REPRINT

CD corporate disputes

SECURITIES LITIGATION

REPRINTED FROM:

CORPORATE DISPUTES MAGAZINE

JAN-MAR 2024 ISSUE

www.corporatedisputesmagazine.com

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KIRKLAND & ELLIS LLP

Published by Financier Worldwide Ltd
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www.corporatedisputesmagazine.com

EXPERT FORUM

SECURITIES LITIGATION

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CD: Could you provide an overview of recent developments in securities litigation? How would you characterise activity levels?

Cooper: Securities litigations continue to be brought at significant levels in the US. Securities fraud class action filings under the Securities Exchange Act of 1934 were up in the first half of 2023 compared to the second half of 2022, and were on par with average filings over the last 25 years. New filings during the same period under the Securities Act of 1933 for new securities issuances and initial public offerings (IPOs), in contrast, were at the lowest levels in a decade. There have been no recent changes in the law or particular legal decisions that have had a significant impact over this area, although the slowdown in IPO activity and previous changes in the law making it harder to bring Securities Act claims in state court undoubtedly account for the decline in 1933 Act filings. The Supreme Court issued its decision in *Slack Techs vs. Pirani* in June 2023 related to direct listings of securities, but that decision merely reaffirmed the prior decades-old understanding of section 11's tracing requirement, and will likely have little to no impact on new case filings.

Atkinson: Activity levels in securities cases are generally on par with where they have been over the last five years. However, studies show that the overall level of activity has significantly increased in the past 10 years. In 2016, after the Delaware Court of Chancery imposed more stringent requirements on disclosure-only settlements, there was a spike in the number of securities cases filed, particularly relating to M&A transactions. Interestingly, it appears that securities class actions have seen a gradual decline since 2016. It could be that plaintiffs' attorneys sometimes favour individual actions over class actions due to the fact that settlements of individual actions receive less scrutiny from the courts than class settlements.

Schwartz: Cornerstone Research reports that the number of US securities class action filings in the first half of 2023, at 114, was remarkably consistent with the number in the first half of 2022, at 115. The potential damages of these cases, however, declined from $505bn in the first half of 2022 to $170bn in the first half of 2023, likely reflecting overall stock market performance. The targets of securities litigation shifted from special purpose acquisition companies (SPACs) and other M&A deals in the broader market to specific problems facing the cryptocurrency, cannabis and financial sectors. 2023 also saw US federal courts thwarting attempts to expand the US securities laws to cover syndicated loans and blockchain tokens, and there are still more potential

blockbuster securities decisions to come from the federal courts in early 2024.

Percopo: Recently, we have seen an interesting combination of landmark legal decisions, new market developments and atypical applications of traditional securities claims. Take SPACs for example. A new market development prompted plaintiffs to use a traditional securities claim in a nontraditional way – section 11 challenges to representations in registration statements. A landmark legal decision, *Slack Techs*, quickly posed a new challenge. As at least one district court has observed, because a SPAC's shares trade on the market before the registration statement for the de-SPAC transaction issues, the universe of plaintiffs with standing to challenge de-SPAC registration statements is exceedingly small. The 2023 *Danimer Scientific, Inc*. securities litigation cited *Slack* and concluded that because named plaintiffs did not purchase shares on the day of the offering at the offering price, no amendment would enable them to plead tracing.

CD: What types of securities claims are typically being seen in the current market?

Atkinson: Securities litigation surrounding environmental, social and governance (ESG) issues is becoming more common. Many of these cases have been premised on an allegation that companies' environmental or diversity and inclusion disclosures were misleading. More recently, plaintiffs' firms have begun to bring cases based on other types of disclosures. For example, in June 2022, shareholders brought a securities class action in the US District Court for the Southern District of New York against Unilever after its subsidiary, Ben & Jerry's, passed a resolution to end sales in areas that the Ben & Jerry's board considered to be unlawfully occupied by Israel. The plaintiffs claimed that Unilever failed to disclose the resolution and that the omission materially misled investors. The court ultimately granted Unilever's motion to dismiss in late August, but plaintiffs' firms continue to seek out and file similar litigation cases as purported securities matters.

