SULLIVAN & CROMWELL LLP

August 2020

Securities Enforcement and Litigation Update

AUGUST 27, 2020

INTRODUCTION

2019 and the first half of 2020 saw extensive activity in both SEC enforcement and private securities litigation. In terms of both the number of standalone enforcement actions brought and the amount of money recovered, 2019 was a banner year for the SEC, although the Supreme Court's recent decision in *Liu* v. *SEC* established important limitations on the SEC's disgorgement authority going forward. Notwithstanding the COVID-19 pandemic, the SEC has continued its busy pace of enforcement activity in the first half of 2020, with a particular focus on protecting "Main Street" investors.

Private securities litigation in 2019 saw a record number of class action filings, in part fueled by the Supreme Court's 2018 decision in *Cyan, Inc.* v. *Beaver County Employees Retirement Fund*, which held that plaintiffs can maintain claims under the Securities Act of 1933 ("1933 Act") in state court. That decision has increased the prevalence of competing state and federal court securities litigation against companies and underwriters across the country. This has raised a number of issues, including threshold procedural questions that have split state trial courts and will significantly affect the course of such parallel litigation. Against this background of growing 1933 Act cases, the federal courts continue to grapple with central issues affecting defendants' ability to defend against claims under the Securities Exchange Act of 1934 ("1934 Act"), including the burden for rebutting the *Basic* presumption of classwide reliance and

www.sullcrom.com

New York | Washington, D.C.
Los Angeles | Palo Alto
London | Paris
Frankfurt | Brussels

the scope of scheme liability. In the first half of 2020, we have witnessed a slowdown in the filing of securities class actions in both federal and state courts, but it is an open question whether this slowdown is due to the impact of the COVID-19 pandemic on the courts or whether there is some longer-term trend at play as well.

The effects of the ongoing COVID-19 pandemic on SEC enforcement and private securities litigation remain to be seen. But the SEC has issued a variety of guidance on COVID-related disclosures and has moved quickly to bring its first enforcement actions against companies for allegedly misstating their ability to provide testing and detection services for COVID-19. Private securities litigation has thus far clustered around companies' responses to COVID-19, alleged attempts to downplay the impact of COVID-19 on continuing operations, and issues allegedly exposed by heightened use of certain companies' products and services during the COVID-19 pandemic.

This update discusses recent developments in both SEC enforcement and private securities litigation. With respect to SEC enforcement, the update addresses: (i) recent numerical trends; (ii) the Enforcement Division's areas of focus; (iii) COVID-related developments; (iv) the *Liu* decision; and (v) a recent memorandum of understanding between the SEC and the Department of Justice's Antitrust Division. Switching gears to private securities litigation, the update discusses: (i) recent numerical trends; (ii) the post-*Cyan* state court landscape; (iii) the circuit split on the standard for rebutting the *Basic* presumption at class certification; (iv) lower courts' interpretations of *Lorenzo* v. *SEC*; (v) the Supreme Court's remand in *Retirement Plans Committee of IBM* v. *Jander*; and (vi) the effects of COVID-19 on securities litigation.

This update was prepared by S&C litigation partners Julia Malkina and Jeffrey Scott and associate Andrew Kaufman, and was reviewed by other S&C litigation partners who are members of the Firm's industry-leading Securities Litigation and Criminal Defense and Investigations Practices.

Table of Contents

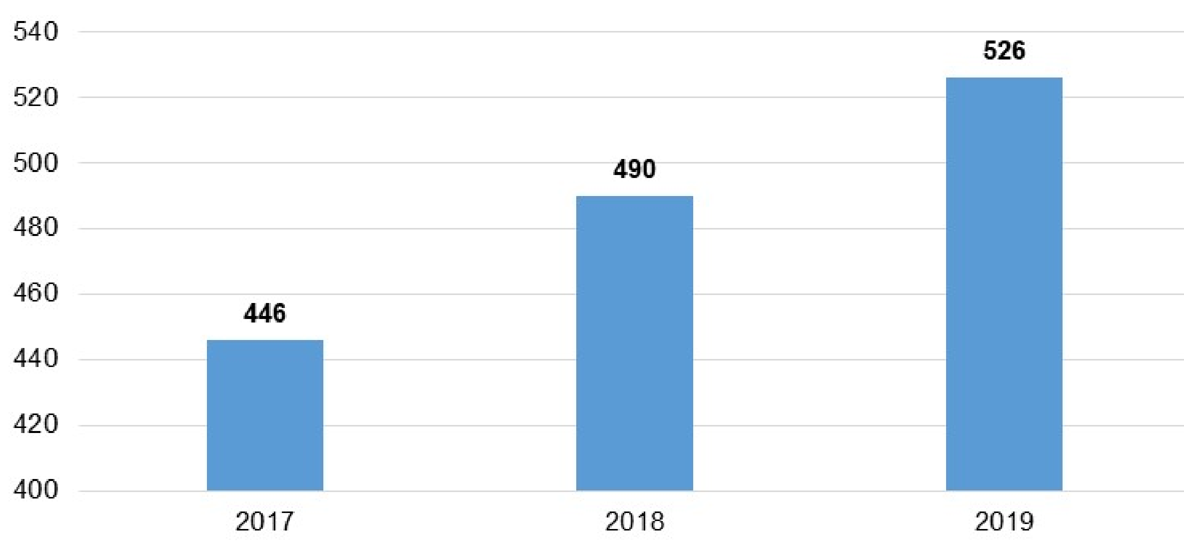
I. PART 1 – SECURITIES ENFORCEMENT

A. NUMERICAL TRENDS IN SEC ENFORCEMENT

In the wake of the last presidential election, many observers predicted a sharp decline in SEC enforcement activity. But the statistics show that those predictions missed the mark. The number of standalone enforcement actions increased in each fiscal year from 2017 through 2019.[1] In 2019, the SEC brought 526 standalone actions, up from 490 in 2018 and 446 in 2017—making 2019 one of the busiest years in the SEC's history.[2] In 2019, the top categories of standalone cases by primary classification were investment adviser and investment company cases at 36% of actions, securities offering cases at 21%, and issuer reporting and audit and accounting cases at 17%.[3]

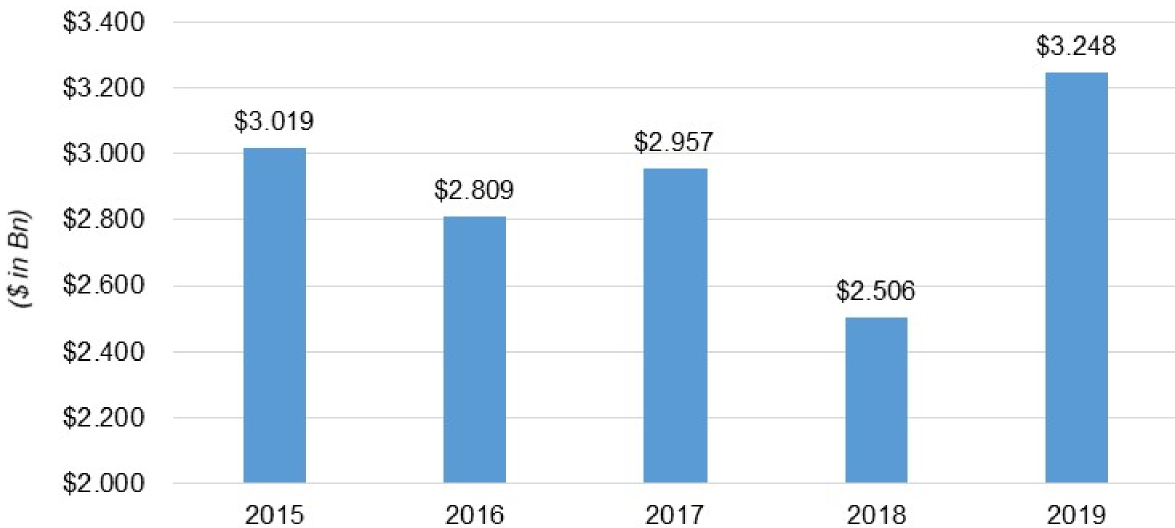
The SEC has also recently recovered a historic level of monetary remedies. In its fiscal year 2019 (which ended September 30, 2019), the SEC obtained approximately $3.25 billion in disgorgement and $1.1 billion in penalties, for a total recovery of approximately $4.35 billion—the highest total amount in the last five years.[4] The median amount recovered by the SEC per case in 2019 was $554,033, which is also the highest per case median amount in the last five years.[5] As discussed in more detail in this review, the Supreme Court's June 22, 2020 decision in *Liu* v. *SEC* upheld the SEC's power to seek disgorgement in federal court, subject to certain notable limitations. This is an important decision for the SEC, given how frequently the SEC uses disgorgement.

Standalone SEC Enforcement Actions FY 2017-2019



---
[1] SEC Division of Enforcement, 2019 Annual Report, at 14.
[2] *Id.*
[3] *Id.* at 15.
[4] *Id.* at 16.
[5] *Id.*

Total SEC Disgorgement FY 2015-2019



B. FOCUS AREAS OF SEC ENFORCEMENT

The Enforcement Division's Annual Report provides insight into its areas of focus. In its 2019 Annual Report, the Enforcement Division highlighted a number of such areas of enforcement focus.

"Main Street" Investors. Both Chairman Jay Clayton and the Enforcement Division have stated that protecting retail investors is a core principle of the SEC.[6] Over the last two years, the SEC has brought hundreds of cases alleging misconduct directed at retail investors.[7] In particular, the SEC has focused on its Share Class Selection Disclosure Initiative, announced in February 2018, pursuant to which the SEC agreed to recommend standardized settlement terms for investment advisory firms that self-reported by June 2018 their failures to disclose conflicts of interest associated with receipt of fees for placing clients in a 12b-1 fee paying share class, when a lower-cost share class of the same mutual fund was available.[8] In fiscal year 2019, the SEC recovered over $135 million for investors from 95 investment advisory firms through the Share Class Selection Disclosure Initiative.[9] The standardized terms for those settlements included consenting to cease-and-desist orders finding violations of Section 206(2) (and, for certain firms, Section 207) of the Investment Advisers Act of 1940, accepting a censure, disgorging improperly disclosed fees, and undertaking to review and correct all relevant disclosure documents, but no penalties or admission of the SEC's findings.[10]

---

[6] *Id.* at 2, 10-11; Jay Clayton, SEC Chairman, Remarks at the Economic Club of New York (July 12, 2017), *available at* https: //www.sec.gov/news/speech/remarks-economic-club-new-york.
[7] SEC Division of Enforcement, 2019 Annual Report, at 15.
[8] *Id.* at 14.
[9] *Id.* at 2.
[10] Press Release, SEC Share Class Initiative Returning More Than $125 Million to Investors (Mar. 11, 2019), *available at* https://www.sec.gov/news/press-release/2019-28.

