SULLIVAN & CROMWELL LLP

November 2022

Securities Enforcement and Litigation Update

NOVEMBER 22, 2022

INTRODUCTION

Over the past year, the SEC's enforcement priorities under Chairman Gary Gensler and Director of the SEC's Enforcement Division Gurbir Grewal have continued to develop and come into focus. The SEC has placed a significant emphasis on climate change and other environmental, social, and governance ("ESG") issues. Most notably, the SEC has proposed a sweeping new regime for regulating climate change disclosures while also pursuing significant ESG-related enforcement actions through the Enforcement Division's newly created Climate and ESG Task Force. In the cryptocurrency and digital assets space, the SEC is continuing to scrutinize digital asset offerings and initiate enforcement actions where it has concluded that offerings meet the definition of a security but lack registration or exemption. Showing a heightened focus on this space, in May 2022, the Enforcement Division announced that it had nearly doubled the size of its Crypto Assets and Cyber Unit, which will concentrate on investigating securities laws violations related to digital asset offerings, cryptocurrency exchanges, cryptocurrency lending and staking products, decentralized finance platforms, non-fungible tokens, and stablecoins.

Although the record growth in special acquisition company, or SPAC, transactions has come to an end, the SEC has continued to prioritize bringing enforcement actions against SPACs and de-SPAC transactions.

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The SEC has proposed new rules requiring additional disclosure that would treat SPAC IPOs more like traditional IPOs. Core areas of SEC enforcement like insider trading and market manipulation also have seen important developments over the last year. In addition, there have been a number of SEC settlements in 2022 with large financial institutions alleging recordkeeping violations related to employees using personal text messages, emails, and WhatsApp messages to send and receive business communications.

In recent months, there have been several lower court decisions that may have a substantial impact on the reach of SEC enforcement. The en banc Fifth Circuit held that the Securities Exchange Act of 1934 ("1934 Act") does not strip federal district courts of jurisdiction to hear suits challenging the constitutionality of SEC enforcement actions. The Supreme Court has agreed to hear the case, and we expect a decision by summer 2023. The Fifth Circuit also held that SEC enforcement proceedings before the SEC's administrative law judges violate the Seventh Amendment right to a jury trial, and, in a split vote, the full Fifth Circuit declined to rehear the case en banc. This case may be the next constitutional challenge to the scope of the SEC's enforcement authority to make its way to the Supreme Court. Lower courts have also issued notable decisions regarding the contours of scheme liability after the Supreme Court's decision in *Lorenzo* v. *SEC* and regarding disgorgement authority after the Supreme Court's decision in *Liu* v. *SEC*.

Many areas with increased SEC enforcement have also seen an increase in private securities litigation. Private litigants are actively litigating suits related to ESG disclosures, cryptocurrency, and SPACs, and such litigation will likely continue to increase in the coming months and years as focus on these spaces continues to intensify. Despite growth in some areas, there has been a reduction in private securities litigation class action filings overall. In particular, claims under the Securities Act of 1933 ("1933 Act") in state court continued their downward trend since the Delaware Supreme Court's 2020 decision in *Salzberg* v. *Sciabacucchi*, which paved the way for federal forum provisions in corporate charters requiring 1933 Act claims to be brought in federal court.

Several notable decisions affecting private securities litigation have come down in the last year. Following the Supreme Court's holding in *Goldman Sachs Group, Inc.* v. *Arkansas Teacher Retirement System* that courts must consider the generic nature of alleged misstatements in determining whether defendants have rebutted the *Basic* presumption at class certification, the Second Circuit agreed to hear a rare third discretionary Rule 23(f) appeal of class certification in that case. Additionally, the Ninth Circuit recently reaffirmed that the federal securities laws do not require real-time updates about business operations in securities class action litigation against Twitter and its senior officers.

Finally, as companies adapt to the COVID-19 pandemic and its challenges, pandemic-related private securities litigation has continued to decrease over the last year. But reflecting the growth in remote work and virtual technologies, private securities litigation challenging disclosures about companies' responses to cybersecurity incidents or the impact of such incidents on companies' finances or operations is on the rise.

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) climate and ESG disclosures; (iii) cryptocurrency and digital asset regulation and enforcement; (iv) SPAC regulation and enforcement; (v) insider trading enforcement; (vi) market manipulation enforcement; (vii) recordkeeping enforcement; (viii) the SEC's whistleblower program; and (ix) SEC enforcement in the courts. From the perspective of private securities litigation, the update discusses: (i) recent numerical trends; (ii) state court proceedings post-*Cyan*; (iii) the Second Circuit's grant of an interlocutory appeal in *Goldman Sachs*; (iv) the Second Circuit's clarification of standing for securities fraud claims; (v) the Ninth Circuit's decision concerning real-time disclosures; (vi) shareholder suits related to cryptocurrency; (vii) shareholder suits related to ESG disclosures; (viii) the effects of COVID-19 on securities litigation; and (ix) shareholder suits related to cybersecurity.

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Table of Contents

I. PART 1 – SECURITIES ENFORCEMENT 1

- A. Numerical Trends in SEC Enforcement 1
- B. Climate and ESG Disclosures 2
- C. Cryptocurrency and Digital Asset Regulation and Enforcement 5
- D. SPAC Regulation and Enforcement 9
- E. Insider Trading Enforcement 11
- F. Market Manipulation Enforcement 13
- G. Recordkeeping Enforcement 14
- H. SEC Whistleblower Program 15
- I. SEC Enforcement in the Courts 16

II. PART 2 – PRIVATE SECURITIES LITIGATION 21

- A. Numerical Trends in Private Securities Litigation 21
- B. Update on State Court Proceedings 22
- C. Second Circuit Grants Third Interlocutory Appeal in *Goldman Sachs* 24
- D. Second Circuit Declines to Expand Securities Standing 24
- E. Ninth Circuit Confirms Securities Laws Do Not Require Real-Time Disclosures 26
- F. Cryptocurrency-Related Securities Litigation 27
- G. Shareholder Suits Related to ESG Disclosures 28
- H. Effects of COVID-19 on Securities Litigation 31
- I. Shareholder Suits Related to Cybersecurity 33

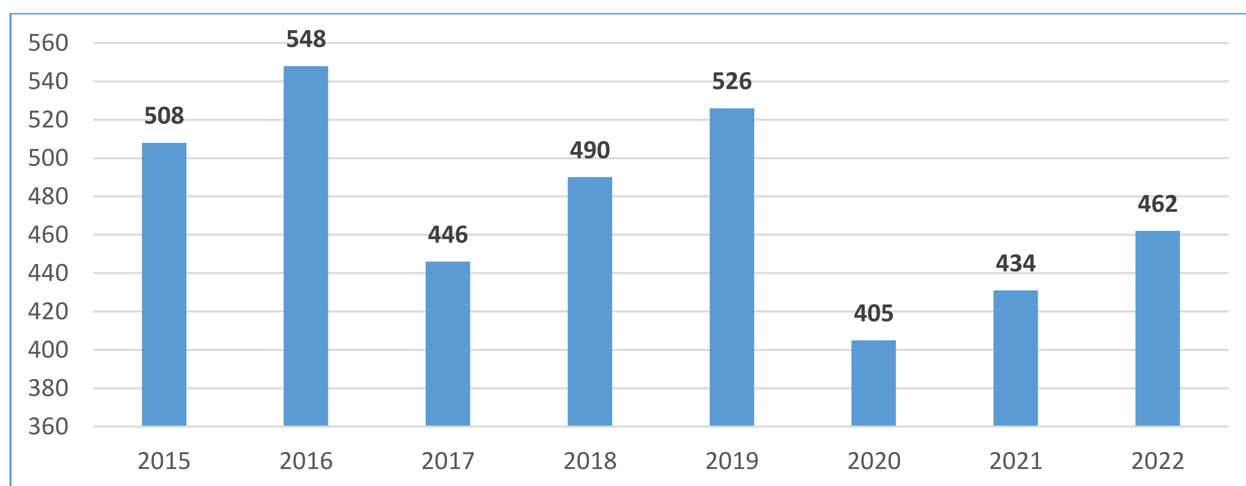
I. PART 1 – SECURITIES ENFORCEMENT

A. NUMERICAL TRENDS IN SEC ENFORCEMENT

The SEC brought enforcement actions at a strong pace in fiscal years 2021 (which ended September 30, 2021) and 2022 (which ended September 30, 2022). After decreasing in fiscal year 2020, the SEC brought 434 standalone actions in 2021, up from 405 in 2020—a seven percent increase, but still below the number of standalone actions brought in each of fiscal years 2017, 2018, and 2019.[1] In 2021, the majority of the SEC's standalone cases arose in two areas: (i) securities offerings cases, at 33%; and (ii) investment adviser and investment company cases, at 28%.[2] The SEC also brought actions relating to issuer reporting, audit, and accounting (12%); broker-dealers (8%); insider trading (6%); market manipulation (6%); public finance abuse (3%); and FCPA (1%).[3] Across enforcement areas, the SEC continued to pursue charges against individuals in the majority of standalone cases; 70% of such cases involved charges against one or more individuals.[4]

In fiscal year 2022, the SEC brought 462 standalone actions, the largest number since fiscal year 2019.[5] These actions chiefly related to investment adviser and investment companies (26%); securities offerings (23%); issuer reporting, audit and accounting (16%); broker-dealers (10%); insider trading (9%); market manipulation (7%); public finance abuse (4%); transfer agents (2%); and FCPA (1%).[6]

Standalone SEC Enforcement Actions FY 2015 to 2022[7]

