far more reasonable inference to draw from these facts is that defendants were at a crossroads and had an honest, genuine debate about whether to continue with a mezzanine-focused investment strategy or transition to a unitranche-focused strategy. In the end, they chose a hybrid strategy in which some investments worked well but some did not. Nothing in that choice indicates fraudulent intent or recklessness."[201]

The court also found that the breadth of the defendants' risk disclosures to investors further strengthened the competing inference of innocence. The court concluded that the plaintiff had not satisfied the PSLRA's heightened burden for pleading scienter because "stacking inference upon inference" cannot be enough to give rise to a cogent inference of scienter, as it "flies in the face" of the PSLRA's mandate that the strong inference of scienter be supported by facts, not other inferences.[202]

LOSS CAUSATION

Supreme Court Denies Petition for Certiorari in Loss Causation Case, Despite Circuit Split

As we discussed in last year's Review,[203] in *BofI Holding, Inc. Securities Litigation*,[204] a divided panel of the Ninth Circuit reversed dismissal of a putative securities class action, holding that a whistleblower suit could serve as a corrective disclosure for the purpose of pleading loss causation—a required element of a cause of action under Section 10(b) and Rule 10b-5 of the Exchange Act—even if there is no additional evidence or disclosure corroborating the allegations. In so holding, the court joined the Sixth Circuit in rejecting a categorical "bright line" rule that "allegations in a lawsuit, standing alone, can never qualify as a corrective disclosure."[205] In a spirited dissent, Judge Lee expressed his "fear that the decision will have the unintended effect of giving the greenlight for securities fraud lawsuits based on unsubstantiated assertions that may turn out to be nothing more than wisps of innuendo and speculation."[206] The dissent argued that the court should have required additional external confirmation of fraud allegations in a whistleblower lawsuit for them to be a corrective disclosure. Describing the loss causation requirement "as a critical bulwark against frivolous securities fraud lawsuits," the dissent cited to an Eleventh Circuit case holding that disclosures such as allegations in a complaint or an announced SEC investigation can be corrective only if the allegations later turn out to have objective merit.[207]

In March 2021, the defendants filed their petition for writ of certiorari in the Supreme Court.[208] Joined by *amicus curiae* Securities and Financial Markets Association and the U.S. Chamber of Commerce, the petition requested the Court to resolve the circuit split as to whether public allegations may, without more, reveal truth for the purpose of establishing the loss causation element of a securities fraud claim. The petition argued that review was needed "to restore certainty for issuers in our national securities markets and deter strike suits that piggy-back on or coordinate with uncorroborated, self-interested complaint allegations by adversaries of the issuer."[209] The petition also asserted that the Ninth Circuit's decision conflicted with the Supreme Court's decision in *Dura*

Pharmaceuticals, Inc. v. Broudo[210] because the majority concluded that the whistleblower's allegations revealed the "truth" about the issuer in large part because the company's stock price declined after the former employee's lawsuit was filed, thereby rendering pleading and proving loss causation as a "mere perfunctory" exercise.[211]

Finally, the petition requested that the Court consider overruling *Basic, Inc. v. Levinson* due to its reliance on the "efficient capital markets hypothesis," the theory that the market price of a security trading in an efficient market reflects all publicly available information (including misrepresentations) about an issuer and the foundation for all loss causation showings in fraud-on-the-market cases.[212] Citing to the concurring opinion of Justice Thomas in *Halliburton Co. v. Erica P. John Fund, Inc.*, the petition asserted that securities class actions continue to be a "costly draft on the effective functioning of the U.S. capital markets while providing no meaningful compensation to victims or effective deterrence.[213] On October 4, 2021, the Court denied the petition. It remains to be seen whether the Court will address the split in the circuits as to what suffices to show a corrective disclosure for purposes of pleading loss causation.

Ninth Circuit Applies Rule 9(b) Particularity Requirement to State-Law Fraud Claims, Including Allegations About Loss Causation

In *Irving Firemen's Relief & Ret. Fund v. Uber Technologies, Inc.*,[214] the Ninth Circuit affirmed dismissal of a complaint alleging state-law securities fraud claims against Uber and its former CEO for failure to allege loss causation. The court rejected the plaintiff's argument that under California law, it need only show that the class members purchased securities that were overvalued—or inflated—at the time of the offerings and that no subsequent corrective disclosures or price declines needed to be alleged. Applying the federal standard for loss causation, the court held that even assuming the defendants made actionable misstatements and that a cascade of bad news revealed the truth about the company to the market, the plaintiff's allegations nevertheless failed to link Uber's reduced valuation to any particular scandal or specific misstatement and thus did not adequately plead loss causation with the particularity required by Rule 9(b). The decision is a reminder that merely "lumping together a string of alleged misstatements" related to an array of corporate scandals will not satisfy a plaintiff's pleading burden as to loss causation.[215]

The complaint alleged that Uber offered and sold securities through a series of private offerings between June 2014 and May 2016 that netted more than $10 billion. By mid-2016, investors valued Uber at as much as $68 billion, higher than any other private technology start-up at the time. In 2017, a series of corporate scandals surfaced publicly. The complaint alleged that a former engineer posted a blog describing her alleged sexual harassment at the company. Google affiliate Waymo sued Uber for theft of its trade secrets relating to self-driving car technology. A news article exposed an alleged Uber program dubbed "Hell," in which the company secretly collected information on its competitor's pricing through spoofed accounts of its drivers. Uber's CEO resigned. The complaint alleged that the U.S. Department of Justice had begun a criminal probe into Uber's foreign business practices, and *Bloomberg* reported "widespread" Asia bribery allegations against the company. Finally, reports surfaced of a massive data breach that allegedly had occurred in October 2016 affecting 57 million riders and drivers. The complaint alleged that as a result of these cascading scandals, several large mutual funds and asset managers holding significant stakes in Uber securities, which were not yet publicly traded, began to write down the value of their Uber holdings in amounts ranging from 28% to 33%. It also alleged that by early 2018, investors estimated a nearly 30% decline in Uber's valuation.

Plaintiff filed its putative securities fraud class action against Uber and the former CEO shortly thereafter. The complaint alleged that the defendants made misstatements and omissions about Uber to induce the purchase of billions of dollars of Uber securities in violation of California Corporations Code sections 25400(d) and 25500. The district court applied the heightened pleading standards of the PSLRA and Rule 9(b) and dismissed the complaint because the plaintiff had not adequately alleged false or misleading representations or loss causation.

On appeal, the Ninth Circuit affirmed the holding that the plaintiff did not adequately allege loss causation and did not address the other elements of the plaintiff's claim. As a preliminary matter, the court held that the district court did not err in looking to cases interpreting loss causation under the Exchange Act. Noting that sections 25400 and 25500 of the California Corporations Code are modeled on subsection (a) and (e) of Section 9 of the Exchange Act, the court held that federal law is "unusually strong persuasive precedent" in construing those sections.[216] Next, the court disagreed that the district court erroneously applied the federal standard for loss causation rather than the "less-rigid state law standard."[217] Specifically, the court rejected the argument that under California law, the class members' damages arose at the moment they purchased securities at inflated prices and that no subsequent corrective disclosures or price declines needed to be pled.[218]

The court explained that "[i]n the loss causation analysis, 'the ultimate issue is whether the defendant's misstatement, as opposed to some other fact, foreseeably causes the plaintiff's loss.'"[219] To establish loss causation under the "fraud-on-the-market theory," a plaintiff must show that after purchasing its shares and before selling them "(1) 'the truth became known,' and (2) the revelation caused the fraud-induced inflation in the stock's price to be reduced or eliminated."[220] The court stated that the second element involves a temporal component because a disclosure followed by an immediate drop in stock price is more likely to have caused the decline. However, the court acknowledged that it has rejected "a bright-line rule requiring an immediate market reaction because the market is subject to distortions that prevent the ideal of a free and open public market from occurring."[221]

Noting that the plaintiff's loss causation theory "lumps together more than 60 alleged misstatements" related to at least eight purported corporate scandals that occurred during one year, the court concluded that the allegations failed to link the decline in Uber's valuation with any particular scandal or misstatement."[222] The court held that the complaint's reliance on general allegations that lump together the effects of various alleged scandals were insufficient to provide the defendants with ample notice of the plaintiff's loss causation theory or to satisfy the particularity requirements of Rule 9(b).

Finally, the court rejected the plaintiff's argument that it was not required to plead a "revelation-of-the-fraud theory" and should be allowed to plead in the alternative.[223] Because the plaintiff's alternative theory consisted only of its argument under California law that losses may arise the moment an investor purchased inflated securities and the court had already rejected that contention, the alternative theory did not plausibly allege that the defendants' alleged misstatements caused plaintiff's damages.

CLASS CERTIFICATION

Supreme Court Clarifies Legal Standard Governing Class Certification and District Court Again Certifies Class in Goldman Sachs Securities Litigation

As discussed in our 2020 Review, [224] in *Arkansas Teacher Retirement System v. Goldman Sachs Group, Inc.*, a divided panel of the Second Circuit affirmed the district court's certification of a class based on its finding that Goldman failed to rebut the *Basic* presumption by a preponderance of the evidence. [225] The court rejected Goldman's request to narrow the inflation-maintenance theory, holding that its proposal to exclude general statements as a matter of law too closely resembles the materiality inquiry, which is inappropriate at the class certification stage.[226] Thereafter, the Supreme Court granted certiorari to consider: (i) whether the presumption of classwide reliance in a securities class action can be rebutted by arguing that the "generic" nature of the alleged misstatements demonstrates a lack of price impact; and (ii) whether a defendant seeking to rebut the *Basic* presumption of classwide reliance has the ultimate burden of persuasion.