In 2017, the SEC created the Retail Strategy Task Force, which uses data analytics to identify practices in the markets that harm retail investors.[11] To further its core objective of protecting retail investors, the SEC has brought cases focusing on affinity fraud, accounting fraud, Ponzi schemes, pump-and-dump schemes, and technology-driven securities fraud. The SEC has also brought a number of cases against public companies alleging fraud, deficient disclosure controls, misleading disclosure of risk factors, and misleading presentation of non-GAAP metrics.[12] In addition, the SEC has brought a number of cases against accounting firms, including high-profile actions against two of the "Big Four" accounting firms, KPMG LLP and Pricewaterhouse Coopers LLP.[13]

As a result of the SEC's focus on protecting retail investors, the operations, activities, and disclosures of investment managers, investment advisers, broker-dealers, auditors, issuers, and other public companies continue to remain under close scrutiny by the SEC.

Actions Against Individuals. The SEC has continued to state the importance of holding individuals accountable and pursuing individuals as part of its investigations.[14] For example, in fiscal year 2019, 69% of the SEC's standalone actions (excluding those brought as part of the Share Class Selection Disclosure Initiative) included charges against at least one individual.[15] In a speech regarding FCPA enforcement, then-Co-Director of the Enforcement Division, Steven Peikin, echoed a point made by Chairman Clayton at his confirmation hearing, emphasizing that "individual accountability drives behavior more than corporate accountability, a point which is supported by logic and experience."[16]

Cyber-Related Misconduct. As a result of profound technology changes affecting the markets, the Enforcement Division has dedicated significant resources to preventing cyber-related misconduct. The SEC established a Cyber Unit in 2017, and the Enforcement Division has brought many enforcement actions centered on digital assets and initial coin offerings.[17] The SEC has not only charged entities with fraud in connection with those offerings, but it has also charged companies and individuals with registration violations, unregistered broker-dealer activity, touting violations, and the unlawful operation of a national securities exchange through a digital asset trading platform. For example, in June 2020, the SEC charged lobbyist Jack Abramoff, among others, with conducting a fraudulent, unregistered offering of AML Bitcoin, alleging that the defendants had falsely claimed AML Bitcoin was a "new and improved version of bitcoin."[18]

---

[11] SEC Division of Enforcement, 2019 Annual Report, at 2, 11.
[12] *Id.* at 2-3.
[13] *Id.* at 4-5.
[14] *Id.* at 5, 17.
[15] *Id.* at 17.
[16] Steven Peikin, SEC Enforcement Division Co-Director, Reflections on the Past, Present, and Future of the SEC's Enforcement of the Foreign Corrupt Practices Act (Nov. 9, 2017), ***available at*** https://www.sec.gov/news/speech/speech-peikin-2017-11-09.
[17] SEC Division of Enforcement, 2019 Annual Report, at 12.
[18] Press Release, SEC Charges Issuer, CEO, and Lobbyist With Defrauding Investors in AML BitCoin (June 25, 2020), ***available at*** https://www.sec.gov/news/press-release/2020-145.

The Enforcement Division is likely to remain busy in this area, as the SEC has announced it has hundreds of cyber-related investigations pending.[19]

In addition to focusing on particular types of cases, the SEC is attempting to advance its priorities by employing specific enforcement strategies.

Coordination with Law Enforcement. Noting that civil sanctions alone can be inadequate, the SEC has emphasized that it often refers matters to, and investigates in parallel with, criminal authorities.[20] The SEC reported that, in fiscal year 2019, other regulators and law enforcement authorities requested access to the SEC's files for more than 400 investigations.[21] As a result, counsel representing companies and individuals before the SEC should always be alert to the possibility that the SEC is coordinating its investigation with other regulators and law enforcement.

Accelerating the Pace of Investigations. In addition to coordinating with law enforcement, the SEC has also stated that it will accelerate the pace of investigations.[22] In 2019, the SEC averaged approximately 24 months between case opening and filing of an enforcement action.[23] The SEC noted that it hopes to lower this metric in fiscal year 2020, especially in financial fraud and issuer disclosure cases, which took approximately 37 months between case opening and filing in 2019 due to their greater complexity.[24]

Because meaningful cooperation can substantially accelerate the time frame for bringing a case, the SEC has stated that it is looking to find additional ways "to message what companies and individuals have done to merit the cooperation credit they received."[25] In some instances, the SEC has included detailed information in public orders concerning the cooperation efforts of settling parties. The SEC has indicated that it anticipates doing so in the future as well.[26]

Seeking Non-Monetary Relief. In 2019, the Enforcement Division continued to pursue non-monetary relief, such as undertakings and independent consultants to review compliance with undertakings, as well as enhancement and implementation of policies and procedures. The Enforcement Division has stated that such non-monetary relief "is important to the Commission's effort to ensure future compliance with the securities laws."[27]

Office of the Whistleblower. Rounding out the SEC's list of priorities is streamlining and accelerating the evaluation of claims brought to the Office of the Whistleblower.[28] The Office of the Whistleblower was

[19] SEC Division of Enforcement, 2018 Annual Report, at 7.
[20] SEC Division of Enforcement, 2019 Annual Report, at 7.
[21] *Id.*
[22] *Id.* at 7-8.
[23] *Id.* at 7.
[24] *Id.*
[25] *Id.* at 8.
[26] *Id.*
[27] *Id.* at 18.
[28] *Id.* at 8.

instituted in 2011. The SEC noted that the Office of the Whistleblower received a record number of tips in fiscal year 2019.[29] Since the Office of the Whistleblower's inception, the SEC has obtained more than $2 billion in financial remedies from whistleblower tips.[30] In recognition of those tips, the SEC has awarded 83 whistleblowers over $500 million,[31] under the SEC's policy of allowing whistleblowers to apply for an award if an SEC action based on a tip results in monetary sanctions of more than $1 million.[32] To date, the largest individual award is $50 million—awarded a short time ago on June 4, 2020.[33]

C. COVID-19 RELATED DEVELOPMENTS

The COVID-19 pandemic is having a significant impact on the SEC's enforcement priorities and likely will continue to have such an impact, at least in the short term. In a May 12, 2020 speech, then-Co-Director Peikin announced that the SEC had formed a Coronavirus Steering Committee, comprising leaders across the Enforcement Division.[34] Among other things, this Committee's mandate is to identify and monitor areas of potential misconduct, ensure appropriate allocation of SEC resources, coordinate responses with other state and federal agencies, and ensure consistency in the Enforcement Division's handling of coronavirus-related matters.[35]

The Enforcement Division has been quite active in addressing potential misconduct related to COVID-19. For example, the SEC has issued more than 30 trading suspensions based on concerns about the adequacy and accuracy of coronavirus information.[36] The SEC has also pursued enforcement actions against certain companies for misstating their ability to provide testing and detection services for COVID-19.[37] Notably, the SEC brought these actions within weeks of the SEC becoming aware of the alleged misconduct. Indeed, then-Co-Director Peikin emphasized in recent remarks that "[t]here are numerous active investigations of COVID-19-related potential misconduct, many of which are also proceeding at an accelerated pace."[38]

On March 25, 2020, the Division of Corporation Finance issued guidance on disclosures in the context of COVID-19.[39] The guidance noted that the Division is "monitoring how companies are reporting the effects and risks of COVID-19 on their businesses" and outlined a series of questions for companies to consider in connection with their disclosure obligations, which focus on the impact of COVID-19 on a company's

---

[29] *Id.*
[30] *Id.*
[31] Press Release, SEC Awards Record Payout of Nearly $50 Million to Whistleblower (June 4, 2020), ***available at*** https://www.sec.gov/news/press-release/2020-126.
[32] *See* 17 C.F.R. § 240.21F-1, *et seq.*
[33] ***See supra*** n.31.
[34] Steven Peikin, SEC Enforcement Division Co-Director, Keynote Address: Securities Enforcement Forum West 2020 (May 12, 2020), ***available at*** https://www.sec.gov/news/speech/keynote-securities-enforcement-forum-west-2020.
[35] *Id.*
[36] *Id.*
[37] *See, e.g.*, SEC Charges Company for Misleading Covid-19 Claims, Litig. Rel. No. 24819 (2020); SEC Charges Penny Stock Company and Its CEO for Misleading Covid-19 Claims, Litig. Rel. No. 24820 (2020).
[38] *Supra* n.34.
[39] *See* SEC Division of Corporation Finance, Disclosure Guidance by Division of Corporation Finance, CF Disclosure Guidance: Topic No. 9 (Mar. 25, 2020), ***available at*** https://www.sec.gov/corpfin/coronavirus-covid-19.

financial condition, resources, operations, balance sheet, and similar matters.[40] The guidance also addressed reporting earnings and other financial results, including noting that "[t]o the extent a company presents a non-GAAP financial measure or performance metric to adjust for or explain the impact of COVID-19, it would be appropriate to highlight why management finds the measure or metric useful and how it helps investors assess the impact of COVID-19 on the company's financial position and results of operations."[41]

On April 3, 2020, the SEC's Office of the Chief Accountant ("OCA") issued a statement regarding the importance of high-quality financial reporting in light of the COVID-19 pandemic, detailing steps taken by the OCA in response to COVID-19.[42] Those steps include engaging with the Financial Accounting Standards Board and International Accounting Standards Board on COVID-19-related matters, working with the Public Company Accounting Oversight Board to address emerging COVID-19 issues, and meeting with stakeholders to promote high-quality financial reporting. On June 23, 2020, the OCA supplemented this statement with additional guidance. The June 23 statement reiterates the importance of financial reporting "in the functioning of our markets and in our collective national effort to mitigate the COVID-19 pandemic," and provides guidance on significant estimates and judgments, disclosure controls and procedures and internal controls over financial reporting, and ability to continue as a going concern, among other matters.[43] The June 23 statement also stresses the importance of audit committee oversight "[i]n these times of rapid change and increased uncertainty."[44]

On April 8, 2020, Chairman Clayton and William Hinman, Director of Corporation Finance, issued a public statement about the importance of COVID-related disclosures.[45] The statement urges public companies to "provide as much information as is practicable regarding their current financial and operating status, as well as their future operational and financial planning."[46] The statement also "encourage[s] companies that respond to our call for forward-looking disclosure to avail themselves of the safe-harbors for such statements."[47] Although the April 8 guidance states that the SEC "would not expect to second guess good faith attempts to provide investors and other market participants appropriately framed forward-looking information,"[48] companies should expect the SEC to monitor COVID-related disclosures closely and to bring enforcement actions if it deems those disclosures misleading or otherwise inadequate.