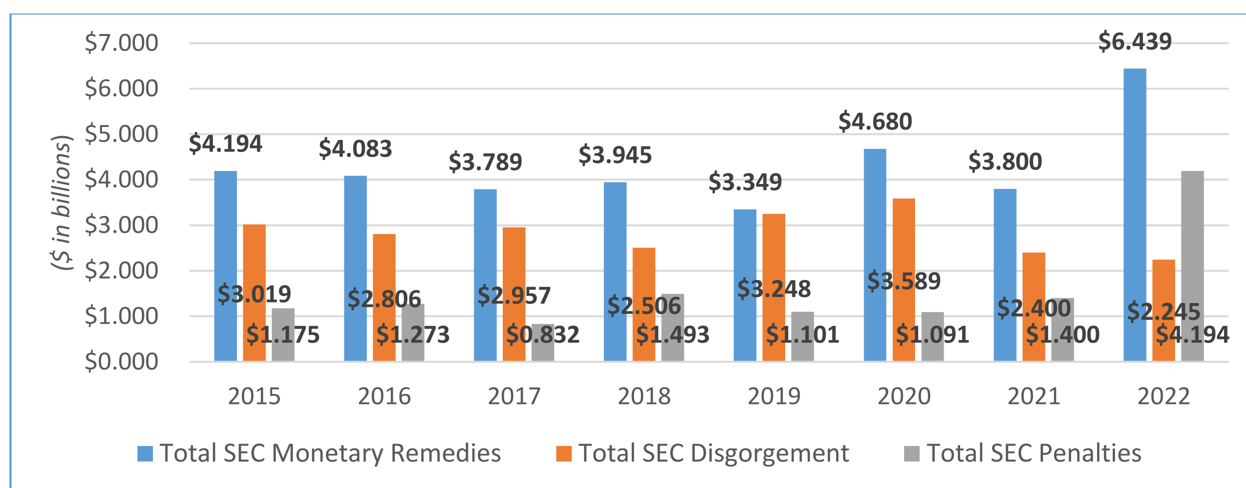


[1] Press Release, *SEC Announces Enforcement Results for FY 2021*, SEC. & EXCH. COMM'N (Nov. 18, 2021), https://www.sec.gov/news/press-release/2021-238.
[2] *Id.*
[3] *Id.*
[4] *Id.*
[5] Press Release, *SEC Announces Enforcement Results for FY22*, SEC. & EXCH. COMM'N (Nov. 15, 2022), https://www.sec.gov/news/press-release/2022-206.
[6] *Addendum to Division of Enforcement Press Release Fiscal Year 2022*, SEC. & EXCH. COMM'N (Nov. 15, 2022), https://www.sec.gov/files/fy22-enforcement-statistics.pdf.
[7] *Id.*

Despite the increase in standalone enforcement actions between fiscal years 2021 and 2020, the amount of monetary remedies recovered by the SEC decreased in fiscal year 2021.[8] The SEC obtained approximately $3.8 billion in disgorgement and penalties ($2.4 billion in disgorgement and $1.4 billion in penalties) in fiscal year 2021, down from approximately $4.68 billion ($3.59 billion in disgorgement and $1.09 billion in penalties) in fiscal year 2020.[9]

In fiscal year 2022, however, the SEC ordered a record $6.439 billion in monetary remedies ($4.194 billion in civil penalties and $2.245 billion in disgorgement).[10] This reflected a marked increase in civil penalties but a 6% decrease in disgorgement recoveries.[11]

Total SEC Monetary Remedies, Disgorgement, and Penalties FY 2015 to 2022[12]



B. CLIMATE AND ESG DISCLOSURES

In 2022, following the creation of the Enforcement Division's Climate and ESG Task Force, the SEC has begun to file charges against companies for allegedly false or misleading ESG-related disclosures. For example, in April 2022, the SEC filed an enforcement action against Vale S.A., a publicly traded Brazilian mining company, claiming that Vale made misleading statements about the safety of its dams prior to one of its dams collapsing in 2019.[13] In its complaint, the SEC alleged that Vale concealed from investors the risk that the dam might collapse in violation of the antifraud provisions of the federal securities laws.[14] Specifically, according to the SEC, Vale knowingly used unreliable data to obtain fraudulent stability

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[8] Press Release, *SEC Announces Enforcement Results for FY 2021*, SEC. & EXCH. COMM'N (Nov. 18, 2021), https://www.sec.gov/news/press-release/2021-238.

[9] *Id.*; SEC. & EXCH. COMM'N DIV. OF ENF'T, 2020 ANNUAL REPORT, at 16.

[10] Press Release, *SEC Announces Enforcement Results for FY22*, SEC. & EXCH. COMM'N (Nov. 15, 2022), https://www.sec.gov/news/press-release/2022-206.

[11] *Id.*

[12] *Addendum to Division of Enforcement Press Release Fiscal Year 2022*, SEC. & EXCH. COMM'N (Nov. 15, 2022), https://www.sec.gov/files/fy22-enforcement-statistics.pdf.

[13] Press Release, *SEC Charges Brazilian Mining Company with Misleading Investors about Safety Prior to Deadly Dam Collapse*, SEC. & EXCH. COMM'N (Apr. 28, 2022), https://www.sec.gov/news/press-release/2022-72.

[14] Complaint, *SEC* v. *Vale, S.A.*, No. 22-cv-02405, Dkt. No. 1, ¶ 1 (E.D.N.Y. Apr. 28, 2022).

declarations for the dam, removed auditors and personnel who jeopardized Vale's ability to obtain the stability declarations, concealed material information from auditors, did not abide by best practices and minimum safety standards, and was aware since 2003 that the dam was "dangerously fragile."[15] Meanwhile, Vale disclosed that it was allocating significant capital to dam safety and stability and that it was using the "strictest" and best practices for dam safety.[16] The SEC also alleged that Vale deceptively assured the market in its sustainability reports that "100%" of its dams were "certified to be in stable condition."[17] In commenting on the case, Enforcement Division Director Gurbir Grewal stated: "Many investors rely on ESG disclosures like those contained in Vale's annual Sustainability Reports and other public filings to make informed investment decisions. By allegedly manipulating those disclosures, Vale compounded the social and environmental harm caused by [the] dam's tragic collapse and undermined investors' ability to evaluate the risks posed by Vale's securities."[18]

A few weeks later, the SEC settled charges concerning ESG disclosures against BNY Mellon Investment Advisor, Inc. ("BNYMIA"), a registered investment adviser, for violations of provisions of the Investment Advisers Act and the Investment Company Act.[19] The SEC alleged that, between 2018 and 2021, BNYMIA misrepresented to investors and to the boards of certain mutual funds advised by BNYMIA that the funds' subadviser considered ESG principles by using proprietary ESG quality reviews to research investments and make investment decisions.[20] Those ESG principles entailed "identifying the ESG risks and opportunities presented by securities in which a fund might invest, and ensuring that ESG challenges were well-managed within the business strategy of any issuer in which a fund was considering an investment."[21] The SEC also alleged that BNYMIA made ESG-related misrepresentations in written responses to requests for proposals from other investment firms.[22] According to the SEC, the funds' subadviser "could and did select portfolio investments" without conducting investment research using the proprietary ESG quality reviews.[23] Without admitting or denying the SEC's allegations, BNYMIA agreed in the cease-and-desist order to: (i) cease and desist from violations of the federal securities laws; (ii) accept a censure; and (iii) pay a $1.5 million penalty to the SEC.[24]

In addition to pursuing charges, the SEC has also demonstrated its focus on regulating climate and ESG disclosures by proposing new climate- and ESG-related rules. On March 21, 2022, the SEC proposed a new set of rules that, if adopted, would require public companies to include a substantial amount of climate-

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15 *Id.* ¶ 12.
16 *Id.* ¶ 10.
17 *Id.* ¶ 29.
18 Press Release, *SEC Charges Brazilian Mining Company with Misleading Investors about Safety Prior to Deadly Dam Collapse*, SEC. & EXCH. COMM'N (Apr. 28, 2022), https://www.sec.gov/news/press-release/2022-72.
19 Press Release, *SEC Charges BNY Mellon Investment Advisor for Misstatements and Omissions Concerning ESG Considerations*, SEC. & EXCH. COMM'N (May 23, 2022), https://www.sec.gov/news/press-release/2022-86.
20 Order, *In re BNY Mellon Investment Advisors, Inc.*, No. 3-20867 ¶¶ 1-2 (Sec. & Exch. Comm'n May 23, 2022).
21 *Id.* ¶ 3.
22 *Id.* ¶ 2.
23 *Id.* ¶ 4.
24 *Id.* at 1, 7.

related information in their disclosures.[25] The proposed rules are discussed in detail in the following S&C publications: *SEC Proposes Expansive Climate-Related Disclosure Rules*, *SEC's Proposed Climate Disclosure Rules Herald Expansive New Obligations for Foreign Private Issuers*, and *Proposed SEC Climate Disclosure Rules—Certain Key Implications for Financial Institutions*. At a high level, the proposed rules would require companies to disclose: (i) climate-related risks and their actual or likely material impacts on the company's business, strategy, and outlook; (ii) the company's governance of climate-related risks and relevant risk management processes; (iii) the company's greenhouse gas emissions; (iv) certain climate-related financial statement metrics and related disclosures in a note to the company's audited financial statements; and (v) information about climate-related targets and goals, and transition plans, if any.[26] For the disclosures concerning greenhouse gas emissions, companies would be required to disclose information about their direct emissions (scope 1), indirect emissions from purchased electricity and other forms of energy (scope 2), and emissions from upstream and downstream activities in their value chains (scope 3).[27] Those disclosures would go into effect at different times depending on the type of issuer.[28]