On June 21, 2021, a unanimous Supreme Court held that the generic nature of a misrepresentation often is important evidence of price impact that courts should consider at the class certification stage, while a six-Justice majority agreed that defendants bear the burden of persuasion—by a preponderance of the evidence—to prove a lack of price impact at class certification.[227] The Court vacated and remanded the case based on its conclusion that "it is unclear whether the [Second Circuit] properly considered the generic nature of Goldman's alleged misrepresentations in reviewing the district court's price impact determination."[228] The Court also instructed that on remand, the lower courts should take into account "*all* record evidence relevant to price impact, regardless of whether that evidence overlaps with materiality or any other merits issue."[229] The Second Circuit subsequently vacated its decision and remanded the case to the district court for further proceedings consistent with the Supreme Court's ruling.[230]

On December 8, 2021, in light of the clarifying guidance from the Supreme Court and the Second Circuit and noting its "due consideration of all evidence" before it, the district court again granted class certification, holding that the plaintiffs had presented compelling evidence that Goldman's alleged misstatements concerning its purported conflicts of interest artificially maintained an inflated stock price and that "[e]ven applying the Supreme Court's updated guidance on genericness," the defendants had failed to show that the alleged misstatements had no price impact.[231] In so holding, the court rejected the defendants' theory that the statements about Goldman's policies for managing conflicts of interest were so generic that—both as a matter of law and as a matter of fact—they could not have had any impact on Goldman's stock price.[232]

To the contrary, the court held that "[t]he alleged misstatements were not so generic as to diminish their power to maintain pre-existing price inflation—and given the strong evidence of price impact [presented by Plaintiffs], the Court finds that the statements *did* in fact maintain price inflation in this instance."[233] The district court noted that "even the more generic statements, when read in conjunction with one another . . . may reinforce misconceptions about Goldman's business practices, and thereby serve to sustain an already-inflated stock price."[234] The district court also rejected the defendants' contention that the alleged misstatements and subsequent corrective disclosures presented a "'glaring informational mismatch' sufficient to defeat any inference of price impact."[235] The district court found that the "comfortable, though certainly not boundless, gap in genericness between the alleged misstatements and subsequent corrective disclosures fail[ed] to satisfy the [d]efendants' burden to demonstrate a complete lack of price impact attributable to the alleged mismatch."[236]

On December 22, 2021, Goldman filed a Rule 23(f) petition, seeking permission to appeal class certification for a third time. A ruling on the petition is expected later this year.

Third Circuit Holds That Equitable Tolling Applies to Individual Opt-Out Claims Filed Before Class Certification Is Decided

In *Bahaa Aly v. Valeant Pharm. Int'l*,[237] the Third Circuit addressed whether the Supreme Court's landmark ruling in *American Pipe & Construction Co. v. Utah*,[238] applies to individual claims of a putative class member that are filed before class certification is decided. *American Pipe* held that the filing of a class action suspends the statute of limitations as to all persons who would have been class members had the suit been permitted to continue as a class action. The Third Circuit joined the Second, Ninth, and Tenth Circuits and held that *American Pipe* does toll the limitations period for individual claims filed before a class certification decision.[239]

Acknowledging that the Supreme Court has not yet considered the issue, the court noted that the Court also has not held that anything beyond the filing of the class complaint, such as a certification denial, is required for a putative class member to benefit from tolling. The court cited the Second Circuit's reasoning that although *American Pipe* was concerned with judicial economy, the doctrine was created to protect class members from being forced to file individual suits to preserve their claims, and it "was not intended to prioritize convenience over its core equitable purpose."[240] Noting that it can take years for a class action to reach the certification stage and, in the meantime, class members may deem their own claims valuable enough to pursue in an opt-out complaint or decide that class certification is doubtful, the court stated that its decision will allow class members in either situation to promptly file an individual action "rather than indefinitely delay the resolution of those claims for no good reason."[241] The decision avoids a rule that would force investors to remain in a class action to obtain the benefit of tolling of the statute of limitations only to have potentially valuable individual claims expire under the separate statute of repose, which is not subject to equitable tolling under *American Pipe.*

The complaint alleged that in 2008, Valeant, a generic drug manufacturer, changed its business strategy to grow through acquisitions rather than research and development. The change in strategy reduced R&D costs, and, in the ensuing years, the company made promising representations about its financial performance based on its new business model. The complaint alleged that the price of Valeant stock skyrocketed nearly 350% by October 2015. The complaint also alleged that in late 2015, following the disclosure of a series of government investigations and private lawsuits against it, Valeant began disclosing its alleged fraudulent practices, and a number of senior executives were fired. Valeant's stock price dropped by 90%. In June 2016, a class action complaint was filed against Valeant and certain senior executives, alleging violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5. Those claims were governed by a two-year statute of limitations or a five-year statute of repose, whichever came first.[242] By 2018, the district court still had not ruled on class certification. Rather than waiting further, the plaintiffs filed an opt-out complaint asserting identical claims in their individual capacity. The district court dismissed the complaint as untimely under the two-year limitations period and concluded that *American Pipe* tolling did not apply. The district court reasoned that judicial efficiency, a primary purpose of *American Pipe*, favors delaying individual claims until after denial of class certification so that identical class and individual suits are not proceeding simultaneously.

On appeal, the Third Circuit disagreed and vacated the dismissal of the complaint. The court explained that *American Pipe* tolling is consistent with the general function of limitations periods, which is to prevent surprise through the "revival of old claims that plaintiffs failed to diligently pursue."[243] The court held that surprise was not an issue in the context of an individual opt-out complaint, because the filing of the class action complaint more than two years earlier had notified the defendants of the claims at issue as well as the number and generic identities of the potential plaintiffs who may participate in the case.

The court also rejected the district court's restriction of *American Pipe* tolling to claims brought after class certification, based on the interplay between the two-year statute of limitations and the five-year statute of repose. "Unlike limitations periods, which generally begin to run when the plaintiff has sufficient knowledge to file a complaint, repose periods begin to run when the wrongdoing occurs, regardless of the plaintiff's knowledge."[244] The Supreme Court has held that repose periods are not subject to equitable tolling under *American Pipe*.[245]

Citing the "persuasive analysis" of *amicus curiae*, which pointed to 92 recent class actions where certification was not resolved within five years of the commencement of the class action,[246] the court concluded that the district court's rule would put class members in an untenable position assuming class certification was not determined until five years after the filing of the class complaint. In that scenario, the district court's rule would require precertification complaints by individual class members to be dismissed as untimely under the two-year statute of limitations because they would not benefit from *American Pipe* tolling. Conversely, claims filed after class certification by individuals who had elected to take advantage of tolling under *American Pipe* could be dismissed as untimely under the five-year statute of repose. "Members in this position would be without any individual recourse, which is precisely the result *American Pipe* seeks to avoid."[247]

Algorithm That Analyzes "Hundreds of Millions of Data Points" Held Insufficient to Determine Classwide Economic Loss: Eighth Circuit Reverses Decision Allowing Expert Testimony to Establish That Questions of Economic Loss Common to Class Members Satisfy the Predominance Requirement of Rule 23

In *Ford v. TD Ameritrade Holding Corporation*, the Eighth Circuit considered class certification in a case involving whether a brokerage firm violated its "duty of best execution" by using a computerized routing system to transmit customer orders to third-party trading venues that pay the brokerage firm the most money rather than to venues that provide the best outcomes to customers.[248] The duty of best execution requires a broker to "use reasonable efforts to maximize the economic benefit to the client in each transaction."[249] To show a breach of this duty, a plaintiff must show that there was a difference between the price at which trades were executed and a "better" price apparently available from an alternative trading source. The case offers important guidance on the availability and limits of advanced technology and expert testimony as a substitute for individual evidence and inquiry to determine economic loss for each class member.

To justify the predominance requirement for class certification under Rule 23(b)(3), the lead plaintiff proposed expert testimony based on a proprietary algorithm that would assess trade execution quality by using class trading history data from the brokerage firm and data about the state of the market at the time of each trade. Specifically, the expert witness proposed to establish that a better price was obtainable for each executed trade by comparing the trade's actual price with the National Best Bid and Offer ("NBBO") price. The NBBO represents the highest price a buyer was willing to pay and the lowest price a seller was willing to accept for a certain stock at a particular time. While the expert witnesses for both parties agreed that certain transactions should be excluded from the algorithm to account for instances when the brokerage firm could not have prevented execution at a price inferior to the NBBO price (such as during volatile or otherwise unusual market conditions), they disagreed about which transactions should be excluded. The district court certified the class and held that the algorithm could solve the predominance problem by making automatic determinations of economic loss for each class member.

The Eighth Circuit reversed based on its conclusion that "despite advances in technology, individual evidence and inquiry is still required to determine the economic loss of each class member."[250] The court reasoned that because a violation of the duty of best execution does not necessarily cause a customer economic loss, ascertaining which class members sustained injury means that individualized issues predominate over common ones. While "[a]dvanced computing power can expedite that determination," the court held that the prevalence of the individual inquiries precludes class certification under Rule 23.[251] Specifically, the court noted that because there is no definitive list of unusual market conditions that account for transactions that depart from the best available price, the algorithm's use of public market data would not identify all legitimate exclusions, and a trier of fact would still have to determine the appropriateness of a particular exclusion. The court also found that the algorithm could not account for each class member's strategy or state of mind at the time of trading and how that strategy might impact the class member's economic loss. Finally, the court disagreed that the execution of trades at prices inferior to the NBBO price necessarily resulted in economic loss since there could be other reasons for the lower price, such as when the order size exceeds the number of shares available at the NBBO price.

RELIANCE

Ninth Circuit Clarifies Limited Availability of *Affiliated Ute* Presumption of Reliance in "Mixed" Securities Fraud Cases Alleging Omissions and Misrepresentations

In *In re Volkswagen "Clean Diesel" Marketing, Sales Practices, and Products Liability Litigation*,[252] the Ninth Circuit reversed the district court's order denying summary judgment to Volkswagen and held that the presumption of reliance first recognized in *Affiliated Ute Citizens of Utah v. United States*[253] does not apply in "mixed" securities fraud cases that allege both omissions and affirmative misrepresentations, when the complaint cannot be characterized primarily as claims of omission.

In *Affiliated Ute,* the Supreme Court held that proof of reliance was not a condition of recovery in claims brought under Rule 10b-5 under certain limited circumstances. The Court held that in cases involving "primarily a failure to disclose," affirmative proof of reliance is not required. Instead, the Court presumed reliance because the obligation to disclose and the withholding of a material fact established the requisite element.[254] Following *Affiliated Ute*, the Ninth Circuit and other courts have recognized the "presumption of reliance" in cases alleging violations of Section 10(b) of the Exchange Act or Rule 10b-5 based on omissions of material facts because of the difficulty of proving a "speculative negative"; namely, that the plaintiff relied on what was not said.[255]

Noting that the complaint in *Volkswagen* was replete with alleged affirmative misrepresentations on which the plaintiff purportedly relied in purchasing Volkswagen bonds, the court concluded that the complaint could not be characterized primarily as making omission claims. Likewise, the plaintiff did not face the difficult or impossible task of proving a speculative negative and thus the case fell outside of *Affiliated Ute*'s narrow presumption.[256] This decision will prevent plaintiffs from invoking the presumption of reliance by artfully framing their claims as primarily involving "omissions." The decision could have the most impact in cases involving securities that are not traded in well-developed, efficient markets, as plaintiffs in those cases would not be able to invoke the fraud-on-the-market presumption of reliance under *Basic Inc. v. Levinson*[257] to win class certification if the *Affiliated Ute* presumption is unavailable.