---

[40] *Id.*
[41] *Id.*
[42] Sagar Teotia, SEC Chief Accountant, Public Statement, Statement on the Importance of High-Quality Financial Reporting in Light of the Significant Impacts of COVID-19 (Apr. 3, 2020), ***available at*** https://www.sec.gov/news/public-statement/statement-teotia-financial-reporting-covid-19-2020-04-03.
[43] Sagar Teotia, SEC Chief Accountant, Public Statement, Statement on the Continued Importance of High-Quality Financial Reporting for Investors in Light of COVID-19 (June 23, 2020), ***available at*** https://www.sec.gov/news/public-statement/teotia-financial-reporting-covid-19-2020-06-23.
[44] *Id.*
[45] Jay Clayton and William Hinman, Public Statement, The Importance of Disclosure – For Investors, Markets and Our Fight Against COVID-19 (Apr. 8, 2020), ***available at*** https://www.sec.gov/news/public-statement/statement-clayton-hinman.
[46] *Id.*
[47] *Id.*
[48] *Id.*

On May 4, 2020, Chairman Clayton and Rebecca Olsen, Director of the Office of Municipal Securities, issued additional guidance directed to issuers of municipal securities "intended to parallel the [April 8] Corporate Issuer Statement."[49] The May 4 guidance explains that although "there are significant differences between our corporate capital markets and our municipal securities markets, the importance of high quality disclosure, particularly in times of uncertainty, is consistent."[50] The May 4 guidance also emphasizes "a similar approach" to the April 8 guidance "to the provision of current and, to the extent practicable, forward-looking disclosure."[51]

On June 23, 2020, the Division of Corporation Finance issued supplemental guidance "encourag[ing] companies to provide disclosures that allow investors to evaluate the current and expected impact of COVID-19 through the eyes of management and to proactively revise and update disclosures as facts and circumstances change."[52] The additional guidance contains a series of questions for companies to consider as they evaluate COVID-related disclosure obligations, including questions regarding how COVID-19 has impacted operational challenges, liquidity risks, and barriers to obtaining funding.[53]

On August 12, 2020, the SEC's Office of Compliance Inspections and Examinations issued a risk alert identifying "a number of COVID-19-related issues, risks, and practices relevant to SEC-registered investment advisers and broker-dealers."[54] The risk alert encourages firms to: (i) review their policies and procedures regarding the protection of investor assets, including taking steps to ensure that COVID-related withdrawals from retirement accounts are secure; (ii) review their policies and procedures regarding supervision of personnel in light of COVID-related changes to working conditions, including increased teleworking; (iii) review their policies and procedures regarding fees, expenses, and financial transactions; (iv) take into account the heightened risk of investment fraud; (v) review their business continuity plans; and (vi) assess their methods, policies, and procedures for protecting sensitive information.[55]

D. SCOPE OF SEC DISGORGEMENT AUTHORITY AND *LIU* v. *SEC*

On June 22, 2020, the Supreme Court issued its much-awaited decision in *Liu* v. *SEC*, a case challenging the SEC's disgorgement authority in federal court. The Court held 8-1 that disgorgement is a type of "equitable relief" that the SEC may obtain in federal court subject to certain traditional equitable limitations that will be the subject of litigation for years to come.[56] *Liu* does not address whether these limitations will

---

[49] Jay Clayton and Rebecca Olsen, Public Statement, The Importance of Disclosure for our Municipal Markets (May 4, 2020), *available at* https://www.sec.gov/news/public-statement/statement-clayton-olsen-2020-05-04.
[50] *Id.*
[51] *Id.*
[52] *See* SEC Division of Corporation Finance, Coronavirus (COVID-19) – Disclosure Considerations Regarding Operations, Liquidity, and Capital Resources, CF Disclosure Guidance: Topic No. 9A (June 23, 2020), *available at* https://www.sec.gov/corpfin/covid-19-disclosure-considerations.
[53] *Id.*
[54] *See* SEC Office of Compliance Inspections and Examinations, Risk Alert, Select COVID-19 Compliance Risks and Considerations for Broker-Dealers and Investment Advisers (Aug. 12, 2020), *available at* https://www.sec.gov/files/Risk%20Alert%20-%20COVID-19%20Compliance.pdf.
[55] *Id.*
[56] *Liu* v. *SEC*, 140 S. Ct. 1936 (2020).

have any application in administrative proceedings. In addition, a bill that has passed the House of Representatives and is currently in committee in the Senate would provide the SEC with broad disgorgement authority in federal court.[57] But at least for now, *Liu* provides important limitations on the scope of disgorgement that the SEC may seek in federal court.

Under 15 U.S.C. § 78u(d)(5), the SEC is authorized to obtain "any equitable relief . . . for the benefit of investors" in securities fraud actions it pursues in federal court. Unlike the statute setting out the relief the SEC may seek in administrative proceedings,[58] § 78u(d)(5) does not expressly include disgorgement as a remedy the SEC may seek. Nevertheless, for decades courts had agreed that the SEC may invoke its "equitable relief" authority to seek disgorgement of the proceeds of a defendant's fraud in federal court. But in a recent case, *Kokesh* v. *SEC*, the Supreme Court described SEC disgorgement as "bear[ing] all the hallmarks of a penalty," raising the question whether that remedy is authorized by § 78u(d)(5)'s reference to "equitable relief," which historically has excluded punitive remedies.[59]

In *Liu*, the Court held that "a disgorgement award that does not exceed a wrongdoer's net profits and is awarded for victims is equitable relief permissible under § 78u(d)(5)."[60] The Court's opinion focuses on two principles of equity jurisprudence: *first*, that "equity practice [has] long authorized courts to strip wrongdoers of their ill-gotten gains," and *second*, that "to avoid transforming an equitable remedy into a punitive sanction, courts restricted the remedy to an individual wrongdoer's net profits to be awarded for victims."[61]

The Court identified three limitations to be fleshed out by the lower courts. *First*, the Court explained that the SEC is "generally require[d]" "to return a defendant's gains to wronged investors for their benefit."[62] The Court left open, however, whether and when "the SEC's practice of depositing disgorgement funds with the Treasury may be justified" if "it is infeasible to distribute the collected funds to investors."[63] The SEC has historically not returned all disgorged funds to investors. For example, in 2019, the SEC returned approximately $1.2 of $3.25 billion of such funds to investors.[64] The SEC is likely to test the scope of this limitation in the years to come.

Second, the Court concluded that disgorgement should be limited to "net profits from unlawful activity."[65] The Court thus explained that "courts must deduct legitimate expenses before ordering disgorgement."[66]

[57] *See* H.R. 4344 (as passed by House Nov. 18, 2019).
[58] 16 U.S.C. §77h-1(e).
[59] *Kokesh* v. *SEC*, 137 S. Ct. 1635, 1644 (2017).
[60] *Liu*, 140 S. Ct. at 1940.
[61] *Id.* at 1942.
[62] *Id.* at 1948.
[63] *Id*.
[64] SEC Division of Enforcement, 2019 Annual Report, at 9.
[65] *Liu*, 140 S. Ct. at 1942.
[66] *Id.* at 1950.

The Court left open, however, what counts as a "legitimate expense."[67] The scope of a "legitimate expense" will likely be the subject of much litigation.

Third, the Court explained that "collective liability," such as a joint and several disgorgement award, cannot be imposed if it violates "the common-law rule requiring individual liability for wrongful profits."[68] But the Court noted that certain types of "collective liability"—such as that for "partners engaged in concerted wrongdoing"—may be permissible.[69] Here too, lower courts will need to look to equitable principles to determine whether "collective liability" is permissible in a given case.

E. DOJ AND SEC MEMORANDUM OF UNDERSTANDING ON COORDINATING EFFORTS TO INCREASE COMPETITION

On June 22, 2020, the SEC and the Department of Justice's Antitrust Division entered into a memorandum of understanding ("MOU") "to foster cooperation and communication between the agencies with the aim of enhancing competition in the securities industry."[70] The MOU "formaliz[es] the exchange of knowledge between" the SEC and DOJ, with the goal of "foster[ing] even greater collaboration and cooperation to ensure" that the agencies "maintain the efficient and competitive markets that American investors rely on."[71] "[K]ey provisions" of the MOU include a framework for regular discussions and periodic meetings between agency officials and the "exchange of information and expertise the agencies believe to be potentially relevant and useful to their oversight and enforcement responsibilities."[72]

Notably, the MOU follows a February 14, 2020 SEC announcement of a proposal to modernize infrastructure that collects, consolidates, and disseminates market data for exchange-listed national market system stocks ("NMS")—a proposal which, according to the SEC, would "seek to introduce competitive forces into this core component of the national market system for the first time."[73] According to Chairman Clayton, by "introducing competitive forces into the market," the proposal "would enhance transparency and ensure that improved NMS market data is available on terms that are accessible to a wide variety of participants in today's markets."[74] Although it remains to be seen what effect this proposal and the MOU will have on SEC enforcement actions, market participants should expect an increased focus on—and greater scrutiny of—potentially anti-competitive conduct in the securities markets.