Then, on May 25, 2022, the SEC proposed new rules that would augment ESG-related disclosure requirements for certain registered investment advisers, advisers exempt from registration, registered investment companies, and business development companies.[29] The proposed rules are discussed in detail in the following S&C publication: *SEC Proposes Enhanced ESG Disclosure Requirements for Investment Advisers and Investment Companies*. According to the SEC, the proposed rules would "promote consistent, comparable, and reliable information for investors concerning funds' and advisers' incorporation of" ESG factors."[30] Specifically, the proposed rules would create three categories of ESG funds: (i) ESG Integration Funds (funds that integrate both ESG and non-ESG factors in investment decisions); (ii) ESG-Focused Funds (funds for which ESG factors are a significant or main consideration); and (iii) ESG Impact Funds (a subset of ESG-Focused Funds that seek to achieve a particular ESG impact).[31] The proposed rules would require inclusion of additional disclosure, depending on the category of ESG fund, regarding funds' ESG strategies in fund prospectuses, annual reports, and adviser brochures.[32] The proposed rules would also require ESG reporting on Forms N-CEN and ADV Part 1A.[33]

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[25] Press Release, *SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors*, SEC. & EXCH. COMM'N (Mar. 21, 2022), https://www.sec.gov/news/press-release/2022-46.
[26] Fact Sheet, *Enhancement and Standardization of Climate-Related Disclosures*, SEC. & EXCH. COMM'N 1-3 (Mar. 21, 2022), https://www.sec.gov/files/33-11042-fact-sheet.pdf.
[27] *Id.* at 2.
[28] *Id.* at 3.
[29] Press Release, *SEC Proposes to Enhance Disclosures by Certain Investment Advisers and Investment Companies About ESG Investment Practices*, SEC. & EXCH. COMM'N (May 25, 2022), https://www.sec.gov/news/press-release/2022-92.
[30] *Id.*
[31] Fact Sheet, *ESG Disclosures for Investment Advisers and Investment Companies*, SEC. & EXCH. COMM'N 2 (May 25, 2022), https://www.sec.gov/files/ia-6034-fact-sheet.pdf.
[32] *Id.* at 1.
[33] Press Release, *SEC Proposes to Enhance Disclosures by Certain Investment Advisers and Investment Companies About ESG Investment Practices*, SEC. & EXCH. COMM'N (May 25, 2022), https://www.sec.gov/news/press-release/2022-92.

As a result of the SEC's focus on climate and ESG disclosures, the climate- and ESG-related operations, activities, and disclosures of public companies will continue to be closely scrutinized by both the SEC and investors. Companies should carefully review and tailor their disclosures in order to avoid allegations of false and misleading disclosures.

C. CRYPTOCURRENCY AND DIGITAL ASSET REGULATION AND ENFORCEMENT

The SEC continues to closely examine digital asset offerings and distributions of digital tokens to determine whether they are securities that require registration or exemption.

Ripple Enforcement Action. In February 2021, the SEC filed an amended complaint alleging that Ripple Labs, Inc. and two of its executives sold unregistered digital asset securities for $1.38 billion.[34] The SEC's complaint sought injunctive relief, disgorgement, and civil penalties.[35] According to the complaint, Ripple began raising funds in 2013 to finance the company's business through the sale of digital assets called "XRP" to investors.[36] After Ripple and its executives allegedly ignored legal advice that XRP could be considered a security under the federal securities laws, they initiated a distribution of XRP to investors without filing a registration statement.[37] In March 2021, Ripple filed its answer to the SEC's complaint, asserting that XRP is a virtual currency that is not subject to securities regulation, which the U.S. Department of Justice, U.S. Treasury Department's Financial Crimes Enforcement Network, and securities regulators in the United Kingdom, Japan, and Singapore have also concluded.[38]

The parties have begun discovery and several contentious discovery battles have ensued. Shortly after Ripple filed its answer to the amended complaint, Ripple moved to compel the SEC to produce SEC communications and documentation that explains how and why the SEC arrived at its statements and conclusions about XRP and various other digital assets.[39] The magistrate judge "in large part" granted Ripple's motion to compel and ordered the SEC to produce documents "as to exclusively Bitcoin or Ether communications as well as XRP communications between the SEC and third-parties, . . . including all market participants and [] other government agencies," finding the documents relevant.[40] The magistrate judge, however, denied the motion to compel as to purely internal SEC communications because such communications are "less relevant" and likely entail "extensive privilege issues," and authorizing their production could "seriously chill government deliberations."[41] The magistrate judge also decided several subsequent discovery motions in 2021—including those pertaining to the production of the SEC's internal trading policies (motion to compel granted),[42] SEC documents reflecting preclearance decisions regarding

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34 First Amended Complaint, *SEC* v. *Ripple Labs, Inc.*, No. 20-cv-10832, Dkt. No. 46, ¶¶ 1-3 (S.D.N.Y. Feb. 18, 2021).
35 *Id.* at 78-79.
36 *Id.* ¶ 1.
37 *Id.* ¶¶ 1-4.
38 Answer, *SEC* v. *Ripple Labs, Inc.*, No. 20-cv-10832, Dkt. No. 51, ¶¶ 1-3 (S.D.N.Y. Mar. 4, 2021).
39 Defendants' Motion to Compel, *SEC* v. *Ripple Labs, Inc.*, No. 20-cv-10832, Dkt. No. 67, at 1 (S.D.N.Y. Mar. 15, 2021).
40 Transcript, *SEC* v. *Ripple Labs, Inc.*, No. 20-cv-10832, Dkt. No. 112, at 51 (S.D.N.Y. Apr. 12, 2021).
41 *Id.* at 52.
42 Order, *SEC* v. *Ripple Labs, Inc.*, No. 20-cv-10832, Dkt. No. 253, at 1 (S.D.N.Y. June 23, 2021).

SEC employees' trading in XRP and other digital assets (motion to compel denied),[43] eight years of personal financial information for the two executive defendants (motion for protective order granted),[44] and Ripple's internal Slack messages (motion to compel granted).[45]

In January 2022, the magistrate judge granted in part and denied in part Ripple's motion to compel notes, communications, and other documents created by SEC personnel that the SEC contended were protected by the deliberative process privilege.[46] The magistrate judge concluded that documents reflecting fact-gathering from third parties and documents without a connection to actual policymaking or deliberative processes are not protected by the deliberative process privilege but that notes and documents reflecting intra-agency discussions about ongoing agency deliberations were privileged.[47] Overall, the magistrate judge held that most of the documents for which the SEC asserted privilege were indeed privileged.

Then, in March 2022, the district court judge denied the SEC's motion to strike Ripple's "fair notice" affirmative defense and also denied the individual defendants' motion to dismiss. In its answer, Ripple pleaded that the SEC failed to provide "fair notice" that Ripple's conduct violated the law.[48] The district court held that the SEC failed to show that Ripple's fair notice affirmative defense should be stricken because questions of fact or law that may allow the defense to succeed still exist.[49] The district court also denied the individual defendants' motion to dismiss because the SEC plausibly demonstrated that the individual defendants aided and abetted Ripple's sale of unregistered securities.[50] The parties filed motions for summary judgment in September 2022.[51]

BitConnect Enforcement Action. In May 2021, the SEC filed an enforcement action against five individuals who allegedly promoted "global unregistered digital asset securities" offered by BitConnect, an online cryptocurrency lending platform, which raised over $2 billion from retail investors.[52] In its complaint, the SEC alleged that the five promoters offered and sold the unregistered digital asset securities without registering the offering with the SEC.[53] Specifically, the SEC claimed that the five promoters touted investing in BitConnect's "lending program" by creating "testimonial" videos and publishing them on YouTube.[54] The SEC further alleged that the promoters received "referral commissions"—*i.e.*, a percentage of the funds invested—and other commissions in exchange for their services but did so without registering

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43 Order, *SEC* v. *Ripple Labs, Inc.*, No. 20-cv-10832, Dkt. No. 354, at 1 (S.D.N.Y. Sept. 21, 2021).
44 Order, *SEC* v. *Ripple Labs, Inc.*, No. 20-cv-10832, Dkt. No. 103, at 1 (S.D.N.Y. Apr. 9, 2021).
45 Order, *SEC* v. *Ripple Labs, Inc.*, No. 20-cv-10832, Dkt. No. 327, at 1 (S.D.N.Y. Sept. 1, 2021).
46 Order, *SEC* v. *Ripple Labs, Inc.*, No. 20-cv-10832, Dkt. No. 413, at 8 (S.D.N.Y. Jan. 13, 2022).
47 *Id.* at 8, 10-11, 12, 15-16.
48 Order, *SEC* v. *Ripple Labs, Inc.*, No. 20-cv-10832, Dkt. No. 440, at 1 (S.D.N.Y. Mar. 11, 2022).
49 *Id.* at 8.
50 Order, *SEC* v. *Ripple Labs, Inc.*, No. 20-cv-10832, Dkt. No. 441, at 20, 28 (S.D.N.Y. Mar. 11, 2022).
51 Motion for Summary Judgment Against All Defendants, *SEC* v. *Ripple Labs, Inc.*, No. 20-cv-10832, Dkt. No. 4639, at 1 (S.D.N.Y. Sept. 17, 2022); Motion for Summary Judgment, *SEC* v. *Ripple Labs, Inc.*, No. 20-cv-10832, Dkt. No. 642 (S.D.N.Y. Sept. 17, 2022).
52 Press Release, *SEC Charges U.S. Promoters of $2 Billion Global Crypto Lending Securities Offering*, SEC. & EXCH. COMM'N (May 28, 2021), https://www.sec.gov/news/press-release/2021-90.
53 Complaint, *SEC* v. *Brown*, No. 21-cv-04791, Dkt. No. 1, ¶ 1 (S.D.N.Y. May 28, 2021).
54 *Id.* ¶ 4.

as broker-dealers with the SEC.[55] The SEC's complaint contends that the defendants violated Section 5 of the 1933 Act and Section 15(a) of the 1934 Act and seeks injunctive relief, disgorgement, and civil monetary penalties.[56] The SEC reached settlements with two of the five promoters.[57]