The complaint alleged that a Puerto Rico public pension fund purchased $4 million in bonds issued by Volkswagen in three private placements between 2014 and 2015. On September 15, 2015, shortly after the plaintiff's last purchase, the U.S. Environmental Protection Agency and the California Air Resources Board issued notices of violations to Volkswagen relating to its use of "defeat devices" in certain diesel vehicles sold in the United States designed to mask high emissions and to cheat on emission tests. Following announcement of those notices, the market prices of some Volkswagen bonds, including those purchased by the plaintiff, dropped below par value. The complaint alleged that the offering documents omitted any mention of the defeat devices or the company's actions to deceive regulators that its diesel vehicles complied with emissions standards. However, the plaintiff also alleged that it and its financial advisor had each relied on affirmative misrepresentations about the company's compliance with applicable regulations and its commitment to reducing emissions in its vehicles when it purchased the bonds prior to the disclosure of the scandal.

While acknowledging that the plaintiff based its claims in part on affirmative misstatements by Volkswagen, the district court did not rule on whether the complaint adequately pled direct reliance. Instead, it denied the company's motion for summary judgment on the grounds that "Volkswagen's failure to disclose [the defeat device issue] is ultimately what drives Plaintiff's claims" and the complaint was "best characterized as a non-disclosure case," thereby entitling the plaintiff to the presumption of reliance under *Affiliated Ute* and Ninth Circuit precedent.[258] The district court certified its decision for interlocutory appeal.

On appeal, a divided panel of the Ninth Circuit reversed. While the court acknowledged that the complaint alleged a "mixed" case with both omissions and affirmative misrepresentations, it held that the district court erred in finding that the complaint primarily alleged an omissions case and thus erroneously applied the *Affiliated Ute* presumption. Although Volkswagen's failure to disclose its use of defeat devices "loom[ed] large" over the claims,[259] the court pointed out that the plaintiff alleged it had relied on multiple affirmative misrepresentations in purchasing the bonds. The court explained that the justification underlying *Affiliated Ute* and relevant Ninth Circuit precedent is that the presumption should be limited to situations in which a plaintiff would be forced to prove "a speculative negative"—that the plaintiff relied on what was not said by a defendant.[260]

In contrast, the multiple affirmative misrepresentations on which the plaintiff allegedly relied showed that the plaintiff's claims were based "as much on what is there as what is purportedly missing."[261] Because the plaintiff could prove the element of reliance through ordinary means by demonstrating a direct connection between the alleged misrepresentations and its injury, there was no basis to apply the *Affiliated Ute* presumption. The court also made clear that a plaintiff's tactical choices in drafting its complaint have consequences. While the "[p]laintiff bears the burden to prove all elements of its Rule 10b-5 claim, including reliance, [it] placed the evidentiary burden on itself by explicitly pleading reliance on extensive, detailed and specific affirmative misrepresentations."[262]

Finally, the majority rejected the dissent's argument that all misrepresentations can be cast as omissions to the extent they fail to disclose facts that are untrue and thus trigger the presumption of reliance. The majority observed that such an interpretation would allow the *Affiliated Ute* presumption to become available to all securities fraud claims and the limited exception would swallow the rule.[263]

In a spirited dissent, Circuit Judge Wallace took issue with the majority's "tortured reading" of *Affiliated Ute* and asserted that controlling Ninth Circuit precedent distinguishing "pure omission" from "mixed" cases dictated that *Affiliated Ute* should be available in this case because the complaint alleged a claim primarily based on Volkswagen's omissions regarding the secret defeat devices and that all of the alleged affirmative misstatements relate back to that central omission.[264] A majority of the panel denied the company's petition for rehearing, and the full court denied Volkswagen's motion for rehearing *en banc*.

JURISDICTION

First and Second Circuits Address the Proper Test for Determining What Constitutes a Domestic Transaction in Other Securities

Recent decisions from the First and Second Circuits highlight the circuit split over the application of *Morrison v. Nat'l Australia Bank Ltd.*, which held that section 10(b) of the Securities Exchange Act of 1934 does not apply extraterritorially but rather applies only to "transactions in securities listed on domestic exchanges, and domestic transactions in other securities."[265] Lower courts have struggled to define "domestic transactions in other securities" under the second prong of *Morrison* to determine when the U.S. securities laws apply to an alleged transnational fraud.

In 2012, the Second Circuit adopted the "irrevocable liability" test in *Absolute Activist Value Master Fund, Ltd.*, requiring a plaintiff to plausibly allege that the purchaser or seller incurred "irrevocable liability" to purchase or sell a security within the United States for section 10(b) to apply.[266] In 2014, the Second

Circuit decided *Parkcentral Global Hub Ltd. v. Porsche Auto. Holdings SE*, which held that section 10(b) does not reach claims that are "predominantly foreign" even if a complaint alleges a domestic transaction under the *Absolute Activist* test.[267] *Parkcentral* involved securities-based swap agreements that were concluded in the United States but concerned securities in a foreign company that were traded entirely on foreign exchanges. Thus, under *Parkcentral*, a domestic transaction is a threshold requirement but not sufficient to make section 10(b) applicable if the claims are so "predominantly foreign as to be impermissibly extraterritorial."[268]

In *SEC v. Morrone*, the First Circuit joined the Third and Ninth Circuits in rejecting *Parkcentral* and adopting the "irrevocable liability" test as the only one that plaintiffs must satisfy to establish the application of section 10(b).[269] In contrast, in *Cavello Bay Reinsurance, Ltd. v. Stein*, the Second Circuit reaffirmed *Parkcentral* in a recent case focusing on whether the features and incidents of a domestic transaction are nevertheless so foreign as to preclude application of U.S. securities laws.[270]

In *Cavello Bay Reinsurance, Ltd. v. Stein*, a Bermuda-based corporate buyer that acquired shares through a private offering sued the seller of the shares in a Bermudan holding company that operated in New York and invested in United States insurance services, alleging securities fraud in violation of section 10(b) and Rule 10b-5 based on alleged misrepresentations in the seller's pitch deck. The district court dismissed the claims after finding that the transaction was not "domestic" under *Absolute Activist* and that even if the transaction were domestic, plaintiff's claims were predominantly foreign and thus impermissibly extraterritorial under *Parkcentral*.

On appeal, the Second Circuit assumed without deciding that the transaction at issue was domestic because "the place of the transaction [was] difficult to locate, and impossible to do without making state law."[271] However, the court affirmed dismissal on the grounds that the transaction at issue was predominantly foreign because it was "structured to avoid the bother and expense (and taxation) of U.S. law" and "implicate[d] only the interests of two foreign companies and Bermuda."[272] The court noted that "the contacts that matter are those that relate to the purchase and sale of securities," not allegations related to contract formation or the alleged fraudulent acts even if some of those occurred in New York, noting that "it is a rare case of prohibited extraterritorial application that lacks *all* contact with the territory of the United States."[273]

In *SEC v. Morrone,* the First Circuit adopted the irrevocable liability test to determine whether a transaction in securities is domestic under *Morrison*. Following the Third and Ninth Circuits, the *Morrone* court noted that "[t]he circuits adopting the 'irrevocable liability' test have reasoned that because 'the point at which the parties became irrevocably bound is used to determine the timing of a purchase or sale,' it 'can [also] be used to determine the locus of a securities purchase or sale.'"[274] In *Morrone*, a U.S. company entered into subscription agreements with international investors providing that the company had "no obligation" under the agreements until they were executed and delivered to investors. Because it was undisputed that the subscription agreements were executed on behalf of the company in Boston, the First Circuit held that the company incurred irrevocable liability to deliver the shares within the United States, and thus the federal securities laws applied to the transaction.

The court also followed the Ninth Circuit in rejecting the Second Circuit's holding in *Parkcentral* as inconsistent with *Morrison*: "*Morrison* says that § 10(b)'s focus is on transactions. . . . The Court explicitly stated that, if a transaction is domestic, § 10(b) applies. . . . The existence of a domestic transaction suffices to apply the federal securities laws under *Morrison*. No further inquiry is required."[275] However, the First Circuit also stated that even if it were to apply *Parkcentral*, there were significantly more U.S. connections rendering the alleged fraud domestic and not so predominantly foreign as to be impermissibly extraterritorial, including that the issuer was a U.S.-based company not traded on a foreign exchange, its senior executives were based in Boston, and nearly all of their activities in furtherance of the alleged fraud were conducted in the United States.

While the Supreme Court declined to address the circuit split following the Ninth Circuit's rejection of *Parkcentral's* "predominantly foreign" exception in *Stoyas v. Toshiba Corp.*,[276] the decision in *SEC v. Morrone* provides the Supreme Court with another opportunity to resolve the split among the circuits and prevent inconsistent decisions. In the meantime, *Parkcentral*'s "predominantly foreign" exception to *Morrison* continues to be a supplemental requirement only for cases filed in the Second Circuit.

AMENDMENTS TO THE COMPLAINT

Third Circuit Allows Third Amended Complaint Under Relation-Back Doctrine of Rule 15(c)

In *Southeastern Pennsylvania Transportation Authority v. Orrstown Financial Services Inc.*, the Third Circuit addressed whether the relation-back provisions of Federal Rule of Civil Procedure 15(c), most commonly applied to statutes of limitation, also apply to statutes of repose.[277] The court held that they do. Rule 15(c) provides that an amended pleading "relates back to the date of the initial pleading" when, among other things, "the amendment asserts a claim or defense that arose out of the conduct, transaction, or occurrence set out—or attempted to be set out—in the original pleading."[278] Because the proposed third amended complaint at issue "both restates claims with greater particularity and amplifies the factual circumstances surrounding the relevant conduct with more factual detail," the court held that the relation-back doctrine applied.[279] The court explained that allowing an amendment after the repose period was permissible because Rule 15's relation-back doctrine leaves the legislatively mandated deadline intact and does not disturb any of the defendants' vested rights to repose.[280]

The complaint alleged that Orrstown Bank made a stock offering at $27 per share in 2010. Plaintiff Southeastern Pennsylvania Transportation Authority ("SEPTA") invested in the offering and also purchased Orrstown stock on the open market thereafter. The complaint alleged that from July 2011 to March 2012, the defendants made a series of disclosures about the bank's financial health, revealing that they had failed to identify impaired loans and otherwise misrepresented the bank's financial stability. Orrstown's stock price dropped after each disclosure and by April 2012, the price had fallen to $8.20. SEPTA filed suit on behalf of two classes. The first class consisted of investors who had purchased Orrstown stock in connection with the offering and alleged violations of Sections 11, 12(a), and 15 of the Securities Act. The second class consisted of investors who purchased stock on the open market during the class period and alleged violations of Sections 10(a) and 20(b) of the Exchange Act.