Schwartz: Although plaintiffs continue to bring fairly standard securities class actions concerning missed earnings and newly disclosed regulatory problems, the industries facing these lawsuits has shifted over the last year. The rash of complaints in 2022 concerning SPAC and other M&A transactions has declined significantly following a recent drop in the number of those transactions. The same is true for IPOs. Conversely, the number of securities actions concerning cryptocurrency, cannabis and bank failures have increased, as those industries face economic headwinds and regulatory scrutiny.

We have also seen an increase in securities class actions targeting companies for their disclosures concerning cyber attacks and ESG policies. Changes in targeted industries and types of disclosures are normal, as plaintiffs' lawyers target industries that are having difficulties at the moment and focus on newly emerging areas of disclosures where there is little guidance from the courts and regulators on what companies can and cannot say.

Percopo: We have not seen much of a change in the 'typical' securities case, but there are definitely specific types of claims that are accounting for a disproportionate percentage. We are continuing to see three trends. Firstly, claims surrounding ESG-related issues. Secondly, claims in particular industries, like cryptocurrency and life sciences and pharmaceuticals. And third, litigations involving SPACs, although SPAC-related case filings are waning. ESG and cryptocurrency cases continue to be filed in record numbers, with cryptocurrency cases also getting outsized attention from regulators. But even as these trends subside, we are likely to continue to see their effects. For example, shareholders' success in bringing direct breach of fiduciary duty claims against SPAC officers and directors in cases like *In re MultiPlan Corp*. are likely to provide a model for creative pleading in other contexts.

Cooper: We continue to see the bulk of securities cases brought following a corporate trauma or event of some kind that results in a drop in the company's stock price. Previously, practitioners referred to this as 'event driven' litigation, where cases were brought following virtually any negative 'event' for a company, following which plaintiffs challenged the accuracy of the company's previous qualitative disclosures. Before that, cases were more commonly accounting or finance based, such as Enron and Worldcom, where plaintiffs mainly challenged quantitative statements made by the company. Today, ESG issues increasingly dominate. As one plaintiff lawyer commented, all cases are ESG today

"Unlike derivative actions, in which shareholders sometimes seek corporate governance changes, securities cases are about money, plain and simple."

Matthew A. Schwartz, Sullivan & Cromwell LLP

– because if not about the environment, climate or social issues, they are surely about governance. Another trend is for plaintiffs to follow the activities of government regulators and enforcers, bringing securities cases following the announcement of a major investigation or resolution. And we are seeing a significant number of cryptocurrency cases continuing to be litigated, some moving past motions to dismiss and into the core factual issue of whether the subject tokens are unregistered securities.

CD: Have there been any securities litigation cases which drew your attention? What lessons can we learn from how these cases were assessed and ultimately resolved?

Schwartz: 2023 was a highly successful year for the securities defence bar in stopping or slowing attempts by plaintiffs' lawyers and the Securities and Exchange Commission (SEC) to expand securities litigation. Federal courts in New York refused to expand the federal securities laws to cover the $12bn secondary blockchain token market in the *Ripple* decision, and the even bigger $2.8 trillion US syndicated loan market in the *JP Morgan* decision. A federal appellate court also allowed an issuer to oppose class action status by showing that the allegedly false statements were too generic and insubstantially tied to the supposed fraud, in the *Goldman Sachs* decision. And the US Supreme Court confirmed lower court decisions that only shareholders who purchased shares directly traceable to a registration statement may sue concerning alleged falsities in the statement, in the *Slack* decision. Given the near impossibility of 'tracing' such securities, as well as the trend away from IPOs and toward direct listings, the US could experience fewer IPO-based securities litigations going forward.

"A motion to dismiss is one of the most powerful tools available to a defendant in a securities case because it is the quickest and most cost-effective method of defeating such a case."

Stefan Atkinson, Kirkland & Ellis LLP

Cooper: In a securities action involving Vale, the publicly traded Brazilian mining company, that was the first brought by the SEC's 22-person Climate and ESG Task Force, the SEC alleged that Vale made