Then, in September 2021, the SEC expanded its BitConnect civil case, filing an enforcement action against BitConnect, BitConnect founder Satish Kumbhani, another promoter of BitConnect, and the promoter's company.[58] In its complaint, the SEC alleges that the defendants "conducted a fraudulent and unregistered offering and sale of securities in the form of investments" in BitConnect's "Lending Program."[59] In particular, the SEC claims that the defendants concealed from investors commissions paid to promoters, none of whom was registered with the SEC as a broker-dealer, for their promotional efforts.[60] The SEC further alleges that the defendants "induce[d] investors to deposit funds into the purported Lending Program" by fraudulently representing that BitConnect "would deploy a purported proprietary 'volatility software trading bot' . . . that, they claimed, would use investor funds to generate" high returns.[61] Instead, according to the SEC, the defendants "siphoned" the investors' funds and used them for their own benefit, including by "transferring th[e] funds to digital wallet addresses controlled by" the defendants.[62] To conceal the misuse of the investors' funds, the defendants allegedly employed a "Ponzi-like scheme in which they . . . used funds deposited by newer investors . . . to satisfy withdrawal demands made by earlier investors."[63] The SEC contends that this conduct violated Sections 10(b) and 15(a) of the 1934 Act and Sections 5 and 17(a) of the 1933 Act.[64] The SEC's complaint seeks injunctive relief, disgorgement, and civil monetary penalties.[65]

In December 2021, the district court ordered a stay of proceedings pending the resolution of criminal charges against Glenn Arcaro, one of the BitConnect promoters, in the Southern District of California.[66] Then, in February 2022, the SEC informed the district court that BitConnect founder Satish Kumbhani—and by extension BitConnect—fled to India, his whereabouts are unknown, and the SEC has therefore been unable to complete service of process.[67] The district court modified the stay to allow service of process and extended the time to serve until May 30, 2022.[68] There have not been any further filings by the parties or other docket activity since the court modified the stay.

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55 *Id.* ¶¶ 2, 5-6.
56 *Id.* ¶¶ 10-13.
57 Press Release, *SEC Charges Global Crypto Lending Platform and Top Executives in $2 Billion Fraud*, SEC. & EXCH. COMM'N (Sept. 1, 2021), https://www.sec.gov/news/press-release/2021-172.
58 *Id.*
59 Complaint, *SEC* v. *BitConnect*, No. 21-cv-07349, Dkt. No. 1, ¶ 1 (S.D.N.Y. Sept. 1, 2021).
60 *Id.* ¶¶ 2-4.
61 *Id.* ¶ 5.
62 *Id.* ¶ 6.
63 *Id.* ¶ 7.
64 *Id.* ¶ 12.
65 *Id.* ¶ 15.
66 Order, *SEC* v. *BitConnect*, No. 21-cv-07349, Dkt. No. 27, at 1 (S.D.N.Y. Dec. 15, 2021).
67 Letter, *SEC* v. *BitConnect*, No. 21-cv-07349, Dkt. No. 28, at 1-2 (S.D.N.Y. Feb. 28, 2022).
68 Memo Endorsement, *SEC* v. *BitConnect*, No. 21-cv-07349, Dkt. No. 29, at 1 (S.D.N.Y. Mar. 1, 2022).

NVIDIA Enforcement Action. In May 2022, the SEC filed an enforcement action against NVIDIA Corporation, a technology company that designs and markets graphics processing units for computer applications, alleging failure to provide adequate disclosures about the impact of "cryptomining" on the company's business.[69] Specifically, the SEC alleged that NVIDIA knew that cryptominers were using its graphics processing units to engage in cryptomining but failed to disclose the impact of that activity in its quarterly filings.[70] The SEC further alleged that NVIDIA failed to maintain adequate disclosure controls and procedures.[71] Without admitting or denying the SEC's findings, NVIDIA settled the action with the SEC, agreeing to: (i) cease and desist from future violations of the antifraud and disclosure control provisions of the federal securities laws; and (ii) pay a civil penalty of $5.5 million.[72]

The NVIDIA enforcement action, along with the ongoing BitConnect and Ripple litigations, suggests that the SEC will continue to scrutinize companies involved in digital asset offerings or other activities in the digital asset space. The SEC will likely focus on whether digital assets meet the definition of a security, which requires filing a registration statement or applying an exemption, as well as whether companies provide adequate disclosures concerning the impact of activities involving digital assets on their businesses.

Other SEC Actions. In April 2022, during a speech at the University of Pennsylvania Law School Capital Markets Association Annual Conference, Chairman Gensler affirmed the SEC's commitment to increasing regulation and enforcement of cryptocurrency markets.[73] In particular, Chairman Gensler highlighted as priorities regulating cryptocurrency trading and lending platforms, stablecoins, and tokens that meet the definition of a security.[74] Just a few weeks after Chairman Gensler's speech, the Enforcement Division announced that it nearly doubled the size of its Crypto Assets and Cyber Unit.[75] According to the SEC, the expanded Crypto Assets and Cyber Unit will focus on investigating securities laws violations related to digital asset offerings, cryptocurrency exchanges, cryptocurrency lending and staking products, decentralized finance platforms, non-fungible tokens, and stablecoins.[76] In September 2022, Chairman Gensler suggested that tokens that allow "staking" of digital assets—granting digital assets in exchange for the right to earn rewards for adding blocks to a blockchain—could be securities under the *Howey* test.[77] These statements, along with the numerous enforcement actions brought by the SEC, indicate that the SEC will continue to aggressively pursue regulation and enforcement in the cryptocurrency and digital asset

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69 Press Release, *SEC Charges NVIDIA Corporation with Inadequate Disclosures about Impact of Cryptomining*, SEC. & EXCH. COMM'N (May 6, 2022), https://www.sec.gov/news/press-release/2022-79.

70 Order, *In re NVIDIA Corp.*, No. 3-20844, ¶¶ 1, 11, 18 (Sec. & Exch. Comm'n May 6, 2022).

71 *Id.* ¶¶ 1, 17, 18.

72 *Id.* at 1, 6.

73 Gary Gensler, *Prepared Remarks of Gary Gensler on Crypto Markets at the Penn Law Capital Markets Association Annual Conference*, SEC. & EXCH. COMM'N (Apr. 4, 2022), https://www.sec.gov/news/speech/gensler-remarks-crypto-markets-040422.

74 *Id.*

75 Press Release, *SEC Nearly Doubles Size of Enforcement's Crypto Assets and Cyber Unit*, SEC. & EXCH. COMM'N (May 3, 2022), https://www.sec.gov/news/press-release/2022-78.

76 *Id.*

77 Paul Kiernan and Vicky Ge Huang, *Ether's New Staking Model Could Draw SEC Attention*, WALL ST. J. (Sept. 15, 2022), https://www.wsj.com/articles/ethers-new-staking-model-could-draw-sec-attention-11663266224.

space. Recent turbulence in the space is likely to further intensify the SEC's focus both from a regulatory and enforcement perspective.

D. SPAC REGULATION AND ENFORCEMENT

The SEC continues to closely scrutinize de-SPAC transactions and initiate enforcement actions against SPACs that allegedly defraud and mislead investors. In December 2021, the SEC filed an enforcement action under the antifraud and disclosure control provisions of the federal securities laws against Nikola Corporation, a publicly traded company created through a de-SPAC transaction in 2020 that manufactures zero emissions transportation systems.[78] The SEC alleged that Nikola and its founder and CEO, Trevor Milton, made material misrepresentations to investors in 2020 through social media and media appearances about Nikola's electric battery and hydrogen fuel cell electric vehicles, technical advancements, potential partnership with General Motors, and other commercial prospects.[79] The SEC further contended that Nikola had insufficient disclosure controls and procedures for monitoring and reviewing Milton's media appearances and social media activity.[80]

Without admitting or denying the SEC's findings, Nikola settled the action with the SEC.[81] As part of the settlement, Nikola agreed to: (i) cease and desist from future violations of the antifraud and disclosure control provisions of the federal securities laws; (ii) pay a civil penalty of $125 million; (iii) cooperate with the SEC in the ongoing investigation and litigation; (iv) establish a "fair fund" under the Sarbanes-Oxley Act to return proceeds to allegedly harmed investors; and (v) undertake certain other remedial actions.[82]

Also in December 2021, Chairman Gensler spoke about de-SPAC transactions at the Healthy Markets Association Conference.[83] Chairman Gensler opened his remarks by quoting a famous Aristotle maxim, "[t]reat like cases alike."[84] He added that he believes that "the investing public may not be getting like protections between traditional IPOs and SPACs" and that SPACs "may have additional conflicts inherent to their structure."[85] As a result, he asked the SEC Staff for "proposals for the Commission's consideration around how to better align the legal treatment of SPACs and their participants with the investor protections provided in other IPOs, with respect to disclosure, marketing practices, and gatekeeper obligations."[86]

As Chairman Gensler's remarks foreshadowed, in March 2022, the SEC proposed new rules aimed at "enhanc[ing] disclosure and investor protection" in SPAC IPOs and business combination transactions involving SPACs such that the SPAC IPO process would more closely emulate the traditional IPO

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78 Press Release, *Nikola Corporation to Pay $125 Million to Resolve Fraud Charges*, SEC. & EXCH. COMM'N (Dec. 21, 2021), https://www.sec.gov/news/press-release/2021-267.

79 Order, *In re Nikola Corp.*, No. 3-20687, ¶¶ 1-2, 20-40 (Sec. & Exch. Comm'n Dec. 21, 2021).

80 *Id.* ¶¶ 3, 17-19.

81 *Id.* at 1.

82 *Id.* at 11-13.

83 Gary Gensler, *Remarks Before the Healthy Markets Association Conference*, SEC. & EXCH. COMM'N (Dec. 9, 2021), https://www.sec.gov/news/speech/gensler-healthy-markets-association-conference-120921.