[67] *Id.*
[68] *Id.* at 1949.
[69] *Id.* at 1950.
[70] Press Release, Securities and Exchange Commission and Justice Department's Antitrust Division Sign Historic Memorandum of Understanding (June 22, 2020), *available at* https://www.sec.gov/news/press-release/2020-140.
[71] *Id.*
[72] *Id.*
[73] Press Release, SEC Proposes to Modernize Key Market Infrastructure Responsible for Collecting, Consolidating, and Disseminating Securities Market Data (Feb. 14, 2020), *available at* https://www.sec.gov/news/press-release/2020-34.
[74] *Id.*

II. PART 2 – PRIVATE SECURITIES LITIGATION

A. NUMERICAL TRENDS IN PRIVATE SECURITIES LITIGATION

The pace of private securities class action filings has slowed significantly in the first half of 2020 as compared to the pace set in 2017 to 2019—presumably caused at least in part by the COVID-19 pandemic. In 2019, securities class actions proceeded at a record pace, with a total of 428 new class action complaints filed in federal and state courts.[75] 2019 filings were up from 420 in 2018, and 413 in 2017, and were nearly double the 20-year average of 215 from 1997 to 2018.[76] In terms of "core" securities filings (excluding M&A-related litigation), federal filings in 2019 against technology companies more than doubled since 2017, from 14 to 29. Similarly, core federal filings against communications companies in 2019 reached their highest number since 2002, with 37 in 2019. By contrast, core federal filings against financial sector companies in 2019, at 22, were below the 20-year historical average.[77]

A driving force in the increase in securities class actions in 2019 was the Supreme Court's 2018 decision in *Cyan*, which held that plaintiffs may bring claims under the 1933 Act in state court and that defendants may not remove those claims to federal court. The 1933 Act encompasses claims that a registration statement or prospectus contained material misstatements or omissions. Since *Cyan*, there has been a significant growth in the filing of 1933 Act claims in state court. In fact, more 1933 Act claims were filed in state court in 2019 than in federal court.[78] In total, plaintiffs filed 65 class actions under the 1933 Act in 2019, a nearly 60% increase from 2018, and the highest number on record.[79] 49 of those filings were in state court, with 18 in New York, 15 in California, and 16 in the other states combined.[80]

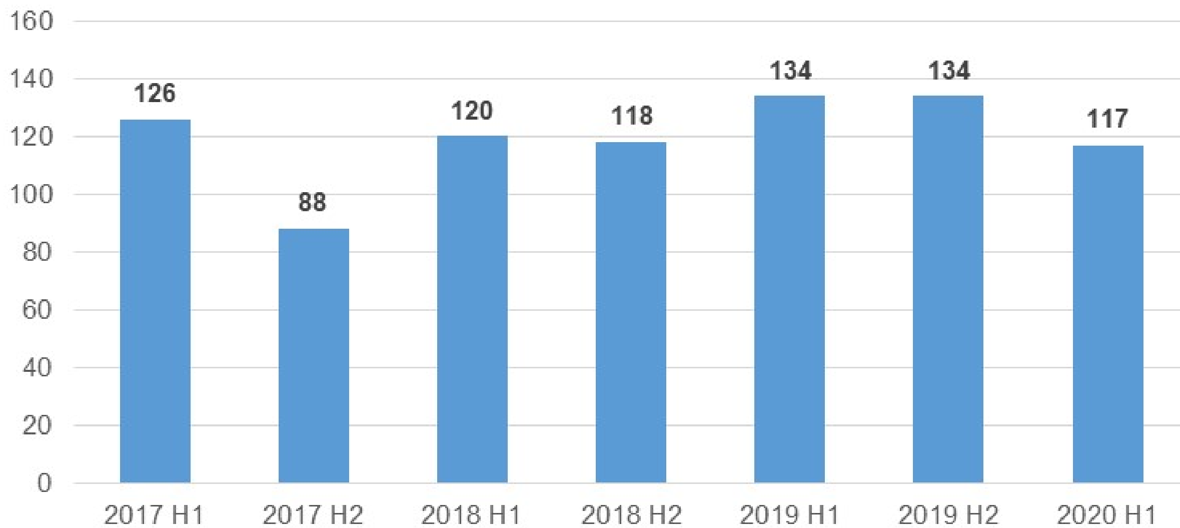
The first half of 2020 has seen the pace of new securities class actions filings slow significantly. There were 117 core filings between January and the end of June, down 18% from the second half of 2019.[81] This slowdown was seen most profoundly in the number of state court 1933 Act class action filings, with only 12 in the first half of 2020, as compared to 29 in the second half of 2019.[82] The decline was especially precipitous in California, which had only one 1933 Act class action filing in the first half of 2020.[83] Federal court 1933 Act class action filings have also declined, with only 11 cases filed in the first half of 2020, as compared to 21 in the second half of 2019—a decline that accounts for most of the difference in total securities class actions filings in federal court between the first half of 2020 and the second half of 2019.[84]

---

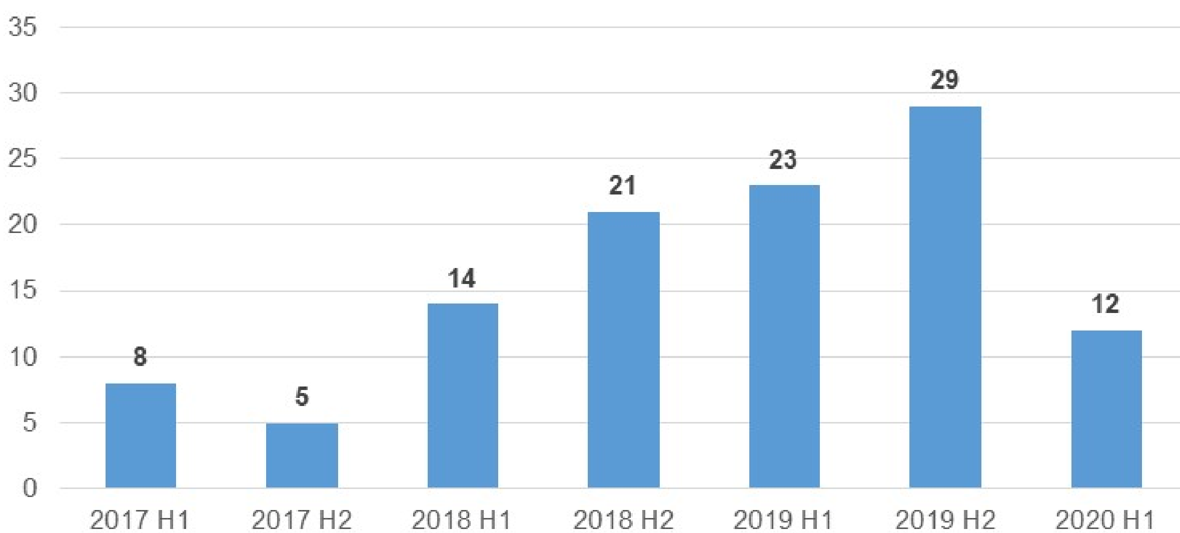
[75] Cornerstone Research, *Securities Class Action Filings 2019 Year in Review*, at 5, *available at*: https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2019-Year-in-Review.
[76] *Id.*
[77] *Id.* at 36.
[78] *Id.* at 4.
[79] *Id.* at 25.
[80] *Id.* at 19.
[81] Cornerstone Research, *Securities Class Action Filings 2020 Midyear Assessment* at 1, https://www.cornerstone.com/Publications/Reports/2020-Securities-Class-Action-Filings-2020-Midyear-Assessment.
[82] *Id.* at 14.
[83] *Id.*
[84] *Id.* at 16.

The number of federal court filings against communications and technology companies in the first half of 2020 also declined relative to the second half of 2019, with 8 filings against communications companies, down from 18 in the second half of 2019, and 14 filings against technology companies, down from 17 in the second half of 2019.[85] The decline in the filing of securities class actions in both federal and state courts may be exclusively or partially attributable to the COVID-19 pandemic, but this will likely not be fully understood until the effects of the COVID-19 pandemic recede.

Core Securities Filings First Half of 2017 to First Half of 2020



State Court 1933 Act Filings First Half of 2017 to First Half of 2020



[85] *Id.* at 22.

B. STATE COURT PROCEEDINGS FOLLOWING *CYAN INC.* v. *BEAVER COUNTY EMPLOYEES RETIREMENT FUND*

With the increase in state court 1933 Act filings following the Supreme Court's decision in *Cyan*, state court jurisprudence on key issues in those suits is continuing to develop, including threshold procedural questions with significant effects on the course of state court securities litigation.

Applicability of PSLRA Discovery Stay. One key issue that is currently the subject of litigation is the applicability of the PSLRA's automatic discovery stay to state court 1933 Act claims. The PSLRA provides that "[i]n any private action arising under this chapter, all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss."[86] Federal courts have consistently held that this provision applies to federal court 1933 Act claims absent exceptional circumstances. But courts both across and within states have disagreed on whether the provision applies to state court 1933 Act claims, and there is not yet appellate guidance on the issue.

Judges in New York state courts, which have seen one of the largest increases in 1933 Act cases since the *Cyan* decision, have split on the issue. One trial court has held that the PSLRA's automatic discovery stay applies to state court 1933 Act claims based on the plain language of the statute. The court explained that "[t]he simple, plain, and unambiguous language expressly provides that discovery is stayed during a pending motion to dismiss '[i]n any private action arising under this subchapter,'" which includes state court 1933 Act claims.[87] The court contrasted that language with other PSLRA provisions, which refer to actions brought "pursuant to the Federal Rules of Civil Procedure," which do not include state court 1933 Act claims.[88] Looking to the purpose of the automatic discovery stay, the court further reasoned that allowing discovery to go forward while a motion to dismiss is pending would "run afoul of the well-recognized purpose" of the PSLRA and the Securities Litigation Uniform Standards Act "to curtail . . . significant discovery requests in otherwise meritless lawsuits . . . in the hope of encouraging early settlement."[89] In applying the PSLRA's automatic discovery stay to state court 1933 Act claims, another trial court has similarly reasoned that "[t]he important purpose underlying enactment of the automatic stay—ensuring that cases have merit at the outset—should not be disregarded merely because a federal cause of action is being prosecuted in state court."[90]

By contrast, another New York trial court has held in two cases that the PSLRA's automatic discovery stay does not apply to state court 1933 Act claims.[91] That court reasoned that applying the automatic discovery

[86] 15 U.S.C. § 78u-4(b)(3)(B).
[87] *In re Everquote, Inc. Sec. Litig.*, 65 Misc. 3d 226, 236 (N.Y. Sup. Ct., N.Y. Cty. 2019).
[88] *Id.* at 237. A Connecticut trial court has also found that the PSLRA's automatic discovery stay applies to state court 1933 Act claims based on a similar textual analysis. *See City of Livonia Ret. Health & Disability Benefits Plan* v. *Pitney Bowes Inc.*, 2019 WL 2293924, at *4 (Conn. Super. May 15, 2019).
[89] *Everquote*, 65 Misc. 3d at 240.
[90] *In re Greensky, Inc. Sec. Litig.*, 2019 WL 6310525, at *2 (N.Y. Sup. Ct., N.Y. Cty. Nov. 25, 2019).
[91] *In re PPDAI Grp. Sec. Litig.*, 2019 WL 2751278 (N.Y. Sup. Ct., N.Y. Cty. July 1, 2019); *In re Dentsply Sirona, Inc. S'holders Litig.*, 2019 WL 3526142 (N.Y. Sup. Ct., N.Y. Cty. Aug. 2, 2019).

stay to such claims "would undermine *Cyan*'s holding that '33 Act cases may be heard in state courts."[92] To date, no New York state appellate court has weighed in on the issue.