false and misleading disclosures about the safety of its dams prior to the January 2019 collapse of the Brumadinho dam that killed 270 people. The matter favourably settled in March 2023. It is significant because it reflects the kinds of cases the SEC and private plaintiffs are eager to bring in the ESG space. In its press release about the settlement, the SEC stated that the terms of the settlement demonstrate that public companies can and should be held accountable for material misrepresentations in their ESG-related disclosures, just as they would for any other material misrepresentations. Another case to watch is the SEC's action against Ripple related to its XRP token. In July 2023, the district court ruled that offers and sales of XRP to institutions and sophisticated individuals constituted securities transactions, but that offers and sales of XRP on cryptocurrency exchanges, distributions to employees and other distributions to third-party developers were not securities transactions. This is a significant partial victory for the cryptocurrency industry and will have significant consequences for many other cases, including private class actions. Finally, the Second Circuit's *Goldman Sachs* decision from August 2023 decertifying the class in a securities action is significant in reinforcing the Supreme Court's 2021 decision in the same case instructing courts to analyse the degree of "mismatch" between the alleged misstatements and the corrective disclosures in inflation-maintenance cases. Here, finally, the Second Circuit found that the "mismatch" between generic statements and a highly specific disclosure was sufficient to "sever the link" between the statements and the stock price drop, and that the defendants therefore rebutted the presumption of reliance. The decision should provide a roadmap, making it more difficult for plaintiffs to certify securities classes based on generic misstatements.

Percopo: The *Goldman Sachs* case, which has progressed from its first 23(f) petition, through the Supreme Court's 2021 decision, and the Second Circuit's order decertifying the class this past summer, provides a concrete example of a massive class action that survived motion to dismiss challenges based on materiality and loss causation. Despite that early win for plaintiffs, the class was decertified, leaving plaintiffs to proceed on an individual basis, because of a mismatch between the challenged statements and alleged corrective disclosures. This changes the risk calculation for plaintiffs who succeed in surviving a motion to dismiss and increases defendants' settlement leverage in any case where the alleged corrective disclosure does not mirror the challenged statement.

Atkinson: The recent trend of ESG securities cases related to companies' environmental policies and statements – one type of what is sometimes

referred to colloquially as 'greenwashing' litigation – is interesting. These cases have led some companies to more carefully assess potential risks when making ESG disclosures. Most so-called greenwashing cases are still in the early stages of litigation, but late last month the US District Court for the Eastern District of New York dismissed one such case against Danimer, a manufacturer of biodegradable plastics. In that case, certain shareholders of Daminer brought a purported class action alleging that Danimer's statements lauding the company's biodegradable plastic products as 100 percent biodegradable and sustainable were materially false and misleading. Although Danimer won its motion to dismiss the complaint on the basis that the plaintiff failed sufficiently to allege scienter, the court did find that the complaint sufficiently alleged that Danimer made materially misleading statements regarding its products' biodegradability. Ultimately, this case provides a cautionary example of how ESG disclosures can give rise to securities litigation.

CD: What remedies are typically pursued by parties in securities litigation? How do plaintiffs generally go about calculating potential damages and considering settlement?

Percopo: In typical securities fraud cases, plaintiffs define damages on a per share basis

and typically argue in settlement negotiations that the per share dollar value should be multiplied by the number of outstanding shares to determine the potential damages at issue. But this oversimplification is unreliable for a number of reasons. First, defendants typically have strong arguments that at least part of the per share stock drop was for reasons unrelated to the challenged statement. Second, multiplying by the outstanding shares is likely a gross overestimate of actual exposure at trial. Because so few securities class actions go to trial, we just do not have reliable data on the percentage of a class likely to submit a claim. But regardless of what that data would show, it is simply not realistic to assume that all eligible class members would participate in the administration process following trial.

Atkinson: Damages are the most common remedy sought in securities actions. The method used to calculate damages depends upon the securities claim at issue. There are a number of highly qualified economists and financial professionals who assist plaintiffs, defendants and courts in analysing and determining damages, if any, in securities cases.

Cooper: The federal securities laws provide for two principal remedies. In most instances, damages alone are available. But in some circumstances,

as in the cryptocurrency cases, a plaintiff may be entitled to recission as a remedy. In the ordinary section 10(b)(5) fraud class action, damages are calculated by determining two components. First, the per-share damage caused by the alleged fraud, which is supposed to reflect the amount of inflation in the stock price at the time of purchase resulting from the alleged fraud. And second, the difference between the actual stock price and what it would have been but for the fraud. This is generally measured at the time of a corrective disclosure based on the drop in the stock following the disclosure of the purported truth. In rescission cases, the investor is entitled to return the shares in exchange for the purchase price.