The district court dismissed the original complaint with leave to amend. Following the filing of the second amended complaint, the district court dismissed all but a few claims under the Exchange Act for failure to state a claim. In April 2019, SEPTA moved for leave to file a third amended complaint, which reasserted some of the previously dismissed claims, and argued that it had found further evidence to support them through discovery. The defendants objected and moved to dismiss because SEPTA sought to file the new complaint outside the three-year repose period for Securities Act claims and the five-year repose period for Exchange Act claims. The district court granted SEPTA leave to amend notwithstanding the expiration of the repose periods. It reasoned that under Rule 54(b), which states that any order that adjudicates fewer than all claims or the rights and liabilities of fewer than all the parties does not end the action as to any of the claims or parties, its earlier dismissal of the second amended complaint did not decide all of SEPTA's claims, and therefore the action had not ended as to those claims with the dismissal order.[281]

On appeal, the Third Circuit affirmed, but based on a different rationale. Noting that Rule 15 embodies a liberal approach to pleading, the court explained that "amendments that restate the original claim with greater clarity or amplify the factual circumstances surrounding the pertinent conduct, transaction[,] or occurrence in the preceding pleading fall within Rule 15(c)."[282] The court concluded that the third amended complaint did just that and thus the relation-back doctrine applied.

It then addressed a question of first impression in the Third Circuit—whether Rule 15(c) permits amendment outside an otherwise applicable repose period. Describing statutes of repose as the "more severe cousins" of statutes of limitation, the court explained that statutes of repose start upon the occurrence of a specific event and may expire before a plaintiff discovers he has been wronged or even before damages have been suffered.[283] In addition, it noted that statutes of repose are not subject to equitable tolling.

The court rejected the defendants' arguments that relation-back under Rule 15(c) is incompatible with the nature and purpose of statutes of repose. Noting that SEPTA originally brought both its Securities Act and Exchange Act claims before the applicable repose periods expired, it reasoned that for those claims to be barred, they had to end. But under Rule 54(b), any order that decides fewer than all the claims or the rights and liabilities of fewer than all the parties does not end the action as to any of the claims or parties. Because the district court had not decided all claims as to all parties at the time the repose period expired, none of SEPTA's claims in the action ended.

The court also rejected the defendants' arguments that the purpose of the relation-back doctrine conflicts with the purpose of statutes of repose and that such statutes permit no exceptions. Granting leave to amend would not deprive the defendants of "fair notice" of the claim within the limitations period or the requirement that the plaintiff bring an action within the time allotted by the statute of repose "even if the plaintiff later amends the precise form of its pleadings."[284] For the same reason, the court held that relation-back does not offend the Rules Enabling Act because a defendant does not have a vested right to repose as to a plaintiff who sues before the deadline, as long as the plaintiff's action remains pending. The court emphasized that SEPTA was not bringing any new claims or adding new parties that were not included in the timely filed first amended complaint, and it expressly stated that its decision did not reach whether a plaintiff could use relation-back for those purposes.

DEVELOPMENTS IN D&O LIABILITY

Delaware Supreme Court Holds That Fraud Can Be Covered Under D&O Insurance

In *RSUI Indemnity Co. v. Murdock, et al.*,[285] the Delaware Supreme Court addressed the issue of whether Delaware has a public policy against the insurability of losses occasioned by fraud that is so strong as to vitiate a company's freedom to purchase D&O insurance to cover such claims. It unanimously held that it does not. The court concluded that section 145 of the Delaware General Corporation Law authorizes companies to afford their directors and officers broad indemnity and advancement rights as well as the purchase of D&O insurance against any liability asserted against those individuals, including breach of loyalty claims based on fraud. The court also held that the policy's profit/fraud exclusion was triggered only when fraudulent acts were established by a "final and non-appealable" adjudication adverse to the insured parties, but that no such adjudication had occurred. Accordingly, the court affirmed the Superior Court's judgment requiring the carrier to pay its $10 million policy limits plus $2.3 million in prejudgment interest. The decision is a reminder that Delaware law is relatively friendly to D&O policyholders compared to other states, and underscores the importance of choice of law in D&O insurance disputes.

The case arose out of a November 2013 transaction in which Dole's CEO, David Murdock, took the company private by acquiring all of its stock that he did not already own for $13.50 per share.[286] The transaction had been negotiated with a special committee of the board and was approved by a vote of 50.9% of disinterested stockholders. After the transaction closed, Dole stockholders filed suit in the Delaware Court of Chancery, alleging breach of fiduciary duty in connection with the merger against Murdock and C. Michael Carter, Dole's President, Chief Operating Officer, and General Counsel.[287] The complaint alleged that the executives manipulated the value of Dole's stock prior to the negotiation of the transaction, thereby enabling them to buy the remaining stock at an artificially low price. The action was consolidated with another lawsuit against Dole by other stockholders seeking appraisal of their shares following the transaction.[288]

The Court of Chancery found, among other things, that Murdock and Carter intentionally and in bad faith engaged in "unfair and fraudulent" actions to drive down Dole's premerger stock price by 16.9%, thereby breaching their duty of loyalty to Dole.[289] The court held Murdock and Carter jointly and severally liable for more than $148 million in damages, amounting to $2.74 per share.[290] The Court of Chancery then directed the parties to confer rather than ruling on the appraisal issue, and the parties commenced settlement discussions.[291] Dole ultimately reached a settlement with the stockholders, subject to the court's approval, for the full amount of damages awarded by the court.[292] Following approval of the settlement and entry of a final order and judgment, Murdock paid the settlement in full plus interest.[293]

Dole had purchased D&O insurance totaling $85 million of coverage. RSUI issued the eighth layer of excess coverage, providing for $10 million following exhaustion of $75 million from the underlying policies and the payment of a $500,000 self-insured retention by Dole. The RSUI policy required the carrier to pay "all loss" not indemnified by Dole arising from any "claim" or "wrongful act" by any director or officer named as a defendant in any "securities claim."[294] Dole informed its insurers of the amount of damages found by the Chancery Court and the potential settlement. All of the insurers reserved their rights regarding coverage.[295]

While the settlement was pending approval in the Chancery Court, Dole stockholders who had sold their stock between January and October 2013—and thus were not parties to the pending stockholder action—filed a federal securities class action in the U.S. District Court for the District of Delaware, alleging violations of Section 10(b) and Rule 10b-5 of the Exchange Act based on the findings of fraud and breach of the duty of loyalty by Murdock and Carter.[296] The federal class action ultimately went to mediation, and Dole's insurers adopted similar coverage positions as asserted in the stockholder action.[297] RSUI, for its part, stated that it would treat both the Delaware and federal class actions as a single "claim" under its policy.[298] Without consent from the insurance carriers, the parties agreed to settle the federal class action for $74 million plus prejudgment interest, and the settlement was ultimately approved by the court.[299] Dole's second layer of excess D&O insurance paid $7 million of the federal class action settlement amount and Dole paid the remaining $66 million.[300]

While the original Chancery stockholder action was pending court approval and before settlement of the federal class action was reached, several of the D&O carriers, including RSUI, filed suit in the Delaware Superior Court seeking a declaratory judgment that they were not required to fund the settlement of the Chancery lawsuit.[301] Murdock and Dole filed counterclaims alleging, among other things, breach of contract and breach of the implied covenant of good faith and fair dealing.[302] Following the class action settlement, the carriers refused to fund that settlement, and Murdock and Dole amended their counterclaim to allege that the insurers had again breached their duties.[303] Prior to entry of final judgment in the Superior Court, all of the excess carriers other than RSUI had either paid their policy limits or settled with the insureds. Applying Delaware law, the Superior Court entered judgment for Murdock and Dole and ordered RSUI to pay its policy limit of $10 million plus $2.3 million in prejudgment interest.[304] RSUI appealed, arguing that the Superior Court should have applied California law rather than Delaware law in interpreting the policy; even if Delaware law applied, Delaware public policy forbids coverage for fraudulent conduct; the fraud/benefit exclusion provision of the RSUI policy precluded coverage of either settlement; and the court improperly applied the policy provision regarding allocation of loss.[305]

The Delaware Supreme Court affirmed. As a preliminary matter, because the policy at issue did not contain a choice of law provision, the court conducted an exhaustive choice of law analysis and determined that Delaware law governed the dispute even though the RSUI policy had been negotiated and issued in California, Dole maintained its headquarters there, and both senior officers lived in that state. The court acknowledged that California's Insurance Code bars insurance coverage for willful acts.[306] Applying the multifactor and fact-specific "most significant relationship test," the court concluded that the state of incorporation is the center of gravity for typical D&O policies and Dole was incorporated in Delaware. Because Dole was a Delaware citizen, it was entitled to Delaware's protection of the ability of corporations to secure D&O insurance in order to attract talented directors and officers.[307]

The court rejected RSUI's argument that Delaware public policy barred coverage for fraud or intentional wrongdoing. The court concluded that any public policy against the insurance of losses occasioned by fraud was not so strong as to vitiate the parties' freedom to contract.[308] The court pointed to the broad language in section 145 of the Delaware Corporation Law authorizing corporations to provide their directors and officers broad indemnification and advancement rights and to purchase insurance against "any liability" asserted against directors and officers—whether or not the corporation itself had the power to indemnify such persons to the same extent.

The court explained that while section 145 limits a Delaware corporation's authority to indemnify directors and officers to situations where "the person, in his underlying conduct, acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation," the statute imposes no such limitation on the corporation's authority to obtain D&O insurance.[309] Describing its deference to the parties' contractual choices and the legislature's prerogative in matters of public policy as "wise," the court stated: "We show this deference not because we condone fraud in Delaware; in fact, we have an unwavering policy against it."[310]

The court also rejected RSUI's argument based upon the profit/fraud exclusion in the D&O policy. The exclusion provides that only fraudulent acts "established by a final and non-appealable adjudication to [the] Insured in the underlying action" would be excluded from coverage.[311] The Superior Court had addressed the profit/fraud argument before the settlement of the federal class action and concluded that the memorandum opinion issued by the Chancery Court in the stockholder action was not a "final and non-appealable" adjudication as required by the policy. But the Delaware Supreme Court focused on whether Dole's settlement of the federal class action was not subject to the profit/fraud exclusion because "if RSUI is on the hook for the [federal class action] settlement, that alone will exhaust its coverage limits rendering consideration of the Profit/Fraud exclusion's application to the Stockholder Action moot."[312] The Delaware Supreme Court held that there was no final and non-appealable adjudication in the federal class action, either. Accordingly, the court held that the $66 million paid by Dole to settle the federal class action was enough to reach and exhaust the carrier's $10 million policy limits.

Finally, the court rejected RSUI's argument that the Superior Court should have conducted a "relative exposure" analysis to identify losses covered by the policy and those attributable to non-covered losses, rather than the "larger settlement rule," which provides that a loss is fully recoverable unless the insurer can show that its liability increased as a result of non-covered conduct.[313] Since RSUI did not even argue that any non-covered actions of the insureds increased the settlement amount, or that its preferred "allocation" theory would lead to a reduction of coverage and liability, the court rejected RSUI's argument.[314]

STATE LAW BREACH OF FIDUCIARY DUTY CLAIMS

Ninth Circuit Holds That SLUSA Does Not Bar Plaintiff From Bringing State Law Fiduciary Duty Claims as a Class Action Where Those Claims Are Based on Conduct That Was Not Material to a Decision to Buy or Sell Covered Securities

In *Anderson, et al. v. Edward D. Jones & Co., L.P.*, the Ninth Circuit held that the Securities Litigation Uniform Standards Act ("SLUSA") does not bar a plaintiff from bringing state law fiduciary duty claims as a class action where those claims are not based on alleged conduct that is material to the decision to buy or sell covered securities.[315] This decision is an important reminder that all five elements of SLUSA must be met if a class action based on state law claims is to be barred.