California precedent is similarly divided. In a pre-*Cyan* case, one California court held that the PSLRA stay applies, similarly contrasting the stay provision's reference to "any private action arising under this title" with "extensive [references] to the Federal Rules of Civil Procedure" in other PSLRA provisions.[93] But another California court held in a recent post-*Cyan* case that "the PSLRA's provision for a discovery stay is of a procedural nature, and therefore only applies to actions filed in federal court."[94]

With conflicting rulings in New York and California—the two states with the most 1933 Act class action filings—and no current appellate guidance, this issue will likely continue to percolate in state trial courts.

Stays of State Cases in Favor of Federal Cases. With the rise in state court 1933 Act filings has also come an increase in parallel filings in both state and federal court. In 2019, approximately 45% of state court 1933 Act cases had parallel federal proceedings, raising the issue of when cases should be stayed in favor of the proceedings pending in the other forum.[95] Defendants in state court 1933 Act cases have advocated for stays or dismissals in favor of federal proceedings to avoid waste of resources and inconsistent rulings in litigating duplicative claims, as well as to benefit from the federal courts' greater experience with and interest in determining questions of federal securities law. By contrast, many plaintiffs' lawyers have pursued a race to judgment approach, testing various state courts as alternative venues to pursue 1933 Act claims, regardless of whether there is a parallel securities class action in federal court. State and federal trial courts across the country have begun to grapple with the question of whether and how to proceed with competing putative class actions. In determining whether to stay state 1933 Act cases in favor of federal proceedings, New York and other state courts have looked to the general comity factors, including: (i) whether the federal action was commenced first and the stage of litigation; (ii) whether there is substantial overlap between the parties, issues, and relief requested; (iii) where a more complete disposition of issues may be obtained; (iv) whether a stay will avoid duplication of effort, waste of judicial resources, and the risk of inconsistent rulings; (v) whether plaintiffs have demonstrated how they would be prejudiced by a stay; and (vi) which court has greater familiarity with the trial of such issues.[96]

Perhaps the most crucial factor in New York courts' stay analysis thus far has been which action was filed first. Several New York courts have stayed state actions filed after similar federal proceedings, relying on the "first-in-time" rule.[97] As one court put it, "New York courts generally follow the . . . 'first-in-time' rule,

---

[92] *PPDAI*, 2019 WL 2751278, at *7.
[93] *Milano* v. *Auhll*, 1996 WL 33398997, at *2-4 (Cal. Super. Ct. Oct. 2, 1996).
[94] *Switzer* v. *Hambrecht & Co.*, 2018 WL 4704776, at *1 (Cal. Super. Ct. Sept. 19, 2018).
[95] Cornerstone Research, *Securities Class Action Filings 2019 Year in Review*, at 4.
[96] *See, e.g.*, *Labourers' Pension Fund of Cent. & Eastern Canada* v. *CVS Health Corp.*, 2020 WL 2857654, at *3 (N.Y. Sup. Ct., N.Y. Cty. June 1, 2020) (*citing Asher* v. *Abbott Labs.*, 307 A.D.2d 211, 212 (N.Y. 1st Dep't 2003)).
[97] *See, e.g.*, *Mahar* v. *Gen. Elec. Co.*, 112 N.Y.S.3d 879, 887 (N.Y. Sup. Ct., N.Y. Cty. 2019); *In re Nio Inc. Sec. Litig.*, No. 653422/2019, slip op., NYSCEF No. 86 (N.Y. Sup. Ct., N.Y. Cty. Dec. 13, 2019); *Gordon* v. *Gridsum Holding Inc.*, 2019 WL 1593484, at *1 (N.Y. Sup. Ct., N.Y. Cty. Apr. 10, 2019); *In re Qudian Sec. Litig.*, 2018 WL 6067209, at *2 (N.Y. Sup. Ct., N.Y. Cty. Nov. 14, 2018).

which provides that the court which has first taken jurisdiction is the one in which the matter should be determined and it is a violation of the rules of comity to interfere."[98]

Unlike the 1933 Act, the 1934 Act, which governs the sale of securities on the secondary market, provides the federal courts with exclusive jurisdiction. Allowing for the disposition of both 1933 Act and 1934 Act claims in one forum also appears to be an important factor in some decisions to stay state cases in favor of federal proceedings. For example, although the cases were filed "roughly contemporaneously" and the state court action was "more advanced than the federal court action," one New York trial court granted a stay in favor of the first-filed federal action, reasoning that "the federal action ha[d] the potential to resolve not just the 1933 Securities Act claims . . . but also 1934 Act claims" and that it would "manifestly be a waste of judicial resources to have duplicative claims pending in two different courts."[99]

By contrast, New York trial courts have thus far been significantly less likely to grant a stay in favor of a federal action when the state court case was filed first.[100] In denying a stay in such a case, one New York trial court noted that "[c]eding responsibility to federal courts without good cause for doing so simply based on tradition would erode what Congress expressly intended as recognized by the Supreme Court in *Cyan*."[101] New York trial courts have denied stays even where the later-filed federal action included 1934 Act claims that could not be resolved in the state proceedings, reasoning that "[i]f the first-to-file rule is uniformly abandoned whenever later filed federal court actions assert other federal claims along with '33 Act claims, New York state courts would never exercise their jurisdiction to resolve first-filed '33 Act claims."[102] To date, no New York appellate court has decided these issues.

Results in other states have likewise been mixed. In Michigan, a state trial court dismissed a putative class plaintiff's 1933 Act claims based on a similar first-filed rule and the doctrine of *forum non conveniens* where the defendants were not headquartered in Michigan and several duplicative putative class actions were already pending in state and federal courts in Tennessee.[103] In a related case, a Tennessee state trial court declined to stay a 1933 Act case in favor of an overlapping case in federal court that was filed shortly after the state court case was filed.[104]

Applicable Pleading Standards. In federal court, 1933 Act claims are subject to, at a minimum, the *Twombly/Iqbal* "plausibility" pleading standard. Federal courts have held that the heightened pleading standard under Federal Rule of Civil Procedure 9(b)—which requires plaintiffs to "state with particularity the

[98] *Mahar*, 112 N.Y.S.3d at 887.
[99] *In re Nio*, No. 653422/2019, slip op. at 1.
[100] *See, e.g.*, *In re Altice USA, Inc. Sec. Litig.*, 2020 WL 3580012, at *2 (N.Y. Sup. Ct., N.Y. Cty. June 4, 2020); *Greensky, Inc. Sec. Litig.*, 2019 WL 6310525, at *1 (N.Y. Sup. Ct., N.Y. Cty. Nov. 25, 2019); *Araujo* v. *Uxin Ltd.*, 2019 WL 3250017, at *1 (N.Y. Sup. Ct., N.Y. Cty. July 15, 2019).
[101] *Greensky*, 2019 WL 6310525, at *1.
[102] *PPDAI*, 2019 WL 2751278, at *7; *see also Dentsply*, 2019 WL 3526142, at *6 (similar); *Hoffman* v. *AT&T Inc.*, 2019 WL 2578360, at *2 (N.Y. Sup. Ct., N.Y. Cty. June 24, 2019) ("In short, the 'first filed' rule must have some vitality in a post-*Cyan* world.").
[103] *Nurlybayev* v. *SmileDirectClub, Inc.*, No. 19-177527-CB, Opinion and Order re: Summary Disposition (Mich. Cir. Ct., Oakland Cty. Feb. 26, 2020).
[104] *In re SmileDirectClub, Inc., Sec. Litig.*, No. 19-1169-IV, Order (Tenn. Ch. Ct. June 4, 2020).

circumstances constituting fraud or mistake"—applies to 1933 Act claims "insofar as the claims are premised on allegations of fraud."[105] As the Second Circuit has explained, although a 1933 Act claim is not necessarily dependent on proof of fraud, Rule 9(b) "is cast in terms of the *conduct alleged*, and is not limited to allegations styled or denominated as fraud or expressed in terms of the constituent elements of a fraud cause of action."[106]

There is more variation in state court pleading standards, some of which are viewed as more lenient than the federal standard. For example, in California, a complaint requires only a "statement of the facts constituting the cause of action, in ordinary and concise language." Cal. Civ. Proc. § 425.10(a)(1). The large volume of 1933 Act cases in California is likely one reason why, between 2010 and 2019, motions to dismiss claims brought under Section 11 of the 1933 Act have been granted in only 26% of cases in state court, as opposed to 43% of cases in federal court over the same timeframe.[107]

Like federal courts, some state courts also have imposed heightened pleading standards for complaints that sound in misrepresentation or fraud even if fraud is not a required element of the asserted claim. In New York, for example, the baseline pleading standard requires pleading facts "sufficiently particular to give the court and parties notice of the transactions, occurrences, or series of transactions or occurrences, intended to be proved and the material elements of each cause of action or defense."[108] But whether the CPLR 3016(b) heightened pleading standard for misrepresentations—under which "the circumstances constituting the wrong shall be stated in detail"—applies to 1933 Act claims has been the subject of recent litigation.[109] One New York trial court held that the CPLR 3016(b) heightened pleading standard applied to 1933 Act claims because the complaint alleged that the offering documents "contain[ed] misrepresentations."[110] Other New York trial courts have disagreed, with one court ruling that the CPLR 3016(b) heightened pleading standard "does not apply to negligence actions," and a "plaintiff need allege no more than negligence" for 1933 Act claims.[111] The court further reasoned that applying the CPLR 3016(b) heightened pleading standard would create "a disparity in pleading standards" based on whether the 1933 Act claims are brought in state or federal court.[112] Several appeals of trial court decisions on motions to dismiss 1933 Act claims are now pending in the New York Appellate Division, which may provide further clarity on this issue in New York.