84 *Id.*

85 *Id.*

86 *Id.*

process.[87] *First*, the proposed rules would require additional disclosures related to SPAC sponsors, conflicts of interests, dilution of shareholder interests, and the fairness of de-SPAC transactions for SPAC investors under Regulation S-K.[88] *Second*, the proposed rules would deem the private operating company in a de-SPAC transaction to be a co-registrant on the SPAC's registration statement filings with the SEC, which would subject the private target company's signatories to potential liability under Section 11 of the 1933 Act.[89] *Third*, the proposed rules would redefine a "smaller reporting company" and require a re-determination of smaller reporting company status within four business days of the de-SPAC transaction's consummation, which could require more robust disclosures from SPACs initially qualified as smaller reporting companies.[90] *Fourth*, the proposed rules would redefine "blank check company" to include SPACs and would take SPACs and certain other blank check companies outside of the Private Securities Litigation Reform Act's safe harbor for forward-looking statements.[91] *Fifth*, the proposed rules would deem underwriters in SPAC IPOs to be underwriters in subsequent de-SPAC transactions if they meet certain criteria, which would subject the underwriters to potential liability under Section 11 of the 1933 Act.[92] *Sixth*, the proposed rules would deem a business combination transaction involving a reporting shell company and a non-shell company entity to be a sale of securities under the 1933 Act.[93] *Seventh*, the proposed rules would more closely align the financial statement requirements for transactions involving private operating companies and shell companies with the registration statement requirements of traditional IPOs.[94] *Finally*, the proposed rules would exempt SPACs from the Investment Company Act's requirement to register as an investment company so long as the SPACs meet certain conditions.[95]

With respect to potential conflicts of interest in connection with SPAC transactions, in September 2022, the SEC charged New York-based investment adviser Perceptive Advisors with failure to disclose conflicts relating to its personnel's ownership of sponsors of SPACs into which Perceptive advised its clients to invest.[96] The SEC's order alleges that Perceptive invested assets of a private fund it advised in various transactions that helped complete the SPACs' business combinations without timely disclosing those conflicts.[97] Without admitting or denying the allegations, Perceptive agreed to censure, a cease-and-desist order, and a $1.5 million penalty to settle the action.[98]

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[87] Press Release, *SEC Proposes Rules to Enhance Disclosure and Investor Protection Relating to Special Purpose Acquisition Companies, Shell Companies, and Projections*, SEC. & EXCH. COMM'N (Mar. 30, 2022), https://www.sec.gov/news/press-release/2022-56.

[88] Fact Sheet, *SPACs, Shell Companies, and Projections: Proposed Rules*, SEC. & EXCH. COMM'N 1-2 (Mar. 30, 2022), https://www.sec.gov/files/33-11048-fact-sheet.pdf.

[89] *Id.* at 2.

[90] *Id.*

[91] *Id.*

[92] *Id.*

[93] *Id.*

[94] *Id.*

[95] *Id.* at 2-3.

[96] Press Release, *SEC Charges Perceptive Advisors for Failing to Disclose SPAC-Related Conflicts of Interest*, SEC. & EXCH. COMM'N (Sept. 6, 2022), https://www.sec.gov/news/press-release/2022-155.

[97] *Id.*

[98] *Id.*

The SEC's willingness to initiate enforcement actions against SPACs and conflicts of interest in connection with SPAC transactions, such as the Nikola and Perceptive Advisors actions, as well as Chairman Gensler's remarks and the newly proposed SPAC rules, indicate that we are likely to see more enforcement actions in this space as the SEC closely monitors de-SPAC transactions, examines disclosures made by SPACs, and increasingly treats SPAC IPOs more like traditional IPOs.

E. INSIDER TRADING ENFORCEMENT

The SEC continues to focus on investigating insider trading and filing insider trading enforcement actions. In a recent case, *SEC* v. *Panuwat*, the SEC proceeded with a novel approach to the misappropriation theory of insider trading—*i.e.*, a purported insider with material, non-public information about a separate but related company may not trade on that information.[99] The SEC brought a complaint against Matthew Panuwat, a former business development executive at biopharmaceutical company Medivation Inc., for violating Section 10(b) of the 1934 Act, after he allegedly purchased stock options in Medivation's competitor, Incyte Corp., "within minutes" of learning that Medivation would be acquired by Pfizer Inc.[100] Incyte's stock price rose following the public announcement that Pfizer would acquire Medivation, allegedly resulting in "illicit profits of $107,066" for Panuwat.[101] In particular, the SEC alleged that, prior to purchasing Incyte stock, Panuwat: (i) reviewed information from Medivation's investment bankers indicating that Medivation and Incyte were "comparable" and had "close parallels"; (ii) "tracked" the stock prices of Medivation, Incyte, and other biopharmaceutical companies; and (iii) engaged in discussions concerning Medivation confidentially soliciting bids from potential acquirers.[102] Further, the SEC claimed that Panuwat knew that "each [] acquisition [of a biopharmaceutical company] was material to [other biopharmaceutical] companies because it made them potentially more valuable acquisition targets and could thus positively affect the stock price of those companies."[103]

In November 2021, Panuwat moved to dismiss the SEC's enforcement action, arguing that the SEC "overstepped its enforcement authority" and "attempt[ed] to improperly expand existing insider trading law to punish innocent conduct without a valid legal basis or fair notice to market participants."[104] In short, Panuwat argued that the SEC failed to plead insider trading because the information concerning Medivation's acquisition was not material to Incyte's stock, Panuwat did not breach his duty to Medivation by trading Incyte's stock, and Panuwat did not act with the intent to defraud Medivation.[105] Panuwat further contended that the SEC's claim against him violates his due process rights because it extended the scope of insider trading laws without fair notice to market participants.[106]

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99 *See* Complaint, *SEC* v. *Panuwat*, No. 21-cv-06322, Dkt. No. 1, ¶¶ 1-5 (N.D. Cal. Aug. 17, 2021).
100 *Id.* ¶¶ 1-2, 4.
101 *Id.* ¶ 5.
102 *Id.* ¶¶ 21-25.
103 *Id.* ¶ 22.
104 Defendant's Motion to Dismiss, *SEC* v. *Panuwat*, No. 21-cv-06322, Dkt. No. 18, at 1 (N.D. Cal. Nov. 1, 2021).
105 *Id.* at 1-2, 9-15.
106 *Id.* at 2, 15-20.

A Northern District of California court was unpersuaded and denied Panuwat's motion to dismiss in January 2022.[107] *First*, the court concluded that the SEC sufficiently pleaded that the information concerning Medivation's acquisition was both nonpublic and material to Incyte's stock because Section 10(b) and Rule 10b-5 prohibit insider trading of any security and the Medivation acquisition made Incyte a more valuable acquisition target.[108] *Second*, the court determined that Panuwat's trading of Incyte's stock breached his duty to Medivation by violating Medivation's policy that prohibited trading another publicly traded company's securities.[109] *Third*, the court stated that Panuwat acted with the requisite scienter because he was aware of the material nonpublic information about Medivation's acquisition and used the information to trade Incyte's stock.[110] *Finally*, although acknowledging that no other insider trading cases have dealt with material nonpublic information about a third party, the court decided that the claim did not violate Panuwat's due process rights because the SEC's theory of liability falls within the "contours of the misappropriation theory" and the "expansive language" of Section 10(b) and Rule 10b-5.[111]

In another recent case, *SEC* v. *Clark*, the SEC brought an action against brothers-in-law Christopher Clark and William Wright for violating Section 10(b) of the 1934 Act, after Clark allegedly purchased stock options in CEB, Inc., where Wright served as corporate controller, shortly before another company acquired CEB.[112] The SEC did not cite any direct evidence of the alleged tip but rather alleged circumstantial evidence showing that an individual with close personal ties to a corporate insider engaged in unusual trading activity following communications aligning with the acquisition's progression.[113] In particular, the SEC alleged that Clark liquidated his wife's IRA, opened a line of credit at his family credit union, and took out a loan on his car to purchase out-of-the-money, short-term CEB call options.[114] This unusual trading took place, the SEC alleged, while Clark and Wright were in "frequent[]" communication.[115]

In October 2021, Wright and the SEC settled. Without admitting or denying the alleged insider trading violations, Wright consented to a final judgment ordering a permanent injunction against future violations of the insider trading laws, a civil monetary penalty of nearly $250,000, and a ban on serving as an officer or director of a public company for two years.[116] Conversely, Clark decided to proceed with the case and go to trial. In December 2021, following the SEC's case-in-chief, an Eastern District of Virginia court granted Clark's motion for judgment as a matter of law and dismissed the action against him.[117] The court reasoned that there was no "evidence that would show that there's something suspicious about [Clark's] trading" and

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[107] Order Denying Defendant's Motion to Dismiss, *SEC* v. *Panuwat*, No. 21-cv-06322, Dkt. No. 26, at 1 (N.D. Cal. Jan. 14, 2022).
[108] *Id.* at 1, 6-8.
[109] *Id.* at 1, 9.
[110] *Id.* at 1, 10-11. The court did not address whether the correct standard for establishing scienter was actual "use" of the material nonpublic information or merely being "aware" of the material nonpublic information. The court instead decided that the SEC's claim satisfied either standard. *Id.* at 10.
[111] *Id.* at 1, 11-13.
[112] Complaint, *SEC* v. *Clark*, No. 20-cv-01529, Dkt. No. 1, ¶¶ 1-6 (E.D. Va. Dec. 11, 2020).
[113] *Id.* ¶¶ 1-10.
[114] *Id.* ¶¶ 5-7.
[115] *Id.* ¶¶ 3-4, 8.
[116] Final Judgment, *SEC* v. *Clark*, No. 20-cv-01529, Dkt. No. 93, at 1-2 (E.D. Va. Oct. 18, 2021).
[117] Order, *SEC* v. *Clark*, No. 20-cv-01529, Dkt. No. 157, at 1 (E.D. Va. Dec. 13, 2021).