The complaint alleged that the plaintiffs initially invested with Edward Jones through commission-based accounts that entitled them to free financial advice while only being charged on a per-trade basis. The complaint alleged that the plaintiffs were "buy-and-hold clients" who seldom traded.[316] In 2008, Edward Jones introduced a new fee-based model in which the firm charged investors a flat annual management fee based on a percentage of the assets maintained in each account, regardless of the number of transactions. The plaintiffs transitioned their accounts after acknowledging that they had received and read a brochure describing the fee-based model in greater detail.

In July 2019, the plaintiffs filed a putative class action lawsuit alleging that the defendants' failure to conduct a suitability analysis before inviting them to switch to a fee-based model constituted a breach of fiduciary duty under California and Missouri law. [317] The complaint alleged that the defendants improperly incentivized and pressured financial advisors to switch clients to fee-based accounts. The complaint also alleged violation of Section 10(b) of the Exchange Act and Rule 10b-5 based on the firm's failure to disclose that its financial advisors did not conduct a suitability analysis when they advised their clients to switch to fee-based accounts. The plaintiffs alleged that due to their low trading volume profile, the fee-based accounts resulted in substantially higher fees, and had they been properly informed, they would have either maintained a commission-based account or ended the relationship with the defendants. Notably, the complaint did not allege that the plaintiffs would have made or not made any particular trade had Edward Jones conducted a suitability analysis.

The district court dismissed the complaint with prejudice and found that it lacked jurisdiction over the state law breach of fiduciary duty claims under SLUSA, which prevents plaintiffs from bringing such claims as a class action consisting of 50 or more persons. SLUSA bars plaintiffs from bringing "(1) a covered class action (2) based on state law claims (3) alleging that the defendants made a misrepresentation or omission or employed any manipulative or deceptive device (4) in connection with the purchase or sale of (5) a covered security."[318] The district court also dismissed the Rule 10b-5 claim based on its determination that the alleged lack of a suitability analysis was not an actionable omission and that the complaint failed to adequately plead scienter, reliance, and loss causation. However, the district court did not address whether the plaintiff's federal claim alleged "a connection between" the lack of a suitability analysis and "the purchase or sale of a security."[319]

The plaintiff appealed the dismissal of the state law claims only. The Ninth Circuit reversed, holding that SLUSA did not bar the state law breach of fiduciary duty claims because the alleged misrepresentation or omission that was the basis of those claims was not "in connection with the purchase or sale of a covered security."[320] Relying on the Supreme Court's decision in *Chadborne & Parks LLP v. Troice*, which held that a "fraudulent misrepresentation or omission is not made 'in connection with' such a 'purchase or sale of a covered security' unless it is material to a decision by one or more individuals (other than the fraudster) to buy or sell a 'covered security,'"[321] the court concluded that the alleged breach of fiduciary duty was material to the plaintiff's decision whether to continue an investing relationship with Edward Jones, but was not material to the purchase or sale of a covered security because the complaint did not allege that the plaintiff would have purchased or sold a different covered security had a suitability analysis been conducted.

The court acknowledged that the Supreme Court's explanation of the phrase "in connection with" has "shifted in recent years,"[322] noting that eight years before *Troice*, in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, the Supreme Court stated that it was enough that the alleged fraud "coincide[d] with a securities transaction—whether by the plaintiff or by someone else."[323] While the court observed that it had previously applied *Dabit*'s "coincide" language, the panel expressly clarified that "the fourth prong of the [SLUSA] test—'in connection with the purchase or sale'—must include an inquiry into the materiality of the alleged misrepresentation or omission to the purchase or sale of a security."[324] Despite the Supreme Court's assertion in *Troice* that the materiality principle enunciated in that case did not modify *Dabit*,[325] the Ninth Circuit's decision is the most recent decision in a split among the circuit courts on this issue. The First and Third Circuits, like the Ninth Circuit, have applied the materiality requirement announced in *Troice*, while the Seventh and Eighth Circuits have continued to apply the broader "coincide" standard articulated in *Dabit*.[326]

The panel denied a motion for rehearing, and the full court denied a motion for rehearing *en banc*. The panel granted the motion to stay issuance of the mandate pending the filing of a petition for a writ of certiorari, which was filed in the Supreme Court on October 12, 2021.[327] The petition asserts that the Ninth Circuit, in conflict with other circuits, erred in concluding that *Troice* narrowed *Dabit*'s interpretation of SLUSA's "in connection with" prong to require that the alleged deception induce a specific transaction in a particular covered security.

Delaware Chancery Court Allows SPAC Merger Challenge to Proceed; Holds "Entire Fairness" Applies to Fiduciary Duty Claims in Redemption Action

On January 3, 2022, in a case of first impression, the Delaware Court of Chancery allowed claims for breach of fiduciary duty to proceed against the board of directors, the sponsor, and the controlling shareholder of a special purpose acquisition company ("SPAC").[328] The investor-plaintiffs alleged that the defendants concealed material information about the SPAC's merger target and thereby impaired shareholders' redemption rights. In denying the defendants' motions to dismiss under the "plaintiff-friendly" Rule 12(b)(6) pleading standard, the court reached several conclusions that could be relevant to sponsors, officers, and directors of other SPACs incorporated in Delaware, including that: (i) the investors' claims were direct (rather than derivative), and thus not subject to the presuit demand requirement;[329] (ii) the investors' claims were not "holder" claims based on shareholder inaction, and therefore could be brought on a classwide basis;[330] and (iii) the onerous "entire fairness" standard of review (rather than the more deferential business judgment standard) applied due to "inherent conflicts between the SPAC's fiduciaries and public stockholders in the context of a value-decreasing transaction."[331] The court also warned: "[t]hat this structure has been utilized by other SPACs does not cure it of conflicts."[332] The case is noteworthy because it addresses some of the conflicts of interest inherent in the SPAC structure and is a reminder that full disclosure in the context of a de-SPAC transaction is critically important.

The complaint alleged that in 2019, Michael Klein formed a SPAC, Churchill Capital Corp. III ("Churchill"), which completed a $1.1 billion IPO in early 2020.[333] Klein, and Churchill directors named in the suit, were compensated with membership interests in the SPAC sponsor, an LLC that held "founder" shares in Churchill, accounting for a 20% equity interest in the SPAC that the LLC purchased for $25,000.[334] The remaining 80% of Churchill's equity comprised 110 million Class A shares, sold at $10 per share.[335] If Churchill successfully completed a merger, the "founder" shares would convert to Class A shares; however, if no transaction occurred within two years of the IPO, the proceeds would be refunded, plus interest, to Class A shareholders, and the founder shares would be left worthless.[336] Additionally, as a unique feature of a SPAC, Class A shareholders held a right of redemption under the Certificate of Incorporation—if Churchill identified a target and proposed a combination, shareholders could redeem their stock (rather than become a shareholder in the newly combined entity) for the $10 IPO price, plus interest.[337]

According to the complaint, Churchill ultimately settled on MultiPlan, a health care data analytics solutions provider, as its acquisition target.[338] Notably, Churchill hired The Klein Group LLC as financial advisor with respect to the merger, a wholly owned subsidiary of the SPAC sponsor.[339] In its proxy, Churchill's board recommended the merger with MultiPlan, given its "attractive valuation" and "opportunities for growth in revenues."[340] The proxy also disclosed that MultiPlan relied on one customer for 35% of its revenue, but failed to mention that this customer intended to create an in-house platform to replace MultiPlan's product by the end of 2022—a plan the customer had publicly announced four months earlier.[341] The proxy also noted that if Class A shareholders exercised their right of redemption, their shares would be valued at $10.04 per share.[342] Notably, the proxy was not accompanied by an independent third-party valuation or fairness opinion, and the financial analysis relied upon by Churchill, included in the proxy, was prepared by Churchill's management and The Klein Group.[343]

Churchill shareholders overwhelmingly approved the merger, and the deal closed on October 8, 2020. The next month, an equity research firm published a report discussing the now-public MultiPlan, including that its largest customer had formed an in-house platform to replace it. Following the report, MultiPlan's share price fell to $6.27 per share.[344]

The plaintiffs, who were shareholders before the record date of the merger, brought claims alleging breach of fiduciary duty by Churchill directors, officers, sponsor, and its controlling shareholder. In short, the complaint alleged that Churchill's structure created conflicting interests between the two classes of shareholders and that the defendants put their own interests above those of the Class A public shareholders by issuing a false and misleading proxy, thus impairing the shareholders' right of redemption.[345] Noting that this case presented the application of Delaware law to SPACs as a matter of first impression, the court announced it would apply "well-worn fiduciary principles . . . despite the novel issues presented."[346]

First, the court agreed with the plaintiffs' characterization of the claims as direct, rather than derivative, holding that the allegedly harmed redemption right belonged to the Class A shareholders, not to Churchill, and it would be those shareholders who had the right to any damages recovered.[347] The court also rejected the defendants' argument that the claims were contractual, thus barring the fiduciary duty claims, because plaintiffs did not allege a breach of contract—they had the opportunity to redeem their shares based on a provision in Churchill's Certificate of Incorporation—but rather that defendants breached their duty to make full disclosures.[348] Regarding the defendant's final threshold argument, the court held that the plaintiffs' claims were not so-called "holder" claims predicated on shareholder inaction, but rather the redemption right was an affirmative choice for each shareholder to either divest or invest in the combined entity.[349]

On the merits of the claims, the court held that "Delaware's 'most onerous [entire fairness] standard of review'" applied rather than the business judgment rule, because a majority of the Churchill directors were self-interested or lacked independence from Michel Klein and because the controlling shareholder, Klein, "compet[ed] with the common stockholders for consideration."[350] The court explained that Klein stood to benefit uniquely from a merger—his founder shares would be worthless if Churchill failed to complete any deal, whereas Class A shareholders would receive $10.04 per share; thus, a merger would be valuable for Klein even if the combined entity's true value was well below $10.04 per share.[351] The court also held the complaint sufficiently alleged the other Churchill directors were self-interested in the same manner as Klein—noting that even if post-merger MultiPlan was worth just $5 per share, the directors holding the fewest founder shares stood to gain more than half a million dollars.[352] The court also concluded the directors other than Klein were all "beholden" to Klein because he held the unilateral authority to fire them, he had hired them to serve as directors of multiple other SPACs controlled by him, or they were employed by other Klein-controlled entities.[353]