Schwartz: Unlike derivative actions, in which shareholders sometimes seek corporate governance changes, securities cases are about money, plain and simple. Plaintiffs in these cases seek damages based on the amount of dollar decline in the security that plaintiffs can link to the alleged fraud or negligence. Some statutes also allow for rescission, meaning the security holder can force the issuer to repurchase the security at the issuance price, regardless of whether the security has declined in value. Regardless of whether a plaintiff seeks damages or rescission, each party typically values a case for settlement by choosing its percentage likelihood of winning the case, and then multiplying by a realistic damages number, which is typically assessed with the aid of outside economic consultants. Parties will also consider attorneys' fees and costs and the distraction and reputational concerns associated with litigation. The availability of insurance coverage may also play a role in deciding the settlement value of a case.

CD: What essential advice would you offer to companies on defending securities litigation? What preparations, strategies and assessments need to be developed?

Atkinson: Companies should invest in their motion to dismiss. A motion to dismiss is one of the most powerful tools available to a defendant in a securities case because it is the quickest and most cost-effective method of defeating such a case. It may be tempting to avoid spending time and resources on a motion to dismiss. But a successful motion to dismiss can knock out one or more of the plaintiffs' claims or resolve the case outright. Given these benefits and others, defendants should consider investing the resources necessary to give themselves the greatest opportunity to win their motion to dismiss. There is no substitute for litigation counsel digging into their client's past disclosures and putting their challenged statements into context at an early stage of the case.

Cooper: Many cases continue to be dismissed on the pleadings without proceeding into the merits phase. So a defendant should file a strong motion to dismiss, and will want experienced counsel to represent them who can prepare a powerful and persuasive brief. If the plaintiff gets past a motion to dismiss, there are two other important opportunities to defeat the claim before trial and without settling. First, defendants should develop a strong strategy for defeating class certification. Particularly after the *Goldman Sachs* decision, which provides a template for defeating certification in the right case, this is an important stage for defendants to prevail. And second, following discovery, a defendant may also defeat a claim on summary judgment by showing that there are no facts supporting the plaintiff's claim, and no trial is necessary.

Schwartz: Issuers need to take immediate steps when securities litigation is anticipated or filed to avoid prejudicing the outcome of the case. These steps include, firstly, preserving information, both to avoid court sanctions and to keep evidence, secondly, alerting insurance carriers, and thirdly, contacting current and former employees to warn them that they might be contacted by plaintiffs and advise on what can and cannot be said. Companies must also make sure that future disclosures about the lawsuit and the underlying issues are vetted to avoid additional claims being added in the litigation. In terms of a litigation strategy, it is worth investing heavily in a motion to dismiss, because the overwhelming majority of securities cases that are not dismissed at that stage are settled, often after significant document and deposition discovery. That said, we have seen companies more frequently positioning securities cases for trial, so we are likely to see an uptick in such cases tried. Finally, throughout the entire litigation, it is important for issuers' lawyers defending the litigation to coordinate with any lawyers dealing with regulators, corporate governance and disclosure issues.

"Whether it is a new market trend or increased scrutiny from investors or regulators on a cultural hot topic, key issues that impact the market will continue to shape securities cases."

Lissa M. Percopo, Gibson, Dunn & Crutcher

Percopo: The statutory structure in which these cases play out can make it very tempting for companies to funnel all their energy into winning a motion to dismiss without considering what could happen beyond that point. Even where the odds of success at the motion to dismiss stage seem good, working with counsel to gain a better understanding of the narrative that will be supported by the facts if the case goes forward is also important. Not only does some factual investigation reduce the risk of presenting a 'story' to the judge at the motion to dismiss stage that cannot be maintained on the merits, it often strengthens the motion to dismiss narrative when the attorneys understand what actually went wrong and what the key players understood at the time.

CD: Regardless of the economic climate, how important is it for companies to stay vigilant of issues that could trigger securities litigation, and take proactive measures to mitigate risks?

Percopo: Staying vigilant and taking reasonable steps to ensure that disclosures are as accurate as possible in light of information known in real time is always important. That is why having outstanding disclosure and corporate governance counsel is just as important as having an outstanding litigation team. But it is also important to realise that even the most diligent company could end up facing a securities litigation. Sometimes business risks do not pay off, and when a business falters and the stock price drops, some shareholder or plaintiff's attorneys will likely try to paint that bad news as the revelation that a prior statement was false. So, yes, companies should stay diligent, but they should not let a fear of litigation that they cannot control paralyse their ability to run their business.