that the SEC's allegations were "just a matter of speculation."[118] Some have noted that this "shocking defeat" for the SEC is a "rare snub of the agency's time-tested reliance in court on statistical evidence of suspicious trading."[119]

Also in December 2021, the SEC proposed amendments to Rule 10b-5-1—which provides an affirmative defense to insider trading for corporate insiders and companies that trade stock according to trading plans—aimed at "enhanc[ing] disclosure requirements and investor protections against insider trading."[120] The proposed amendments would alter the requirements for the Rule 10b-5-1 affirmative defense, including by: (i) imposing a cooling-off period between the trading plan's adoption and the commencement of trading; (ii) prohibiting multiple overlapping trading plans; (iii) limiting the use of single-trade plans to one during any 12-month period; (iv) requiring directors and officers to certify in writing that they are not aware of material nonpublic information when adopting a trading plan; and (v) extending the good-faith requirement to both the adoption of a trading plan and the operation of the trading plan.[121] The proposed amendments would also require more robust disclosures concerning companies' insider trading policies and procedures, as well as the timing of companies' equity grants and the release of material nonpublic information.[122]

F. MARKET MANIPULATION ENFORCEMENT

In late April, the SEC charged Archegos and its founder, CFO, CRO, and head trader with violating the antifraud and other provisions of the federal securities laws in connection with an alleged fraudulent market manipulation scheme that caused billions of dollars in credit losses among Archegos's counterparties.[123]

The SEC's complaint contends that between March 2020 and March 2021, Archegos and its founder, Sung Kook "Bill" Hwang, purchased billions of dollars of total return security-based swaps to grow Archegos.[124] To ensure the appreciation of its exposures, the extension of its credit margin from its counterparties, and its continued growth, Archegos and its executives allegedly engaged in manipulative trading practices that artificially inflated the stock prices of the issuers representing Archegos's top 10 holdings.[125] When Archegos sought to extend its credit margin and capacity, Archegos's counterparties inquired about Archegos's risk profile, exposures, concentration, and liquidity.[126] In response, the SEC alleges, Archegos and its executives "deliberately misled" the counterparties and "knowingly provided . . . false assurances," which "fraudulently convinced" the counterparties that Archegos's positions were less concentrated and

[118] Transcript of Dec. 13, 2021 Proceedings, *SEC* v. *Clark*, No. 20-cv-01529, Dkt. No. 161, at 12-14 (E.D. Va. Dec. 13, 2021).

[119] Dean Seal, *SEC's Stunning Trial Loss Rattles Its Insider Trading Strategy*, LAW360 (Dec. 16, 2021), https://www.law360.com/articles/1449115.

[120] Press Release, *SEC Proposes Amendments Regarding Rule 10b5-1 Insider Trading Plans and Related Disclosures*, SEC. & EXCH. COMM'N (Dec. 15, 2021), https://www.sec.gov/news/press-release/2021-256.

[121] *Id.*

[122] *Id.*

[123] Press Release, *SEC Charges Archegos and Its Founder with Massive Market Manipulation Scheme*, SEC. & EXCH. COMM'N (Apr. 27, 2021), https://www.sec.gov/news/press-release/2022-70.

[124] Complaint, *SEC* v. *Hwang*, No. 22-cv-03402, Dkt. No. 1, ¶¶ 1-2 (S.D.N.Y. Apr. 27, 2022).

[125] *Id.* ¶¶ 3-4.

[126] *Id.* ¶¶ 5-6.

more liquid.[127] In March 2021, according to the SEC, "the house of cards collapsed" when Archegos's most concentrated positions declined in price, which resulted in margin calls that Archegos could not meet.[128] Archegos eventually defaulted, causing billions of dollars in losses among its creditor counterparties and other market participants invested in Archegos's top 10 holdings.[129]

In parallel actions, the Commodity Futures Trading Commission ("CFTC") is also pursuing civil charges and the U.S. Attorney's Office for the Southern District of New York is pursuing criminal charges for the conduct.[130] A week after the SEC filed its complaint, Archegos's CRO, Scott Becker, reached a settlement with the SEC and other agencies.[131] William Tomita, Archegos's head trader, is also cooperating with the SEC and other agencies.[132]

In addition, Chairman Gensler recently made remarks indicating that the SEC is considering requiring the registration of security-based swap execution facilities, which the SEC believes would "increase the transparency and integrity of the traditionally opaque over-the-counter security-based swap market," "bring[] together buyers and sellers with transparent, pre-trade pricing," "lower[] risk in the market place," and "protect[] investors."[133] The registration framework would "harmonize" with the analogous framework promulgated by the CFTC, which, according to Chairman Gensler, is "working well."[134]

G. RECORDKEEPING ENFORCEMENT

In December 2021, the SEC settled charges against JPMorgan Securities, a broker-dealer subsidiary of JPMorgan Chase, for recordkeeping violations under the federal securities laws.[135] The SEC alleged that, between 2018 and 2020, JPMorgan Securities employees—including managers and senior business personnel—used personal text messages, emails, and WhatsApp messages to send and receive business communications in violation of JPMorgan's policies and procedures.[136] The cease-and-desist order concludes that this conduct violated the recordkeeping requirements of the federal securities laws imposed on broker-dealers.[137] The order further alleges that JPMorgan did not search employees' personal devices for communications responsive to SEC subpoenas, which purportedly "impacted the [SEC's] ability to carry out its regulatory functions and investigate potential violations of the federal securities laws."[138]

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[127] *Id.*
[128] *Id.* ¶ 7.
[129] *Id.*
[130] Press Release, *SEC Charges Archegos and Its Founder with Massive Market Manipulation Scheme*, SEC. & EXCH. COMM'N (Apr. 27, 2021), https://www.sec.gov/news/press-release/2022-70.
[131] Bob Van Voris, *Archegos's Former Risk Director Settles SEC Claims*, YAHOO NEWS (May 4, 2022), https://www.yahoo.com/now/archegos-former-risk-director-settles-211258484.html.
[132] *Id.*
[133] Gary Gensler, *Statement on Registration of Security-Based Swap Execution Facilities*, SEC. & EXCH. COMM'N (Apr. 6, 2022), https://www.sec.gov/news/statement/gensler-registration-sbs-20220406.
[134] *Id.*
[135] Press Release, *JPMorgan Admits to Widespread Recordkeeping Failures and Agrees to Pay $125 Million Penalty to Resolve SEC Charges*, SEC. & EXCH. COMM'N (Dec. 17, 2021), https://www.sec.gov/news/press-release/2021-262.
[136] Order, *In re J.P. Morgan Securities LLC*, No. 3-20681, ¶¶ 5-6 (Sec. & Exch. Comm'n Dec. 17, 2021).
[137] *Id.* ¶¶ 1-4.
[138] *Id.* ¶ 7.

As part of the settlement and corresponding cease-and-desist order, JPMorgan Securities admitted to the SEC's factual findings and conclusions.[139] The order further required JPMorgan Securities to: (i) cease and desist from future violations of the recordkeeping provisions of the federal securities laws; (ii) pay a $125 million penalty to the SEC (in addition to a $75 million penalty to the CFTC for a parallel enforcement action); (iii) retain a compliance consultant to conduct reviews of its electronic communications policies and procedures; and (iv) undertake other remedial efforts.[140]

In September 2022, 15 broker-dealers and one affiliated investment adviser settled similar charges based on alleged failures by the firms and their employees to maintain and preserve electronic communications.[141] As part of the settlements, the firms admitted the SEC's factual findings and conclusions, agreed to cease and desist from future violations of the recordkeeping provisions of the federal securities laws, and began implementing improvements to their compliance policies and procedures.[142] The firms agreed to pay a combined total of $1.1 billion in penalties.[143]

H. SEC WHISTLEBLOWER PROGRAM

The SEC continued to issue significant awards to "whistleblowers whose information and assistance [lead] to successful SEC and related actions" in 2021.[144] The SEC's whistleblower program had another "record-breaking" year for whistleblower awards in 2021.[145] In fiscal year 2021, the SEC's whistleblower program surpassed $1 billion in awards to whistleblowers since the program's creation, including $564 million in 2021 alone.[146] Fiscal year 2021 also saw the highest number of awards—both in terms of monetary amount and number of individuals awarded—and the largest number of whistleblower tips received by the SEC.[147]

In August 2021, Chairman Gensler stated that the SEC will consider "potential revisions to . . . two rules that would address the concerns that [previous] amendments would discourage whistleblowers from coming forward."[148] The two amendments that the SEC will consider revising "preclude the Commission in some instances from making an award in related enforcement actions brought by other law-enforcement and regulatory authorities if a second, alternative whistleblower award program might also apply to the

[139] Press Release, *JPMorgan Admits to Widespread Recordkeeping Failures and Agrees to Pay $125 Million Penalty to Resolve SEC Charges*, SEC. & EXCH. COMM'N (Dec. 17, 2021), https://www.sec.gov/news/press-release/2021-262.

[140] Order, *In re J.P. Morgan Securities LLC*, No. 3-20681, at 11 & ¶¶ 37-46 (Sec. & Exch. Comm'n Dec. 17, 2021); Katanga Johnson, *J.P.Morgan Securities to Pay $200 Million to Settle U.S. Regulatory Charges on Record-Keeping Lapses*, REUTERS (Dec. 17, 2021), https://www.reuters.com/business/jpmorgan-securities-pay-125-mln-settle-sec-charges-record-keeping-lapses-2021-12-17/.

[141] Press Release, *SEC Charges 16 Wall Street Firms with Widespread Recordkeeping Failures*, SEC. & EXCH. COMM'N (Sept. 27, 2022), https://www.sec.gov/news/press-release/2022-174.