Applying the entire fairness standard, the court concluded it to be reasonably conceivable that public shareholders of Churchill would have been substantially likely to find the information that MultiPlan's largest customer had created an in-house solution that would enable it to move its business away from MultiPlan to be important when deciding whether to exercise their redemption rights, and thus allowed the fiduciary duty claims to proceed against the directors.[354] The court allowed the claims against Klein to survive in his capacity as an officer for prioritizing his own financial interests over those of the public shareholders.[355] And finally, the court allowed aiding and abetting claims against the Klein Group, as financial advisor for the transaction, to proceed as the plaintiffs adequately alleged the Klein Group knew the MultiPlan valuation was materially misleading and the court held that, at the motion to dismiss stage, Klein's knowledge could be imputed to the firm.[356]

As the court's opinion acknowledged, this was a first-of-its-kind Delaware decision in the SPAC context, and there is no guarantee that other courts will reach similar conclusions in SPAC-related cases. In addition, the de-SPAC transaction at issue in *MultiPlan* had some features that may limit broader applicability of the decision (and use of the entire fairness standard), including that certain members of the SPAC's board also served as directors for several other SPACs affiliated with Klein, and the SPAC allegedly paid more than $30 million for advisory services to an entity affiliated with Klein. Nonetheless, this decision may prompt additional Delaware suits seeking to vindicate SPAC shareholders' redemption rights. Market participants should continue to monitor the other redemption actions that are currently pending in the Chancery Court. In addition, given the current volatility in the markets, we expect that this decision will result in the filing of additional Delaware suits seeking to vindicate SPAC shareholders' redemption rights for Delaware incorporated SPACs whose stock prices decline below their redemption price after their de-SPAC transaction. Finally, this decision is an important reminder that full disclosure in the context of a de-SPAC transaction is critically important.

CONCURRENT STATE JURISDICTION AND FEDERAL FORUM PROVISIONS

Supreme Court Review of Applicability of the PSLRA Discovery Stay Provisions in State Court Proceedings Under the Securities Act Mooted by Settlement

One of the most anticipated developments in securities litigation in 2021 was the Supreme Court's decision to grant certiorari in *Pivotal Software, Inc. v. Superior Court of California*, to determine whether the PSLRA's discovery stay provision applies to complaints alleging violations of the Securities Act in both state and federal courts or solely to actions filed in federal court.[357] In the Supreme Court's landmark ruling in *Cyan v. Beaver County Employees Retirement Fund*,[358] the Court held that state courts have concurrent jurisdiction over claims asserted under the Securities Act. Since *Cyan*, state courts have split over the applicability of the PSLRA discovery-stay provisions.[359] On July 2, 2021, the last day of the Court's 2020–2021 term, the Supreme Court granted Pivotal's petition and agreed to hear the case.[360]

The case arose out of a putative class action filed against Pivotal Software, a company that provides a cloud-native platform that allows customers to produce and use cloud-based software and applications. In April 2018, Pivotal announced its initial public offering at $15 per share and ultimately raised approximately $638.2 million. In June 2019, after Pivotal lowered its going-forward guidance, its stock price fell and stockholders filed securities class actions in state and federal courts alleging that the company made false and misleading statements and inadequate risk disclosures in its registration statement in violation of Section 17 of the Securities Act. A federal court dismissed the consolidated federal complaints for failure to state a claim. Thereafter, the plaintiffs in the consolidated state cases asserted that the discovery stay provisions of the PSLRA did not apply in state court. The company asserted that the discovery stay applies in both state and federal court. Both the California Court of Appeal and the state Supreme Court denied the defendants' request for a stay.[361]

The company's petition for certiorari was supported by amicus briefs from the U.S. Chamber of Commerce and the Securities Industry and Financial Markets Association, which argued that refusing to apply mandatory discovery stays in state securities class actions "creates additional risk and uncertainly for issuers and underwriters participating in IPOs."[362] The Supreme Court granted the petition for certiorari even though no federal appellate court had addressed the issue of the application of the PSLRA discovery stay in state courts. In September 2021, the parties requested the Court to remove the case from its argument calendar, and in early 2022, the parties notified the Court that the case had been settled.

While a ruling by the Supreme Court on the applicability of the PSLRA discovery stay in state court had been anticipated, the widespread adoption by companies of federal forum provisions ("FFPs") likely offset the concerns raised in the company's petition. As we discussed in last year's Review, in *Salzburg v. Blue Apron Holdings, Inc.*, the Delaware Supreme Court upheld the validity of FFPs under Delaware law and federal and state public policy.[363] In late 2020, in the wake of *Salzburg*, a California state court addressed the issue as a matter of first impression in *Wong v. Restoration Robotics* and likewise held that FFPs are valid under California law and federal and California public policy.[364] As discussed below, in *Hook v. Casa Systems, Inc.*, a New York appellate court upheld the validity of FFPs under New York law and policy, becoming the third state to do so. In light of these developments, we expect that the trend of parallel filings in state and federal courts will continue to decline.[365]

New York Appellate Court Nixes Post-*Cyan* Class Action Asserting Claims Under the Securities Act of 1933

In *Matter of Sundial Growers, Inc. Securities Litigation*, the Appellate Division of the Supreme Court of New York, First Department, affirmed the dismissal of a class action alleging that a cannabis company failed to disclose issues relating to the quality of its product, thereby rendering misleading statements in its offering documents that it was a producer of "high quality" and "premium" cannabis in violation of the Securities Act.[366] This decision is notable for its analysis of whether general statements about product quality may constitute mere "puffery" or otherwise nonactionable statements of opinion. The court concluded that the context of the alleged misrepresentations and their placement among robust risk disclosures refuted any alleged violation of the Securities Act. *Sundial Growers* is also the second recent decision by the Appellate Division rejecting claims brought under the Securities Act following the Supreme Court's decision in *Cyan v. Beaver County Employees Retirement Fund* holding that state courts have jurisdiction of such claims.[367]

Shareholders of Sundial alleged that statements in its offering documents such as "[w]e are developing high-quality, premium cannabis brands for the adult-use market" and "[i]n our purpose-built indoor modular grow rooms, we produce high-quality, consistent cannabis" were materially false and misleading in light of product quality issues experienced by the company.[368] Specifically, plaintiffs alleged that deficient manufacturing and quality-control processes led to the production and distribution of adulterated cannabis products, including significant batches that were not fit for human consumption or that failed to meet Sundial's contractual commitments to its most important customers. Plaintiffs also focused on the company's failure to disclose the return of a large order due to deficient quality representing 10% of the company's sales in a prior quarter.

The trial court dismissed the complaint and held that each of the alleged misstatements was either corporate puffery that was too vague to be actionable, a sincere statement of corporate optimism, or sufficiently offset by robust risk disclosures. The court noted that the terms "high quality" and "premium" are clear examples of puffery because they are general and not subject to verification. While the plaintiffs argued that the statements could not be considered puffery or opinions because they misrepresented current facts, the trial court pointed out that many of the statements began with language such as "we believe," "we intend," "will result," and other opinion-based or forward-looking language. The court also noted the "robust" 35-page risk disclosure section of the offering documents, which explained various risks relating to potential quality issues and disclosed that certain quality problems had occurred prior to the IPO.

The Appellate Division affirmed, holding that statements about "high quality" and "premium" cannabis were non-actionable puffery and to the extent the statements were more than puffery, they were non-actionable opinion.[369] Moreover, the court noted that the risk disclosures in the offering materials expressly warned of risks relating to quality control, including fire, insects, and contamination and also disclosed that there had been a quality control incident in the past. As such, the disclosures were not rendered misleading by the omission of a single incident of returned product.

The *Sundial* case is the second decision by the Appellate Division rejecting class action claims brought under the Securities Act following *Cyan*. In *Cyan*, the Supreme Court held that state courts have jurisdiction over actions alleging only violations of the Securities Act and that defendants are precluded from removing such actions to federal court. The *Cyan* decision resolved a split among courts as to whether SLUSA deprived state courts of jurisdiction of class actions brought under the Securities Act and unanimously held that it did not.

In the wake of *Cyan*, filings in state courts alleging Securities Act claims exceeded those brought in federal court, and a substantial number of all state filings had a parallel action filed in federal court.[370] In *Lyu v. Ruhnn Holdings Ltd.*, the Appellate Division rejected claims that defendants had misled investors in offering materials that allegedly concealed information about the company's intention to change its business model and should have disclosed data from a prior period showing a decline in key metrics of the former business model.[371] Reversing the trial court's denial of a motion to dismiss, the Appellate Division held that the company's disclosures were sufficient to put a reasonable investor on notice of the risks of the change in business model and dismissed plaintiff's "myopic" focus on the alleged omissions because they would not significantly alter the total mix of information available to a reasonable investor.[372]

New York Court Upholds Exclusive Federal Forum Selection Provision for Securities Act Claims Filed in State Court

In 2018, the Supreme Court held in *Cyan, Inc. v. Beaver County Employees Retirement Fund* that state courts have concurrent jurisdiction over lawsuits asserting violations of the Securities Act of 1933 and that those lawsuits cannot be removed to federal court.[373] In response, plaintiffs increasingly brought Securities Act claims in state court, and, in some instances, companies were forced to defend overlapping Securities Act suits in both state and federal courts because there is no procedure or mechanism to consolidate or coordinate such cases. To avoid the risk of inconsistent judgments and rulings, several companies incorporated in Delaware adopted forum selection provisions in their certificates of incorporation requiring that any claims alleging violations of the Securities Act be brought exclusively in federal court.

As we discussed in last year's Review, following the *Cyan* decision, state courts in Delaware and California analyzed such FFPs and concluded that they are valid and enforceable under Delaware and California law and are consistent with federal and state public policy.[374] However, two important issues remained after the Delaware Supreme Court's decision in *Salzberg.* First, because that case involved only a facial challenge to an FFP rather than an "as-applied" challenge, it did not foreclose a shareholder from challenging an FFP under the facts of a specific case. Second, *Salzberg* expressly invited the courts of other states to determine whether FFPs violate the law or public policies of other jurisdictions. California became the first jurisdiction after Delaware to affirm the validity and enforceability of FFPs, but it remained to be seen how courts in other jurisdictions—in particular, New York, the locus of many cases brought under the Securities Act—would view FFPs.

In 2021, a New York state court addressed for the first time the enforceability of FFPs under New York law and public policy.[375] In *Hook v. Casa Systems, Inc.*, a shareholder filed a putative class action suit against Casa Systems, a Delaware corporation, alleging that Casa violated Sections 11 and 15 of the Securities Act after the company's stock price plummeted to almost half of the IPO price in the wake of disclosures that it was going through a "digestion period," in which Casa's core customers would stop buying its products while newer technology is adopted, thereby lowering the company's expected revenues. Casa moved to dismiss the complaint, arguing that the suit was barred by the FFP in its corporate charter. Casa relied on *Salzberg v. Blue Apron Holdings, Inc.*, which held that FFPs are facially valid under Delaware law.