Federal Forum Selection Provisions. With the additional burdens, risks, and uncertainties of state court 1933 Act claims, some companies have added a Federal Forum Provision ("FFP") to their charters or bylaws providing that all 1933 Act claims against them must be brought in federal court. In *Salzberg* v.

[105] *Rombach* v. *Chang*, 355 F.3d 164, 171 (2d Cir. 2004); *see also Rubke* v. *Capitol Bancorp Ltd*, 551 F.3d 1156, 1161 (9th Cir. 2009).
[106] *Rombach*, 355 F.3d at 171 (emphasis added).
[107] Cornerstone Research, *Securities Class Action Filings 2019 Year in Review*, at 26.
[108] CPLR 3013.
[109] CPLR 3016(b).
[110] *Hoffman* v. *AT&T Inc.*, 2020 WL 2236189, at *2 (N.Y. Sup. Ct., N.Y. Cty. May 6, 2020).
[111] *In re Netshoes Sec. Litig.*, 2020 WL 2893433, at *3-4 (N.Y. Sup. Ct., N.Y. Cty. June 2, 2020).
[112] *Id.* at *5.

Sciabacucchi, the Delaware Supreme Court considered the validity of FFPs under Delaware corporate law.[113]

There, the plaintiff, a shareholder in three companies with FFPs in their certificates of incorporation (Blue Apron Holdings, Inc., Roku, Inc., and Stitch Fix, Inc.), sought a declaratory judgment in the Delaware Court of Chancery that the FFPs were invalid under Delaware law. The Court of Chancery granted summary judgment in favor of the plaintiff, holding that the "constitutive documents of a Delaware corporation cannot bind a plaintiff to a particular forum when the claim does not involve rights or relationships that were established by or under Delaware's corporate law."[114]

The Delaware Supreme Court reversed, holding that the FFPs are facially valid under the Delaware General Corporation law ("DGCL") and do not violate Delaware public policy. Under Section 102 of the DGCL, a Delaware company's certificate of incorporation may contain "[a]ny provision for the management of the business and for the conduct of the affairs of the corporation" and "any provision creating, defining, limiting and regulating the powers of the corporation, the directors, and the stockholders, or any class of the stockholders," as long as such provisions "are not contrary to" Delaware law.[115] The court reasoned that the FFPs are facially valid because they "could easily fall within either of these broad categories": "The drafting, reviewing, and filing of registration statements by a corporation and its directors"—from which 1933 Act claims arise—"is an important aspect of a corporation's management of its business and affairs and of its relationship with its stockholders."[116] In holding that the FFPs do not violate Delaware public policy, the court explained that "the DGCL allows immense freedom for businesses to adopt the most appropriate terms for the organization, finance, and governance of their enterprise."[117] The court, however, left open that FFPs could be subject to "as applied" challenges and could be invalidated "if adopted or used for an inequitable purpose."[118]

As the court recognized, FFPs can provide "certain efficiencies in managing the procedural aspects of securities litigation following the United States Supreme Court's decision in *Cyan*."[119] It remains to be seen, however, whether non-Delaware courts—where most state court 1933 Act cases are brought—will enforce FFPs in 1933 Act cases against Delaware corporations. If other state courts enforce FFPs, they may become a significant tool in curbing the rise of state court 1933 Act claims.

C. PRICE IMPACT AND REBUTTING THE *BASIC* PRESUMPTION

An important issue that continues to be litigated in federal securities class actions is the burden defendants bear for rebutting the *Basic* presumption of classwide reliance at the class certification stage. In *Halliburton*

[113] 227 A.3d 102 (Del. 2020).
[114] *Id.* at 112.
[115] *Id.* at 113.
[116] *Id.* at 114.
[117] *Id.* at 116.
[118] *Id.* at 135.
[119] *Id.* at 114.

Co. v. *Erica P. John Fund, Inc.* ("*Halliburton II*"), the Supreme Court declined to overturn *Basic* but held that "defendants should at least be allowed to defeat the presumption at the class certification stage through evidence that the misrepresentation did not in fact affect the stock price."[120] The Court explained that whether "a misrepresentation 'was reflected in the market price at the time of [the] transaction' . . . has everything to do with the issue of predominance at the class certification stage."[121] But the Court left open the standard defendants must meet to rebut the presumption through a showing of a lack of price impact.

A circuit split has developed over the burden defendants bear for rebutting the *Basic* presumption, with the Eighth Circuit on one side and the Second and Seventh Circuits on the other. In *IBEW Local 98 Pension Fund* v. *Best Buy Co.*, the Eighth Circuit held that "defendants had the burden to come forward with evidence showing a lack of price impact," leaving plaintiffs with the ultimate burden of persuasion.[122] In doing so, the Eighth Circuit relied on Federal Rule of Evidence 301, which provides that "the party against whom a presumption is directed has the burden of producing evidence to rebut the presumption" while the burden of persuasion "remains on the party who had it originally."

By contrast, in *Waggoner* v. *Barclays PLC*, the Second Circuit expressly disagreed with the Eighth Circuit's application of Rule 301, holding that defendants bear "the burden of persuasion, not production" for rebutting the *Basic* presumption at the class certification stage.[123] To rebut the *Basic* presumption at the class certification stage in the Second Circuit, a defendant thus must "disprov[e] reliance by a preponderance of the evidence."[124] In its recent decision in *In re Allstate Corp. Securities Litigation*, the Seventh Circuit "agree[d]" with the Second Circuit that Rule 301 "imposes no impediment to our conclusion that [once plaintiffs have made a prima facie showing] the burden of persuasion, not production, to rebut the *Basic* presumption shifts to defendants."[125]

D. LOWER COURT INTERPRETATIONS OF *LORENZO* v. *SEC*

Rule 10b-5(b) makes it unlawful "[t]o make any untrue statement of a material fact" in connection with the purchase or sale of securities. In turn, Rule 10b-5(a) and (c)—the "scheme liability" provisions—make it unlawful, in connection with the purchase or sale of securities, "to employ any device, scheme, or artifice to defraud" and "to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit."[126] In 2011, in *Janus Capital Group, Inc.* v. *First Derivative Traders*, the Supreme Court clarified the scope of liability under Rule 10b-5(b), holding that only "the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it," could be

---

[120] 573 U.S. 258, 279 (2014).
[121] *Id.* at 283.
[122] 818 F.3d 775, 782 (8th Cir. 2016).
[123] 875 F.3d 79, 103 (2d Cir. 2017).
[124] *Id.* at 99.
[125] 2020 WL 4013360, at *10 (7th Cir. July 16, 2020) (alteration in original).
[126] Sections 17(a)(1) and (a)(3) of the 1933 Act, 15 U.S.C. § 77q(a)(1), (a)(3), contain similar provisions, prohibiting the use of any "device, scheme, or artifice to defraud" and "any transaction, practice, or course of business which operates or would operate as a fraud or deceit" in the offer or sale of securities.

considered the "maker" of a false or misleading statement.[127] The Court further held that "[o]ne who prepares or publishes a statement on behalf of another is not its maker."[128]

Following *Janus*, a circuit split developed over whether a defendant who was not the "maker" of an alleged misstatement under *Janus* could nevertheless be held liable for that misstatement under Rule 10b-5(a) and (c). The Second, Eighth, and Ninth Circuits held that "a scheme liability claim must be based on conduct beyond misrepresentations or omissions actionable under Rule 10b-5(b)(5)."[129] Conversely, the Eleventh and D.C. Circuits rejected "that actions involving false statements must fit within Rule 10b-5(b) and cannot be brought separately under Rule 10b-5(a) or (c)."[130]

The Supreme Court granted certiorari on this issue and clarified the scope of "scheme" liability under Rule 10b-5(a) and (c) in its March 27, 2019 decision in *Lorenzo* v. *SEC*.[131] The Court rejected the argument that each provision of Rule 10b-5 "should be read as governing different, mutually exclusive, spheres of conduct."[132] To hold that Rule 10b-5(b) "*exclusively* regulates conduct involving false or misleading statements," the Court reasoned, "would mean those who disseminate false statements with the intent to cheat investors might escape liability under the Rule altogether."[133] The Court thus held that "those who do not 'make' statements (as *Janus* defined 'make'), but who disseminate false or misleading statements to potential investors with the intent to defraud, can be found to have violated" Rule 10b-5(a) and (c).[134]

In *Malouf* v. *SEC*, the Tenth Circuit became the first court of appeals to assess in detail the scope of *Lorenzo*.[135] In that case, the SEC alleged that the defendant, who held a senior position at an investment firm, knowingly failed to correct false statements regarding his conflicts of interest that were prepared by the firm's chief compliance officer and outside consultant.[136] The defendant argued that the SEC's attempt to impose liability under Rule 10b-5(a) and (c) for his alleged failure to correct "obliterate[d] the distinction" between maker and scheme liability "because the failure to correct is inseparable from the misstatements themselves."[137] The Tenth Circuit rejected the defendant's argument. The Tenth Circuit held that a failure to correct misstatements "could trigger liability" under *Lorenzo*, reasoning that "the Supreme Court rejected the same argument urged by [the defendant]"—*i.e.*, that "the SEC's interpretation would render Rule 10b-5(b) superfluous."[138] Notably, unlike in *Lorenzo*, there was no allegation in *Malouf* that the defendant

---

[127] 564 U.S. 135, 142 (2011).
[128] *Id*.
[129] *Pub. Pension Fund Grp.* v. *KV Pharm. Co.*, 679 F.3d 972, 987 (8th Cir. 2012); *see also WPP Luxembourg Gamma Three Sarl* v. *Spot Runner, Inc.*, 655 F.3d 1039, 1057 (9th Cir. 2011); *Lentell* v. *Merrill Lynch & Co.*, 396 F.3d 161, 177 (2d Cir. 2005).
[130] *Lorenzo* v. *SEC*, 872 F.3d 578, 591 (D.C. Cir. 2017); *see also SEC* v. *Monterosso*, 557 F. App'x 917, 925 (11th Cir. 2014).
[131] 139 S. Ct. 1094 (2019).
[132] *Id.* at 1102.
[133] *Id.* at 1102-03.
[134] *Id.* at 1099.
[135] 933 F.3d 1248 (10th Cir. 2019), *cert. denied*, 140 S. Ct. 1551 (2020).
[136] *Id.* at 1254-55.
[137] *Id.* at 1259.
[138] *Id.* at 1260.

disseminated misleading information to investors; rather, the court held that the defendant could be liable under Rule 10b-5(a) and (c) based solely on a failure to correct.