[142] *Id.*

[143] *Id.*

[144] Press Release, *SEC Surpasses $1 Billion in Awards to Whistleblowers with Two Awards Totaling $114 Million*, SEC. & EXCH. COMM'N (Sept. 15, 2021), https://www.sec.gov/news/press-release/2021-177.

[145] SEC. & EXCH. COMM'N, 2021 ANNUAL REPORT TO CONGRESS: WHISTLEBLOWER PROGRAM 1 (2021).

[146] *Id.*

[147] *Id.*

[148] Gary Gensler, *Statement in Connection with the SEC's Whistleblower Program*, SEC. & EXCH. COMM'N (Aug. 2, 2021), https://www.sec.gov/news/public-statement/gensler-sec-whistleblower-program-2021-08-02.

action," and "could be used by a future Commission to lower an award because of the size of the award in absolute terms," respectively.[149]

In response to concerns about these amendments, the SEC recently proposed changes to the rules governing the whistleblower program that seek to "ensure that whistleblowers are both incentivized and appropriately rewarded for their efforts in reporting potential violations of the law."[150] Revised rules tracking these proposals went into effect on October 3, 2022.[151]

SEC Rule 21F-3 previously permitted the SEC to pay a whistleblower award for certain related enforcement actions bought by other agencies, but only if the SEC had a "more direct or relevant connection" to the enforcement action.[152] The revised rule offers alternative approaches under which the SEC may pay a whistleblower award for a related enforcement action, including when the SEC does not have a "more direct or relevant connection" to the action.[153] Chairman Gensler noted that this rule change was "designed to ensure that a whistleblower is not disadvantaged by another whistleblower program that would not give them as high an award as the SEC would offer."[154]

SEC Rule 21F-6 governs the determination of the whistleblower award amount and provides the relevant factors for the analysis.[155] The previous rule authorized the SEC to consider the dollar amount of a whistleblower award when determining an award.[156] The revised rule reaffirms the SEC's authority to consider the dollar amount but only to increase, and not decrease, the award amount.[157] Chairman Gensler remarked that this rule change would "give whistleblowers additional comfort knowing that the SEC could consider the dollar amount of the award" only to increase the award.[158]

I. SEC ENFORCEMENT IN THE COURTS

Supreme Court to Consider Proper Venue for Challenging SEC Administrative Proceedings. On May 16, 2022, the Supreme Court granted the SEC's petition for a writ of certiorari in *Cochran* v. *SEC*, a case concerning the proper venue for challenging SEC administrative proceedings.[159] In *Cochran*, the SEC initiated an enforcement action before an administrative law judge against an accountant for violating the auditing requirements of the federal securities laws.[160] Before the case was decided, the Supreme Court

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[149] *Id.* (citing 17 C.F.R. § 240.21F-3 and 17 CFR § 240.21F-6).
[150] Press Release, *SEC Proposed Changes to Two Whistleblower Program Rules*, SEC. & EXCH. COMM'N (Feb. 10 2022), https://www.sec.gov/news/press-release/2022-23.
[151] Whistleblower Program Rules, Exchange Act Release No. 95,620, 87 FR 54140, 54140 (Sept. 2, 2022).
[152] 17 C.F.R. § 240.21F-3 (as amended 2020).
[153] 17 C.F.R. § 240.21F-3; *see also* Fact Sheet, *Proposed Changes to Whistleblower Program Rules*, SEC. & EXCH. COMM'N 1 (Feb. 10, 2022), https://www.sec.gov/files/34-94212-fact-sheet.pdf.
[154] Press Release, *SEC Proposed Changes to Two Whistleblower Program Rules*, SEC. & EXCH. COMM'N (Feb. 10 2022), https://www.sec.gov/news/press-release/2022-23.
[155] 17 C.F.R. § 240.21F-6.
[156] Fact Sheet, *Proposed Changes to Whistleblower Program Rules*, SEC. & EXCH. COMM'N 2 (Feb. 10, 2022), https://www.sec.gov/files/34-94212-fact-sheet.pdf.
[157] 17 C.F.R. § 240.21F-6.
[158] Press Release, *SEC Proposed Changes to Two Whistleblower Program Rules*, SEC. & EXCH. COMM'N (Feb. 10 2022), https://www.sec.gov/news/press-release/2022-23.
[159] *SEC* v. *Cochran*, 142 S. Ct. 2707, 2707 (2022)
[160] *Cochran* v. *SEC*, 20 F.4th 194, 198 (5th Cir. 2021) (en banc).

held in *Lucia* v. *SEC* that SEC administrative law judges must be appointed by someone under presidential control rather than selected by SEC staff.[161] *Lucia*, however, did not settle the constitutionality of how administrative law judges are removed.[162] After *Lucia*, the SEC reassigned all actions, including Cochran's, to administrative law judges that had been properly appointed.[163]

Cochran subsequently filed suit against the SEC in federal district court challenging the constitutionality of the SEC's action against her and alleging that the multiple layers of "for cause" removal protections for SEC administrative law judges are unconstitutional.[164] After a Northern District of Texas court and Fifth Circuit panel sided with the SEC, the en banc Fifth Circuit agreed to hear the case.[165] The en banc Fifth Circuit held that the 1934 Act does not strip federal district courts of jurisdiction to hear suits challenging the constitutionality of SEC enforcement actions.[166] The court also concluded that Cochran's underlying claims concerning the constitutionality of the removal process are ripe for judicial decision.[167]

The SEC appealed the Fifth Circuit's decision and the Supreme Court agreed to hear the case in November.[168] The Supreme Court will decide only the jurisdictional issue and will not decide the merits of Cochran's constitutional claims concerning the removal process. *Cochran* likely will have significant consequences for agency enforcement proceedings and constitutional challenges to enforcement actions brought by the SEC, as well as other agencies.

Then, on May 18, 2022, in a 2-1 decision, the Fifth Circuit held that SEC enforcement proceedings before the SEC's administrative law judges violate the Seventh Amendment right to a jury trial.[169] The three-judge panel further held that the delegation of certain legislative power to the SEC violates Article I of the Constitution and that the statutory removal restrictions on the SEC's administrative law judges violate Article II's Take Care Clause.[170]

Petitioner George Jarkesy founded two hedge funds and chose petitioner Patriot 28, LLC to serve as the funds' investment adviser.[171] Following an investigation into the petitioners' investing activities, the SEC charged the petitioners with violating the antifraud provisions of the federal securities laws and initiated an enforcement action within the SEC.[172] A District of Columbia court and the D.C. Circuit declined the petitioners' request to enjoin the SEC's proceedings, deciding that the district court lacked jurisdiction over the SEC's proceedings.[173] The district court, however, noted that the petitioners could petition the court of

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161 *Id.* (citing *Lucia* v. *SEC*, 138 S. Ct. 2044, 2049, 2051 n.3 (2018)).
162 *Id.*
163 *Id.*
164 *Id.*
165 *See id.* at 198-99.
166 *Id.* at 198, 212.
167 *Id.* at 213.
168 *SEC* v. *Cochran*, 142 S. Ct. 2707, 2707 (2022).
169 *Jarkesy* v. *SEC*, 2022 WL 1563613, at *1, 7 (5th Cir. May 18, 2022).
170 *Id.* at *1, 11, 13.
171 *Id.* at *1.
172 *Id.*
173 *Id.* (citing *Jarkesy* v. *SEC*, 48 F. Supp. 3d 32, 40 (D.D.C. 2014), *aff'd*, 803 F.3d 9, 12 (D.C. Cir. 2015)).

appeals to review a final order issued by the SEC.[174] Following proceedings before the SEC, the SEC found that the petitioners violated the antifraud provisions of the federal securities laws.[175] In doing so, the SEC rejected the petitioners' constitutional arguments concerning the SEC's enforcement proceedings.[176] The petitioners subsequently asked the Fifth Circuit to review the SEC's decision.[177]

In holding that SEC enforcement proceedings before the SEC's administrative law judges violate the Seventh Amendment right to a jury trial, the Fifth Circuit reasoned that the proceedings were "akin to traditional actions at law to which the jury-trial right attaches" and that the proceedings implicated more than just public rights.[178] The court added that other courts have reached similar decisions concerning SEC enforcement actions and the Seventh Amendment right to a jury trial.[179] In holding that Congress's provision to the SEC of "unfettered authority to choose whether to bring actions in Article III courts or within the [SEC itself]" was unconstitutional, the court noted that Congress's failure to provide an "intelligible principle" for exercising the delegated power was fatal for the delegation.[180] Finally, in holding that the statutory removal restrictions on the SEC's administrative law judges violate Article II's Take Care Clause, the court reasoned that multiple layers of "for cause" removal protections for executive officers that "perform substantial executive functions" prevent the President from "tak[ing] care" that the laws be faithfully executed.[181]

On July 1, 2022, the SEC asked the full Fifth Circuit to rehear the case.[182] On October 21, 2022, in a 10-6 vote, the full Fifth Circuit denied the petition for rehearing.[183] The *Jarkesy* decision, absent a reversal, suggests that the SEC must bring civil fraud enforcement actions in federal court rather than through agency proceedings. The *Jarkesy* decision may also result in courts invalidating proceedings before and decisions by SEC administrative law judges until Congress revises the removal protections. *Cochran* and *Jarkesy* will have major implications for the SEC's enforcement power and could significantly alter how the SEC brings enforcement actions. The cases could also have additional implications that extend to other administrative agencies.