The Supreme Court of the State of New York for New York County agreed and dismissed the complaint based on its holding that Casa's FFP was valid and enforceable under New York law and public policy. As a preliminary matter, the court found that it was bound by the *Salzberg* decision because "issues of internal corporate governance"—including the applicability of FFPs found in corporate charters—were determined by Delaware law as the state where Casa was chartered.[376] The court reasoned that even if the FFP was not an "internal affair" of the corporation (and thus governed by Delaware law), the FFP would still be enforceable under New York law because, under New York law, forum selection clauses are "prima facie valid unless shown by the resisting party to be unreasonable," which the plaintiff failed to do.[377]

The court concluded that enforcement of the FFP was not "unreasonable or unjust" or the subject of "fraud or overreaching" because a trial in the contractual forum would not deprive the plaintiff of his day in court.[378] The court also rejected the argument that enforcement of the FFP would be unjust and unreasonable because any federal action would be untimely, noting that the statute of repose did not expire until nine months after the *Salzberg* decision was issued and seven months after the defendants first raised the argument, yet the plaintiff failed to file any action in federal court during that period.

Finally, the court rejected the plaintiff's argument that the FFP violated the Supremacy Clause of the U.S. Constitution because provisions like FFPs that waive the sections of the Securities Act providing the right to select the judicial forum have been upheld by the Supreme Court.[379] The court also held that the FFP did not violate the Commerce Clause of the U.S. Constitution because provisions like the FFP are "process oriented and not substantive" and thus do not implicate the Commerce Clause, which exists to prevent a valid state law from having extraterritorial application.[380]

STANDING

Ninth Circuit Affirms Standing to Bring Securities Act Claims in Connection with Direct Listing Despite Tracing Difficulties

In *Pirani v. Slack Technologies, Inc.*,[381] a divided panel of the Ninth Circuit affirmed the decision of the district court holding that a purchaser of shares in a direct listing who could not determine whether he had purchased registered or unregistered securities nevertheless had standing to allege misstatements in a registration statement and prospectus under Section 11 and Section 12(a)(2) of the Securities Act of 1933. The court concluded that whether or not some of the purchased shares had been previously registered, all of the shares sold in the direct listing could be traced back to a single registration statement filed with SEC relating to the direct listing. While the specifics of any direct listing may be distinguishable from Slack's listing, under *Pirani*, investors in direct listings may pursue claims under the Securities Act even if they cannot trace their shares to a particular registration statement.

In 2019, Slack became one of the first companies to go public through a "direct listing" on the New York Stock Exchange.[382] Unlike a traditional initial public offering, a company going public in a direct listing does not issue any new shares and instead files a registration statement with the SEC solely for the purpose of allowing existing shareholders to sell their shares; thus, both registered and unregistered shares may be available for purchase by the public.

On its first day of trading, Slack released 118 million registered and 165 million unregistered shares at an initial price of $38.50 per share. Plaintiff purchased 30,000 shares that day and went on to purchase another 220,000 shares over several months. Following the direct listing, Slack experienced multiple service disruptions that caused the stock price to drop below $25 per share. Plaintiff filed a class action lawsuit against the company and senior executives alleging misrepresentations in the registration statement and prospectus in violation of Sections 11 and 12(a)(2) of the Securities Act of 1933. Specifically, plaintiff asserted that the registration statement did not adequately alert prospective purchasers to the generous terms of Slack's service agreements that required payout of generous "service credits" whenever its service was disrupted and downplayed the competition the company faced from Microsoft Teams.

Slack moved to dismiss on the ground that the plaintiff lacked standing because he could not allege whether he had purchased registered or unregistered shares in the direct listing. The district court expressed concern that the company's argument would "obviate" the availability of Securities Act remedies in the context of a direct listing. The district court denied the motion to dismiss the Section 11 claim holding that the plaintiff had standing to sue because he could show that the securities he purchased, even if previously unregistered, were "of the same nature" as the securities registered via the registration statement for the direct listing. The district court's conclusion was based on an admittedly "broad reading" of the term "such security" in Section 11 to account for the difficulty of distinguishing between registered and unregistered shares sold in a direct listing. The court likewise held that the plaintiff had standing to sue the individual defendants under Section 12(a)(2) for the same reason.[383]

In a split opinion, the Ninth Circuit affirmed but declined to adopt the district court's reasoning based on a broad reading of the term "such security" in Section 11. While the court acknowledged that it had long defined "such security" to mean "a security issued under a specific registration statement, not some later or earlier statement," it characterized the issue as one of first impression and applied its own analysis of the statutory text and legislative history to conclude that securities purchased in a direct listing, even if previously unregistered, fall within the reach of Section 11 as long as they were purchased after the effective date of a registration statement.[384]

The court reasoned that because registered and unregistered shares were sold simultaneously upon the effectiveness of a single registration statement and because the purchase could only have occurred because of the effectiveness of that registration statement, all of the shares "can be traced to that one registration," and thus the case does not present the traceability problem identified in cases with successive registration statements.[385] The court also noted that if directly listed shares were not considered "such securit[ies]" under Section 11, companies would be allowed to "avoid any risk of Section 11 liability by choosing a direct listing" and thereby "create a loophole large enough to undermine the purpose" of that provision "as it has been understood since inception."[386] For the same reasons, the court also affirmed the district court's holding that the plaintiff had standing to bring the Section 12(a)(2) claims against the individual defendants. The court did not disturb the district court's finding that the plaintiff lacked standing under Section 12(a)(2) to sue Slack because the company had not issued any new shares in the offering.

The dissent argued that the text of Sections 11 and 12 limits standing to purchasers of registered shares even if that meant no plaintiff had standing to sue under the Securities Act in connection with Slack's direct listing. The dissent also criticized the majority's broad "policy-driven interpretation" of the term "such security" in Section 11 and stated that it defied decades of precedent in the Ninth Circuit and from "every court of appeals to consider the issue" of the tracing requirement in other contexts.[387] According to the dissent, the majority went astray by treating the statute as "a chameleon, its meaning subject to change based on the varying facts of different cases" when it should be left to Congress to update the securities laws to address unwanted consequences stemming from developments in the financial markets.[388] Finally, the dissent noted that issuers in a direct listing could still be held liable under section 10(b) of the Exchange Act.

On November 3, 2021, Slack and the individual defendants petitioned for rehearing *en banc* before the Ninth Circuit, arguing that the decision breaks with "five plus decades of previously uniform precedent on the meaning of Section 11 and applies policy concerns over the plain language of the statute." The court is expected to rule on the petition in early 2022.

STATUTES OF LIMITATIONS

Eleventh Circuit Holds That Cryptographic Tokens Sold to the Public Are Securities but Equitable Tolling of Statute of Limitations Does Not Excuse the Untimely Filing of Complaint Alleging Sale of Unregistered Securities

In *Fedance v. Harris, Jr. et al.*, the Eleventh Circuit affirmed the dismissal of a complaint alleging failure to register an offering of cryptographic tokens in violation of sections 12(a)(1) and 15(a) of the Securities Act of 1933 because it was filed too late.[389] The court held that the tokens met the requirements of an investment contract and were thus subject to the federal securities laws. Section 13 of the Securities Act creates a one-year statute of limitations period for claims brought under section 12(a)(1) that begins to run on the date of the alleged sale of unregistered securities. Applying Supreme Court precedent and noting that nothing in the text of the statute of limitations foreclosed it, the court presumed equitable tolling to be available.[390] However, the court held that because plaintiff did not plausibly allege that the defendants fraudulently concealed facts that prevented him from recognizing that he had cognizable claims under sections 12(a)(1) or 15(a) during the one-year limitations period, equitable tolling was not warranted, and the complaint was properly dismissed as untimely. The decision is notable for its reasoning that courts must carefully distinguish between the accrual of a claim, which may be delayed when a discovery rule applies, and the tolling of a statute of limitations under an equitable tolling doctrine such as fraudulent concealment.

The complaint alleged that plaintiff purchased $3,000 worth of cryptographic tokens issued in August 2017. The proceeds were purportedly to be used to license content, fund future film projects, and integrate a yet-to-be-developed platform into additional web-based streaming platforms. The tokens were widely promoted on social media by the company's owners, including rapper Clifford "T.I." Joseph Harris Jr. and other celebrities, and portrayed the issuer as a promising company with major investments and deals. The promoters also represented that investors would be able to "redeem" the tokens on its platform after its launch. The initial coin offering sold tokens for approximately six cents each, and in the ensuing months, the price soared to 35 cents.

Despite frenetic public announcements about the company's projects and high-profile investors, the tokens soon crashed and fell to less than one cent a token before the company was sold. In May 2019, approximately 21 months after his purchase and nine months after the one-year limitations period had expired, plaintiff commenced a class action lawsuit against the company and its owners for the sale of unregistered securities and further alleged that fraudulent concealment equitably tolled the limitations period. The district court concluded that because the applicable statute of limitations was not subject to either a discovery rule or equitable tolling, the complaint was untimely and dismissed it.

On appeal, the Eleventh Circuit reversed, holding that the district court made the "all-too-common mistake" of conflating the doctrine of fraudulent concealment, an equitable tolling doctrine, with the discovery rule, which delays accrual of a fraud claim until victims discover their cause of action. The court explained that fraudulent concealment works differently than the discovery rule because it is not limited to actions that sound in fraud and tolls the statute of limitations where a defendant acts "above and beyond the wrongdoing upon which a plaintiff's claim is founded to keep a plaintiff from suing in time."[391] The court also rejected the district court's reasoning, based on a Sixth Circuit decision, that since Congress included a discovery rule for Section 12(a)(2) claims but not for Section 12(a)(1) and 15(a) claims, it intended to negate equitable tolling "in this context."[392] "The expression of a rule of accrual for one kind of claim does not imply anything about the tolling of the limitations period for another kind of claim."[393] Accordingly, the court held that nothing in the text of the applicable statute of limitations foreclosed equitable tolling in this case.

Although the court held that equitable tolling is available in Section 12(a)(1) and 15(a) cases, it nevertheless affirmed dismissal because the complaint did not plausibly allege that the defendants fraudulently concealed the facts necessary for plaintiff to reach the legal conclusion that the tokens he purchased were securities. Noting that the Securities Act defines a "security" to include an "investment contract" and that the courts have interpreted "investment contract" broadly to encompass many money-raising schemes, the court held that the tokens met all three elements established by the Supreme Court for distinguishing an investment contract from other commercial dealings: (i) an investment of money; (ii) a common enterprise; and (iii) the expectation of profit.[394]

The court rejected plaintiff's argument that alleged misstatements by the promoters that the tokens would have actual "utility" in the future caused him to be "unaware" that the tokens were securities until nearly two years after he had invested in them. "Plenty of items that can be consumed or used—from cosmetics to boats to Scotch whiskey—have been the subject of transactions determined to be securities because they had the attributes of an investment."[395] Because the complaint failed to allege any concealed facts necessary to bring plaintiff's claim to light until a year after his purchase or any misrepresentations to make plaintiff or putative class members ignorant of a claim under Section 12(a)(1) or Section 15(a), the court held that equitable tolling did not excuse the untimeliness of the complaint.