The extent to which *Lorenzo* will affect scheme liability beyond situations where the defendant "disseminated" false statements remains to be seen. The Supreme Court itself noted that "we can assume that *Janus* would remain relevant (and preclude liability) where an individual neither *makes* nor *disseminates* false information—provided, of course, that the individual is not involved in some other form of fraud."[139] In line with that language, in *Geoffrey A. Orley Revocable Trust* v. *Genovese*, a Southern District of New York judge held that plaintiffs failed to state a claim under Rule 10-b5(a) and (c) where the defendant was "alleged to have advised . . . during the creation of the documents or to have provided certain language," including recommending the inclusion of misleading language, but, unlike in *Lorenzo*, was "not alleged to have disseminated the [misleading] statements" contained in those documents.[140] To allow a scheme liability claim to proceed based on those allegations, the court reasoned, would "erase the distinction between primary liability, which may be punished through private suits under 10b-5, and secondary liability, which may not."[141]

In *SEC* v. *Kameli*, the Northern District of Illinois addressed whether the SEC could successfully assert claims for both "statement maker" liability under Rule 10b-5(b) and scheme liability under Rule 10b-5(a) and (c).[142] The court rejected that *Lorenzo* "merely carves out an exception allowing" scheme liability claims based solely on a misrepresentation "where the defendant is alleged to have *disseminated* the misrepresentation, *rather than having made it*."[143] Instead of "positing a fine distinction between 'making' statements and 'disseminating'" misrepresentations, the court reasoned that "*Lorenzo* effectively abrogated the line of cases" requiring proof of additional fraudulent conduct beyond misrepresentations in scheme liability cases, allowing for scheme liability claims based on either making or disseminating false statements.[144]

There also remains ambiguity as to the scope of scheme liability based on disseminating (but not making) false statements. As the Supreme Court recognized in *Lorenzo*, the breadth of Rule 10b-5(a) and (c) "may present difficult problems of scope in borderline cases."[145] In *In re Cognizant Technology Solutions Corp. Securities Litigation*, a District of New Jersey judge examined whether *Lorenzo* requires that "the *act of dissemination* be inherently deceptive" to impose scheme liability.[146] The plaintiffs alleged that an individual defendant disseminated false financial information by signing Forms 8-K containing material misstatements.[147] The plaintiffs also alleged that the defendant participated in a bribery scheme, which

[139] *Lorenzo*, 139 S. Ct. at 1103.
[140] 2020 WL 611506, at *7-8 (S.D.N.Y. Feb. 7, 2020).
[141] *Id.* at *8.
[142] 2020 WL 2542154 (N.D. Ill. May 19, 2020).
[143] *Id.* at *14 (second emphasis added).
[144] *Id.*
[145] 139 S. Ct. at 1101.
[146] 2020 WL 3026564, at *16 (D.N.J. June 5, 2020).
[147] *Id.* at *18.

resulted in the misrepresentation of payments on the company's financial statements, which in turn were reflected on the 8-Ks.[148] The defendant argued that the act of disseminating the 8-Ks in itself was not deceptive because the plaintiffs failed to plead that he actually knew that the bribery scheme would result in material misstatements in the 8-Ks.[149] The court explained that although *Lorenzo* permits scheme liability claims based solely on the dissemination of a misstatement, it does not "preclude from liability instances where the dissemination of a misstatement is preceded by *additional* allegedly deceptive conduct."[150] The court therefore held that it could "plausibly infer" that, even if the defendant did not act deceptively in signing the 8-Ks, he "engaged in a pattern of deceptive conduct leading up to and encompassing the dissemination of the alleged misstatements that he plausibly knew to be false by virtue of his participation in the [bribery] scheme and its concealment."[151] Rather than "view the alleged misstatement in isolation," the court found that the combination of the defendant's participation in the bribery scheme and dissemination of the misstatements, "viewed cumulatively," supported scheme liability.[152]

The precise contours of scheme liability under *Lorenzo* will likely continue to be the subject of significant litigation in both private suits and SEC enforcement actions.

E. REMAND OF *RETIREMENT PLANS COMMITTEE OF IBM* v. *JANDER*

On January 14, 2020, in a *per curiam* decision in *Retirement Plans Committee of IBM* v. *Jander*, the Supreme Court vacated the Second Circuit's decision and remanded for further consideration without deciding the question on which the Supreme Court had granted certiorari.[153] *Jander* is a so-called ERISA "stock-drop case" where participants in an employee stock ownership plan ("ESOP") alleged that the ESOP fiduciaries breached their duty of prudence by failing to disclose that IBM's stock was overvalued, thereby "artificially inflat[ing] IBM's stock price [and] harming the ESOP's members."[154] As established by the Supreme Court's 2014 decision in *Fifth Third Bancorp* v. *Dudenhoeffer*, to plead that an ESOP fiduciary breached the duty of prudence "on the basis of inside information," a plaintiff "must plausibly allege an alternative action that the defendant could have taken that would have been consistent with the securities laws and that a prudent fiduciary . . . would not have viewed as more likely to harm the fund than to help it."[155]

At its core, *Jander* involves a dispute over what allegations satisfy *Dudenhoeffer*'s standard for pleading a breach of the duty of prudence by an ESOP fiduciary. The district court granted defendants' motion to dismiss, reasoning that plaintiffs' allegations that the ESOP fiduciaries' failure to promptly disclose the alleged stock inflation was imprudent "because the eventual disclosure of a prolonged fraud causes

---

148 *Id.*
149 *See* Def. Steven E. Schwartz's Mem. of Law in Supp. Mot. to Dismiss Second Am. Class Action Compl., *In re Cognizant Tech. Sols. Corp. Sec. Litig.*, No. 2:16-cv-06509, Dkt. No. 94-1, at 26-27 (D.N.J. June 10, 2019).
150 *Cognizant*, 2020 WL 3026564, at *17.
151 *Id.* at *18.
152 *Id.* at *17, *18.
153 140 S. Ct. 592 (2020).
154 *Jander* v. *Ret. Plans Comm. of IBM*, 910 F.3d 620, 622 (2d Cir. 2018).
155 *Jander*, 140 S. Ct. at 594 (quoting *Fifth Third Bancorp* v. *Dudenhoeffer*, 573 U.S. 409, 428 (2014)).

reputational damage that increases the longer the fraud goes on" were "general, theoretical, and untested."[156] The Second Circuit reversed, holding that plaintiffs' allegations were sufficient to survive a motion to dismiss. The Second Circuit reasoned that "[a]ssertions grounded in economic studies of general market experience cannot be dismissed as merely 'theoretical,' and the fact that they are 'untested' at this early stage of the litigation does not necessarily render them implausible."[157] By contrast, the Fifth and Sixth Circuits have both held that generalized allegations that the reputational damage from concealment of fraud increases over time, standing alone, cannot support a claim for breach of the duty of prudence.[158]

The Supreme Court granted certiorari to decide "whether *Dudenhoeffer*'s 'more harm than good' pleading standard can be satisfied by generalized allegations that the harm of an inevitable disclosure of an alleged fraud generally increases over time."[159] The Supreme Court explained, however, that the briefing from petitioners and the SEC and Department of Labor as *amici* focused on whether ERISA imposed a duty on ESOP fiduciaries to act on inside information, or to disclose inside information, despite the lack of any such obligation under the securities laws.[160] Because the Second Circuit did not address those issues below, the Court vacated the judgment and remanded for the Second Circuit "to determine their merits, taking such action as it deems appropriate."[161]

In separate concurring opinions, Justices Kagan and Gorsuch expressed different views as to the likely success of petitioners' arguments. Justice Kagan, joined by Justice Ginsburg, reasoned that *Dudenhoeffer* itself controls the issues. In Justice Kagan's view, "*Dudenhoeffer* makes clear than an ESOP fiduciary at times has [] a duty" to act on inside information and that, under *Dudenhoeffer*, "when an action does not . . . conflict [with the securities laws], it might fall within a[] . . . fiduciary's duty—even if the securities laws do not require it."[162] Justice Gorsuch, on the other hand, reasoned that "*Dudenhoeffer* was silent on the argument now before us for the simple reason that the parties in *Dudenhoeffer* were silent on it too."[163] And Justice Gorsuch expressed skepticism that "ERISA plaintiffs may hold fiduciaries liable for alternative actions they could have taken only in a nonfiduciary capacity"—*i.e.*, "ordering up a special disclosure . . . in their capacities as corporate officers, not ERISA fiduciaries."[164]

Following supplementary briefing on remand, the Second Circuit issued a short *per curiam* opinion declining to consider new arguments not raised in the initial briefing and reinstating the previous judgment remanding the case to the district court for further proceedings.[165] As a result, neither the Supreme Court nor the Second Circuit has addressed the issues raised in the Supreme Court briefing regarding the interaction of

[156] *Jander*, 910 F.3d at 629.
[157] *Id.*
[158] *Martone* v. *Robb*, 902 F.3d 519, 526-27 (5th Cir. 2018); *Graham* v. *Fearon*, 721 F. App'x 429, 436 (6th Cir. 2018).
[159] *Jander*, 140 S. Ct. at 594.
[160] *Id.* at 594-95.
[161] *Id.* at 595.
[162] *Id.* at 596 (Kagan, J., concurring).
[163] *Id.* at 597 (Gorsuch, J., concurring).
[164] *Id.* at 596, 597 (Gorsuch, J., concurring).
[165] *Jander* v. *Ret. Plans Comm. of IBM*, 962 F.3d 85, 85-86 (2d Cir. 2020).

the securities laws with the *Dudenhoeffer* standard, and the circuit split remains over whether generalized allegations of harm from delayed disclosures state a claim for breach of the duty of prudence.

F. EFFECTS OF COVID-19 ON SECURITIES LITIGATION

Beginning in March 2020, plaintiffs started filing securities class action complaints involving disclosures relating to the COVID-19 pandemic. In total, such suits were filed against more than ten companies in the first half of 2020.[166] These cases involve responses to COVID-19 and alleged attempts to downplay the impact of COVID-19 on continuing operations. With the exception of suits against two large cruise operators, these cases have been brought against smaller companies, many of which are in the healthcare field and are actively involved in COVID-19 diagnostics and treatment.