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>
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> *Cleary Gottlieb Steen & Hamilton LLP*

Schwartz: New developments in civil litigation and regulatory enforcement expose issuers to substantial securities litigation even if issuers are doing well financially. Two new areas in particular

stood out in 2023. First, the SEC's new rules concerning cyber security take effect in December 2023 and generally require issuers to disclose details about their exposure to cyber attacks and their capability to respond to them, and information about any material cyber security incidents within four business days of occurrence. Second, the SEC, state regulators and civil litigants are also taking aim at issuers' disclosures concerning ESG. These two developments are areas of concern for all major issuers in 2023 and beyond and require issuers to think deeply about how to handle them.

Cooper: Staying vigilant is clearly important. Companies should identify key risks around accounting and finances, ESG, cyber and other areas that for them present greater risk of developments, like a cyber attack, that could harm to the company, result in a significant stock drop and subsequent securities case. Being vigilant means not only taking steps to prevent such events from occurring but also drafting risk factors and other disclosures that make clear to investors the vulnerabilities and risks the company has in these areas and what the consequences may be if one of these vulnerabilities is realised. And once a corporate trauma like this happens, a company needs to be mindful of the securities litigation risk when drafting subsequent disclosures about what took place and consult with counsel to avoid creating further litigation risk.

Atkinson: Anticipating and mitigating risk are important. Taking a proactive approach to disclosures can help avoid securities litigation or, at the very least, put the company in a stronger position should it find itself defending a securities case. Companies should work closely with in-house or outside counsel to carefully review and consider each of their disclosures, as well as their decisions not to disclose information. Capital markets attorneys are generally very helpful and knowledgeable in this regard, but it may also be smart to consult litigation counsel where particularly thorny issues arise.

CD: What is the outlook for securities litigation in the months ahead? What key issues do you expect to shape these cases?

Schwartz: There are some important securities cases pending before the US Supreme Court this term. In *Macquarie*, the court will consider whether a plaintiff can bring securities claims on the ground that an issuer allegedly violated Item 303 of SEC Regulation S-K by failing to affirmatively disclose certain trends that could negatively affect the issuer. If the Supreme Court sides with the plaintiff, it could significantly increase an issuer's disclosure obligations. In *Jarkesy*, the court is considering the constitutionality of the SEC's ability to force issuers

to defend against regulatory claims in front of the SEC's in-house administrative judges, as opposed to federal court. If the court rules against the SEC, it will remove an important piece of leverage that the SEC has used to force issuers to settle SEC claims against them.

Cooper: Securities litigation is not going away. It remains a strong area of litigation in the US, and US-listed public companies need to keep the risks of such litigation in mind and draft robust disclosures that give them strong defences if sued, and regularly review those disclosures for updating and refinement. The plaintiffs' bar has also started to focus significant resources on identifying and pursuing opportunities for securities litigation in jurisdictions outside the US, in Europe and elsewhere. This is in part because of the Supreme Court's *Morrison* decision more than a decade ago, limiting the extraterritorial reach of US securities laws. As litigation funder Woodsford recently announced, for example, it will shift its litigation funding to matters outside the US, in particular to securities suits that pre-*Morrison* would have been filed under US law. Increasingly, such securities class actions are being brought in the UK, Germany and the 'magnet jurisdiction' of the Netherlands.

Atkinson: I expect the securities plaintiffs' bar to continue to pursue securities litigation aggressively, including the area of ESG. Materiality, falsity, loss causation and scienter, all required elements in most securities cases, will likely be relevant to how these matters are pursued and ultimately resolved. We encourage companies to interface with counsel early and often, as part of a strategy to manage and, if possible, avoid, lengthy and costly securities litigation.

Percopo: Securities litigation will continue to evolve with the market. Coronavirus (COVID-19) and SPAC-related cases are waning as we move beyond the pandemic and SPACs become less popular. ESG and cryptocurrency cases are picking up as litigants fight for and against diversity, equity and inclusion initiatives in a host of settings and as regulators hone in on cryptocurrency platforms and their operators. Whether it is a new market trend or increased scrutiny from investors or regulators on a cultural hot topic, key issues that impact the market will continue to shape securities cases. CD