CONCLUSION

2022 Outlook

The COVID-19 pandemic continued to defy projections in 2021 and continued to bring unexpected and sustained economic consequences for companies and volatility in the markets. Unsurprisingly, COVID-related claims remained a substantial portion of the securities class actions filed in 2021, a trend likely to continue as the pandemic enters its third year. As of mid-January 2022, three new COVID-related class action complaints have been filed, all against companies in medical or health-related fields. Given the ever-changing nature of the pandemic, and the increasing number of COVID variants, companies must continue to grapple with the business impacts caused by the public health crisis in 2022 while investors, and the SEC, remain vigilant in addressing false or misleading statements or omissions relating to the pandemic's effects on issuers. And while courts to date have indicated a lack of tolerance for "fraud by hindsight" complaints, those cases dealt with statements made in early 2020. A vast majority of COVID-related cases remain unresolved, and it is possible that courts may be less inclined to find that issuers were unaware or unable to foresee the effects of the pandemic months, or even years, after its beginning.

As discussed above, the popularity of SPACs exploded in 2021. However, the use of SPACs declined over the course of the year, with SPACs going from 70% of the U.S. IPO market in Q1 to just 47% by Q4. Looking forward in 2022, it is possible that the decline in SPAC popularity will continue. An increase in SPAC-related private securities litigation in 2022 is likely given market volatility and heightened regulatory scrutiny, and the SEC has indicated that new rules governing SPACs are on the horizon. While numerous SPAC-related lawsuits were filed in federal and state courts in 2021, both pre- and post-combination, the majority of these cases are still in the pleading stage or have been mooted by amended disclosures, so it remains to be seen how the courts will rule on the federal securities law claims. It also remains to be seen whether investors in Delaware-incorporated entities will continue to bring state law fiduciary duty claims based on undisclosed conflicts of interest and other theories following the Delaware Chancery Court's early January 2022 decision allowing a de-SPAC merger challenge to proceed and holding that the entire fairness standard applied. As a result, continued uncertainly in the SPAC sector may lead to traditional IPOs regaining favor as a more stable and predictable method of taking companies public in 2022.

Multiple indicators suggest that cryptocurrency-related securities litigation will remain elevated in 2022. First, as the SEC maintains its aggressive posture, enforcement actions will likely accelerate—particularly actions asserting that cryptocurrencies fall under the *Howey* definition of a security. Whether it be in the cybersecurity or the cryptocurrency space, the SEC has made clear that it will be aggressive on both the regulatory and enforcement fronts this year.[396] Second, the SEC's aggressive enforcement will likely contribute to increased follow-on private securities class actions related to cryptocurrencies. Finally, as of mid-January 2022, cryptocurrency markets were down from their 2021 highs.[397] We expect more private securities class actions related to cryptocurrencies as investors seek to recoup losses sustained in the recent market decline. And in the wake of *Rensel*, one of the first cryptocurrency cases in which a court granted class certification, we will watch for more class certifications in this sector and the development of case law on plaintiffs' varying theories of recoveries as the cases move through the courts.[398] Market trends led to more cryptocurrency-related securities litigation last year. Expect the same in 2022.

While it is too early to say how another year of pandemic-related volatility will impact overall securities fraud filings, there have already been 13 securities fraud class action cases filed in January 2022. Looking ahead, 2022 will also likely be another record year for substantial shareholder recoveries, since at least seven nine-figure settlements have been announced and are likely to be approved in 2022.[399] Finally, we expect that there will again be a substantial number of significant securities-related decisions from the federal appellate courts. Following last year's important Supreme Court ruling in the Goldman Sachs securities litigation clarifying the evidence of price impact that may be considered at the class certification, as well as affirming the defendant's burden of persuasion by preponderance of evidence to prove a lack of price impact at class certification, the case was remanded back to the district court. Applying the clarifying guidance from the Supreme Court and noting its due consideration of all evidence before it, the district court again granted class certification holding that Goldman failed to show that the alleged misstatements had no price impact.[400] The defendants have already filed a Rule 23(f) petition for permission to appeal class certification for a third time, so we may see another decision from the Second Circuit on the proper application of the clarified standards enunciated by the Supreme Court later this year.

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Jones Day lawyers are available to assist in addressing any questions you may have about this annual review. Please contact any of the members of the Securities Litigation & SEC Enforcement Practice listed below.

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326 *See e.g.*, *United States v. McLellan*, 959 F.3d 442 (1st Cir. 2020); *Taksir v. Vanguard Grp.*, 903 F.3d 95 (3d Cir. 2018); *Goldberg v. Bank of America, N.A.*, 846 F.3d 913 (7th Cir. 2017); *Zola v. TD Ameritrade*, 889 F.3d 920 (8th Cir. 2018).

327 *Edward D. Jones & Co., L.P. v. Anderson*, petition for cert. pending, No. 21-552 (filed Oct. 12, 2021).

328 *See In re Multiplan Corp. Stockholders Litig.*, C.A. No. 2021-0300-LWW (Del. Ch. Jan. 3, 2022).

329 *Id.*, Slip Op. at 32.

330 *Id.* at 38.

331 *Id.* at 3.

332 *Id.* at 46.

333 *Id.* at 1.

334 *Id.* at 1, 5, 7–8.

335 *Id.* at 6.

336 *Id.* at 7.

337 *Id.* at 10.

338 *Id.* at 11.

339 *Id.* at 12.

340 *Id.* at 15.

341 *Id.*

342 *Id.* at 16.

343 *Id.* at 15–16.

344 *Id.* at 17.

345 *Id.* at 18.

346 *Id.* at 3.

347 *Id.* at 32.

348 *Id.* at 33.

349 *Id.* at 38.

350 *Id.* at 40–41.

351 *Id.* at 42–43.

352 *Id.* at 49–50.

353 *Id.* at 50–52.

354 *Id.* at 56.

355 *Id.* at 58.

356 *Id.* at 59–60.

357 Order Denying Defendants' Joint Motion to Stay Discovery, *In re Pivotal Software, Inc. Sec. Litig.*, No. CGC-19-576750 (Cal. Super. Ct. Mar. 4, 2021).

358 138 S. Ct. 1061 (2018).

359 *See, e.g.*, *In re Greensky, Inc. Sec. Litig.*, No. 655626/2018, 2019 WL 6310525, at *2 (N.Y. Sup. Ct. Nov. 25, 2019) (holding that the discovery-stay provisions apply in federal and state courts); *In re Dentsply Sirona, Inc.*, No. 155393/2018, 2019 WL 3526142, at *6 (N.Y. Sup. Ct. Aug. 2, 2019) (denying the defendants' motion to stay discovery).

360 *Pivotal Software, Inc. v. Superior Court of California*, 141 S. Ct. 2884 (2021).

361 Order Denying Petition for Review and Application for Stay, *Pivotal Software, Inc. v. Superior Court*, No. S267949 (Cal. Apr. 14, 2021).

362 *Amicus Curiae* Brief of the Securities Industry and Financial Markets Assoc. in Support of Petitioners at 5, *Pivotal Software, Inc. v. Superior Court of California*, No. 20-1541 (U.S. Aug. 23, 2021).

363 Jones Day, *2020 Securities Litigation Year in Review*, at 13–14 (Feb. 2021).

364 *Id.* at 14–15.

365 *See* *Securities Class Action Filings: 2021 Midyear Assessment*, Cornerstone Research 14 (July 27, 2021).

366 191 A.D. 3d 543, 138 N.Y.S.3d 330 (First Dep't. 2021).

367 *Cyan v. Beaver County Employees Retirement Fund*, 136 S. Ct. 1061 (2018).

368 191 A.D. 3d at 543-544, 138 N.Y.S. at 330-331.

369 *Id*. at 544.

370 Cornerstone Research, *Securities Class Action Filings 2019 Year in Review*, at 4; *see also Sun, A Series of E Squared Investment Fund, LLC v. Sundial Growers Inc.*, 2021 WL 4482276 (S.D.N.Y. Sept. 30, 2021) (dismissing parallel federal action against Sundial Growers alleging violations of the Securities Act and the Securities Exchange Act as well as common law claims).

371 189 A.D. 3d, 441,137 N.Y.S. 322 (1st Dep't 2020).

372 *Id*. at 442.

373 *Cyan, Inc. v. Beaver Cnty. Emps. Ret. Fund*, 583 U.S. _____ (2018).

374 *See Salzberg v. Blue Apron Holdings, Inc.*, No. 346,2019, 2020 WL 1280785 (Del. Mar. 18, 2020) (reversing *Sciabacucchi v. Salzberg*, No. 2017-0931-JTL, 2018 WL 6719718 (Del. Ch. Dec. 19, 2018); *Wong v. Restoration Robotics*, No. 18-CIV-02609 (Cal. Sup. Ct. Sept. 1, 2020). *See also In re Dropbox, Inc. Secs. Litig.*, No. 19-CIV-05089 (Cal. Super. Ct. Dec. 4, 2020) (dismissing securities class action complaint, holding that FFP in company's bylaws was valid and enforceable and was not unfair, unreasonable, or unconscionable); *In re Uber Tech., Inc. Secs. Litig.*, No. CGC-19-579544 (Cal. Super. Ct. Nov. 16, 2020) (dismissing securities class action complaint, holding that FFP in company's charter was valid and enforceable and was not unexpected, unreasonable, or unconscionable).

375 *Hook v. Casa Systems, Inc.*, No. 654548/2019, 2021 WL 3884063 (N.Y. Sup. Ct. Aug. 30, 2021).

376 *Id*. at *3.

377 *Id.*

378 *Id*.

379 *Quijas v. Shearson/Am. Exp., Inc.,* 490 U.S. 477, 481 (1989).

380 *Id.* at *4.

381 *Pirani v. Slack Techs., Inc.*, No. 20-16419, 2021 U.S. App. LEXIS 28319 (9th Cir. Sept. 20, 2021).

382 *Id.* at 943.

383 *Id.* at 945.

384 *Id*. at 946.

385 *Id.* at 953.

386 *Id.* at 948.

387 *Id*. at 952.

388 *Id*.

389 *Fedance v. Harris,* 1 F.4th 1278, 1282 (11th Cir. 2021).

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391 *Fedance*, 1 F.4th. at 1286.

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