In March 2020, during the early stages of the COVID-19 pandemic, shareholders sued Norwegian Cruise Lines in the Southern District of Florida.[167] The complaint alleges that Norwegian made unduly positive statements in its SEC filings regarding its outlook in light of the COVID-19 outbreak and that statements about Norwegian's safety measures were misleading because Norwegian purportedly engaged in deceptive sales practices to attract customers despite its knowledge of the severity of the COVID-19 pandemic.[168] Similarly, shareholders filed a suit against Carnival Cruise Lines in May 2020, alleging that Carnival made misleading disclosures regarding its compliance with health and safety protocols despite being aware of increasing incidents of COVID-19 aboard its ships and continued violations of port-of-call regulations and health-and-safety protocols.[169] To date, similar suits have not been filed against companies in related industries, but it is possible that other companies that have experienced significant business disruptions from the pandemic (*e.g.*, airlines, rental car companies, and non-essential retail stores) could be subject to future suits alleging inadequate COVID-related risk disclosures.

Securities class actions alleging misstatements surrounding COVID-19 treatment and testing have also been filed against pharmaceutical and biotechnology companies. *McDermid* v. *Inovio Pharmaceuticals, Inc.*, filed in March 2020 in the Eastern District of Pennsylvania, alleges that Inovio made misleading statements regarding its development of a COVID-19 vaccine, including statements by its CEO that Inovio was "able to fully construct [a] vaccine within three hours" after obtaining the DNA sequence of the virus.[170] Similarly, in May 2020, shareholders filed a class action against Sorrento Therapeutics, Inc. in the Southern District of California alleging that its CEO made misleading statements that a COVID-19 antibody discovery made by the company was a "cure."[171]

---

[166] Cornerstone Research, Securities Class Action Filings 2020 Midyear Assessment at 7, *available at* https://www.cornerstone.com/Publications/Reports/2020-Securities-Class-Action-Filings-2020-Midyear-Assessment.
[167] *Douglas* v. *Norwegian Cruise Lines*, No. 1:20-cv-21107, Dkt. No. 1 (S.D. Fla. Mar. 12, 2020).
[168] *Id.* at 4-9.
[169] *Service Lamp Corp. Profit Sharing Plan* v. *Carnival Corp.*, No. 1:20-cv-22202, Dkt. No. 1, at 1-4 (S.D. Fla. May 27, 2020).
[170] No. 2:20-cv-01402, Dkt. No. 1, at 3-4 (E.D. Pa. Mar. 12, 2020).
[171] *Wasa Medical Holdings* v. *Sorrento Therapeutics, Inc.*, No. 3:20-cv-00966, Dkt. No. 1, at 2 (S.D. Cal. May 26, 2020).

Statements regarding diagnostic testing have been a particular area of focus of COVID-related securities litigation, with suits currently pending against three companies involved in the manufacture and distribution of diagnostic tests. In *Yannes* v. *SCWorx Corp.*, filed in April 2020 in the Southern District of New York, plaintiffs allege that the company's statements about distributing an anticipated large order of COVID-19 diagnostic tests were "overstated or entirely fabricated."[172] In June 2020, shareholders filed a suit in the District of Utah, alleging that Co-Diagnostics, Inc., a diagnostic test provider, made misleading statements that its COVID-19 tests demonstrated 100% sensitivity and specificity, despite purportedly acknowledging data indicating lower accuracy.[173] Similarly, in *Chernysh* v. *Chembio Diagnostics, Inc.*, filed in June 2020 in the Eastern District of New York, plaintiffs allege that statements that a COVID-19 antibody test was 100% accurate and provided "high sensitivity and specificity" were rendered false when the FDA revoked the company's Emergency Use Authorization, citing "performance concerns with [the test's] accuracy."[174] As demand for COVID-19 testing and treatment continues, additional litigation in this area may emerge.

Companies also face a risk of suits arising from increased scrutiny caused by the COVID-19 pandemic, with shareholders alleging that underlying product, supply chain, or operational risks brought to light by the pandemic were not adequately disclosed. The most prominent example are the claims currently pending against Zoom Video Communications, Inc. in the Northern District of California. Plaintiffs there allege that Zoom made false statements regarding its security and data privacy measures, issues that gained widespread media attention following the immense increase in the use of Zoom's video conference software during the COVID-19 pandemic.[175] Several other securities cases filed in the past several months alleging inadequate or misleading risk disclosures have involved the general impact of COVID-19 on business operations across several industries, including information security software,[176] real estate,[177] commodities trading,[178] animal health products,[179] and in one recent case, a private prison company alleged to have maintained inadequate COVID-19 procedures in its halfway houses.[180]

In short, COVID-related securities litigation has not been widespread to date, and claims have generally been concentrated against companies either directly involved in the response to the pandemic or whose operations are uniquely vulnerable to disruption caused by COVID-19. As the pandemic continues across the world, it remains to be seen whether additional areas of COVID-related securities litigation will emerge and how courts will view the merits of both pending claims and any new claims that are filed.

---

[172] No. 1:20-cv-03349, Dkt. No. 1, at 2 (S.D.N.Y. Apr. 29, 2020).

[173] *Gelt Trading, Ltd.* v. *Co-Diagnostics, Inc.*, No. 2:20-cv-00368, Dkt. No. 2, at 3, 13 (D. Utah June 15, 2020).

[174] No. 2:20-cv-02706, Dkt. No. 1, at 2-4 (E.D.N.Y. June 18, 2020).

[175] *Drieu* v. *Zoom Video Commc'ns, Inc.*, No. 3:20-cv-02353, Dkt. No. 1, at 1-3 (N.D. Cal. Apr. 7, 2020).

[176] *Arbitrage Fund* v. *Forescout Techs., Inc.*, No. 4:20-cv-03819, Dkt. No. 1 (N.D. Cal. June 10, 2020).

[177] *Wandel* v. *Gao*, No 1:20-cv-03259, Dkt. No. 1 (S.D.N.Y. Apr. 24, 2020); *Berg* v. *Velocity Fin., Inc.*, No. 2:20-cv-06780, Dkt. No. 1 (C.D. Cal. July 29, 2020).

[178] *Lucas* v. *U.S. Oil Fund LP*, No 1:20-cv-04740, Dkt. No. 1 (S.D.N.Y. June 19, 2020); *Di Scala* v. *Proshares Ultra Bloomberg Crude Oil*, No. 1:20-cv-05865, Dkt. No. 1 (S.D.N.Y. July 28, 2020).

[179] *Hunter* v. *Elanco Animal Health Inc.*, No. 1:20-cv-01460, Dkt. No. 1 (S.D. Ind. May 20, 2020).

[180] *Hartel* v. *Geo Grp., Inc.*, No. 9:20-cv-81063, Dkt. No. 1 (S.D. Fla. July 7, 2020).

SULLIVAN & CROMWELL LLP

ABOUT SULLIVAN & CROMWELL LLP

Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance, corporate and real estate transactions, significant litigation and corporate investigations, and complex restructuring, regulatory, tax, and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 875 lawyers on four continents, with four offices in the United States, including its headquarters in New York, four offices in Europe, two in Australia, and three in Asia.

S&C'S SECURITIES LITIGATION PRACTICE

S&C provides superior legal representation to U.S. and non-U.S. corporations, financial institutions, and individuals in their most complex, high-value securities matters. Our lawyers have played a fundamental role in the evolution of U.S. banking and securities law and are well respected by courts, regulators, and adversaries. The Firm is regularly ranked as one of the top firms for defending securities litigation.

S&C'S CRIMINAL DEFENSE & INVESTIGATIONS GROUP

S&C represents the world's most sophisticated clients in high-stakes criminal and regulatory enforcement matters, as well as sensitive internal investigations. Our lawyers are often the first to deal with novel issues as the regulatory landscape changes. With numerous former prosecutors in the Group, we understand how government authorities work and have the experience to navigate clients through any challenges that may arise.

CONTACTING SULLIVAN & CROMWELL LLP

This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers listed below, or to any other Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future publications by sending an e-mail to SCPublications@sullcrom.com.

CONTACTS

New York

Nicolas Bourtin	+1-212-558-3920	bourtinn@sullcrom.com
David H. Braff	+1-212-558-4705	braffd@sullcrom.com
Justin J. DeCamp	+1-212-558-1688	decampj@sullcrom.com
Marc De Leeuw	+1-212-558-4219	deleeuwm@sullcrom.com
Stephen Ehrenberg	+1-212-558-3269	ehrenbergs@sullcrom.com
Andrew J. Finn	+1-212-558-4081	finna@sullcrom.com
Brian T. Frawley	+1-212-558-4983	frawleyb@sullcrom.com
Robert J. Giuffra Jr.	+1-212-558-3121	giuffrar@sullcrom.com
Suhana S. Han	+1-212-558-4647	hans@sullcrom.com

Richard H. Klapper	+1-212-558-3555	klapperr@sullcrom.com
Julia A. Malkina	+1-212-558-4869	malkinaj@sullcrom.com
William B. Monahan	+1-212-558-7375	monahanw@sullcrom.com
Sharon L. Nelles	+1-212-558-4976	nelless@sullcrom.com
Richard C. Pepperman II	+1-212-558-3493	peppermanr@sullcrom.com
Matthew J. Porpora	+1-212-558-4028	porporam@sullcrom.com
David M.J. Rein	+1-212-558-3035	reind@sullcrom.com
Jeffrey T. Scott	+1-212-558-3082	scottj@sullcrom.com
Matthew A. Schwartz	+1-212-558-4197	schwartzmatthew@sullcrom.com
Penny Shane	+1-212-558-4837	shanep@sullcrom.com
Michael T. Tomaino Jr.	+1-212-558-4715	tomainom@sullcrom.com
Thomas C. White	+1-212-558-3551	whitet@sullcrom.com
Alexander J. Willscher	+1-212-558-4104	willschera@sullcrom.com
Washington, D.C.		
Amanda Flug Davidoff	+1-202-956-7570	davidoffa@sullcrom.com
Kathleen S. McArthur	+1 202-956-7591	mcarthurk@sullcrom.com
Los Angeles		
Diane L. McGimsey	+1-310-712-6644	mcgimseyd@sullcrom.com
Robert A. Sacks	+1-310-712-6640	sacksr@sullcrom.com
Palo Alto		
Brendan P. Cullen	+1-650-461-5650	cullenb@sullcrom.com