Second Circuit Rejects Scheme Liability Claim. On July 15, 2022, in an interlocutory appeal, the Second Circuit held that scheme liability under the federal securities laws requires something beyond material misstatements or omissions, such as dissemination.[184] In doing so, the Second Circuit rejected the SEC's

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[174] *Id.*
[175] *Id.* at *2.
[176] *Id.*
[177] *Id.*
[178] *Id.* at *2, 6-7.
[179] *Id.* at *4 (citing *SEC* v. *Lipson*, 278 F.3d 656, 662 (7th Cir. 2002); *SEC* v. *Badian*, 822 F. Supp. 2d 352, 365 (S.D.N.Y. 2011); and *SEC* v. *Solow*, 554 F. Supp. 2d 1356, 1367 (S.D. Fla. 2008)).
[180] *Id.* at *8, 10-11.
[181] *Id.* at *11-13.
[182] Petition, *Jarkesy* v. *SEC*, No. 20-61007, at 1 (5th Cir. July 1, 2022).
[183] Court Order, *Jarkesy* v. *SEC*, No. 20-61007, at 1 (5th Cir. Oct. 21, 2022).
[184] *SEC* v. *Rio Tinto*, 41 F.4th 47, 49 (2d Cir. 2022).

interpretation of the Supreme Court's 2019 decision in *Lorenzo* v. *SEC*[185] and concluded that *Lorenzo* did not overrule Second Circuit precedent[186] that scheme liability requires more than alleged misstatements or omissions.[187] In *Lorenzo*, the Supreme Court held that the dissemination of false statements made by another could result in scheme liability.[188] The Second Circuit noted that false statements alone did not form the basis for scheme liability in *Lorenzo* and that the dissemination of those false statements was "something extra that ma[de] a violation a scheme."[189]

In reaching that conclusion, the Second Circuit reasoned that the respective subsections of Rule 10b-5 and Section 17(a) of the 1933 Act are "distinct" and that the "scheme subsections" in each provision do not envelop the "misstatements subsection[s]."[190] The Second Circuit then explained that the SEC's scheme liability theory would "undermine two key features of Rule 10b-5(b)"—first, liability under Rule 10b-5(b) extends only to the "maker" of a statement under the Supreme Court's 2011 decision in *Janus Capital Group* v. *First Derivatives Traders*,[191] and second, Rule 10b-5(b) claims brought by private plaintiffs are subject to the heightened pleading standard of the PSLRA but scheme liability claims are not.[192] The Second Circuit added that "overreading *Lorenzo* would muddle primary and secondary liability" because, unlike the SEC, private parties cannot bring aiding and abetting claims.[193]

***District Court Orders Disgorgement Post-*Liu**. On August 10, 2022, a Middle District of Florida court ordered disgorgement following a jury verdict finding that the defendants violated the federal securities laws.[194] The district court first addressed "whether it may order disgorgement at all," which it answered in the affirmative despite the inability to identify allegedly harmed investors.[195] The district court reasoned that in *Liu* v. *SEC*, the Supreme Court held that "the SEC could seek disgorgement . . . so long as the award did not exceed the wrongdoer's net profits and was 'awarded for victims.'"[196] The Supreme Court, however, did not address the question of whether disgorgement was available when the allegedly defrauded victims could not be identified.[197] After the Supreme Court's *Liu* decision, Congress amended the federal securities laws to explicitly authorize federal courts to "order disgorgement."[198] The district court concluded that under the amended federal securities laws, it may order disgorgement and direct that disgorged funds be sent to the Treasury.[199] The district court further held, in the alternative, that a balancing of the equities still favored

[185] 139 S. Ct. 1094 (2019).
[186] Specifically, the Second Circuit cited *Lentell* v. *Merrill Lynch & Co.*, 396 F.3d 161 (2d Cir. 2005).
[187] *Rio Tinto*, 41 F.4th at 49.
[188] *Lorenzo*, 139 S. Ct. at 1100.
[189] *Rio Tinto*, 41 F.4th at 54.
[190] *Id.* at 49.
[191] 564 U.S. 135 (2011).
[192] *Rio Tinto*, 41 F.4th at 52.
[193] *Id.* at 55.
[194] *SEC* v. *Spartan Sec. Grp., Ltd.*, 2022 WL 3224008, at *1, *12 (M.D. Fla. Aug. 10, 2022).
[195] *Id.* at *8-9.
[196] *Id.* at *8 (quoting *Liu* v. *SEC*, 140 S. Ct. 1936, 1940 (2020)).
[197] *Id.* (citing *Liu*, 140 S. Ct. at 1948-49).
[198] *Id.* at *8-9 (quoting 15 U.S.C. § 78u(d)(7)).
[199] *Id.* at *9.

ordering disgorgement to the Treasury.[200] To support its balancing analysis, the district court identified other post-*Liu* cases that "allowed disgorgement awards to be directed toward the Treasury."[201] This decision will likely further embolden the SEC to pursue disgorgement penalties in federal courts even where specific allegedly harmed investors cannot be identified.

200 *Id.* at *9-10.

201 *Id.* at *9 (citing *SEC* v. *Bronson*, 2022 WL 1287937, at *14 (S.D.N.Y. Apr. 29, 2022); *SEC* v. *Almagarby*, 2021 WL 4461831, at *3 (S.D.N.Y. Aug. 16, 2021); and *SEC* v. *Laura*, 2020 WL 8772252, at *5 (E.D.N.Y. Dec. 30, 2020)).

II. PART 2 – PRIVATE SECURITIES LITIGATION

A. NUMERICAL TRENDS IN PRIVATE SECURITIES LITIGATION

In 2021, federal and state private securities litigation activity declined for the second year in a row, dropping to 218 class action filings, compared to 333 filings in 2020 and an all-time high of 427 filings in 2019.[202] Meanwhile, "core" filings (*i.e.*, excluding M&A-related litigation) dropped to 200 filings in 2021, down from 234 filings in 2020.[203] The decline is attributable to the drop in M&A-related filings and core filings without Section 11 claims (*i.e.*, filings unrelated to IPOs or secondary offerings), by 82% and 17%, respectively, from 2020.[204] Although the number of new filings decreased last year, the typical filing size increased as measured by Cornerstone Research's median Disclosure Dollar Loss Index (by 41%) and median Maximum Dollar Loss Index (by 105%), which track changes in defendant companies' market capitalization following alleged corrective disclosure dates.[205]

State court activity also declined again in 2021,[206] continuing its downward trend since the Delaware Supreme Court's 2020 decision in *Sciabacucchi*.[207] The number of state court 1933 Act class action filings dropped to the lowest level in the past four years, with 13 in 2021, compared to 23 in 2020, 52 in 2019, and 35 in 2018. Of those 13 filings, ten were filed in New York and only one in California.[208] In addition, parallel filings in state and federal courts dropped from eight filings in 2020 to five filings in 2021.[209]

Even as private litigation activity decreased overall, core federal filings related to SPACs increased more than six-fold over the previous year.[210] In 2021, there were 32 filings arising from SPACs, compared to just five in 2020.[211] Of those filings, nearly one-third (11 filings) were against companies in the automotive industry and nine filings were against companies in the consumer non-cyclical sector.[212] With the exception of one M&A-related action, all federal SPAC filings in 2021 involved Section 10(b) claims.[213]

Overall, the likelihood of securities class action filings against U.S. exchange-listed companies dropped to its lowest level since 2014.[214] In 2021, the percentage of such companies subject to filings decreased to 4.2%, down from 6.3% the previous year and an all-time high of 8.9% in 2019.[215] Only 2.2% of companies

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[202] CORNERSTONE RESEARCH, SECURITIES CLASS ACTION FILINGS: 2021 YEAR IN REVIEW 1, 37 (2022), https://www.cornerstone.com/wp-content/uploads/2022/02/Securities-Class-Action-Filings-2021-Year-in-Review.pdf [hereinafter SECURITIES CLASS ACTION FILINGS 2021].

[203] *Id.* at 37.

[204] *Id.* at 4.

[205] *Id.* at 3, 10-13.

[206] *Id.* at 3, 21.

[207] *Salzberg* v. *Sciabacucchi*, 227 A.3d 102 (Del. 2020).

[208] SECURITIES CLASS ACTION FILINGS 2021, at 19.

[209] *Id.* at 4.

[210] *Id.* at 5.

[211] *Id.*

[212] *Id.* at 5-6.

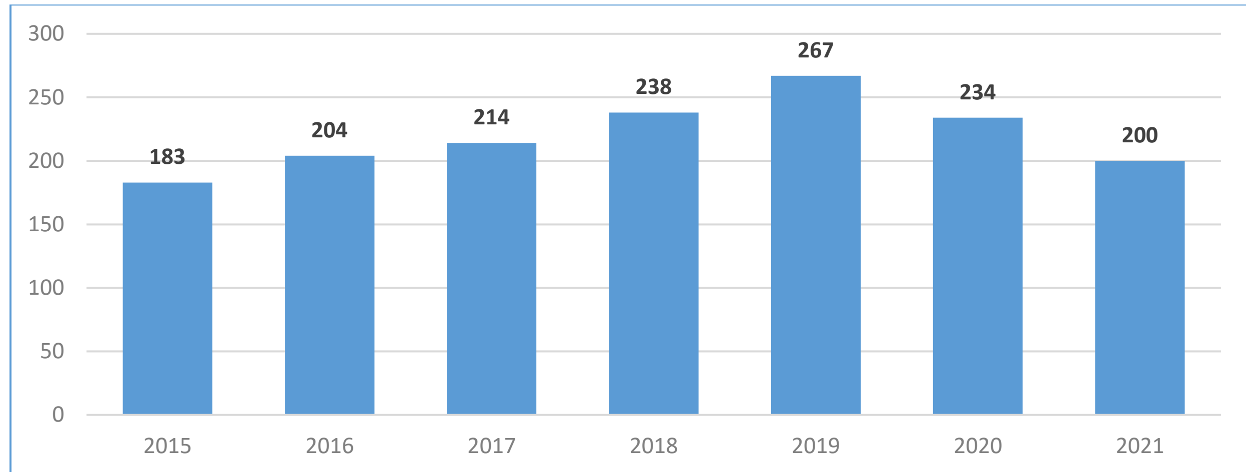
[213] *Id.* at 8.

[214] *Id.* at 2.

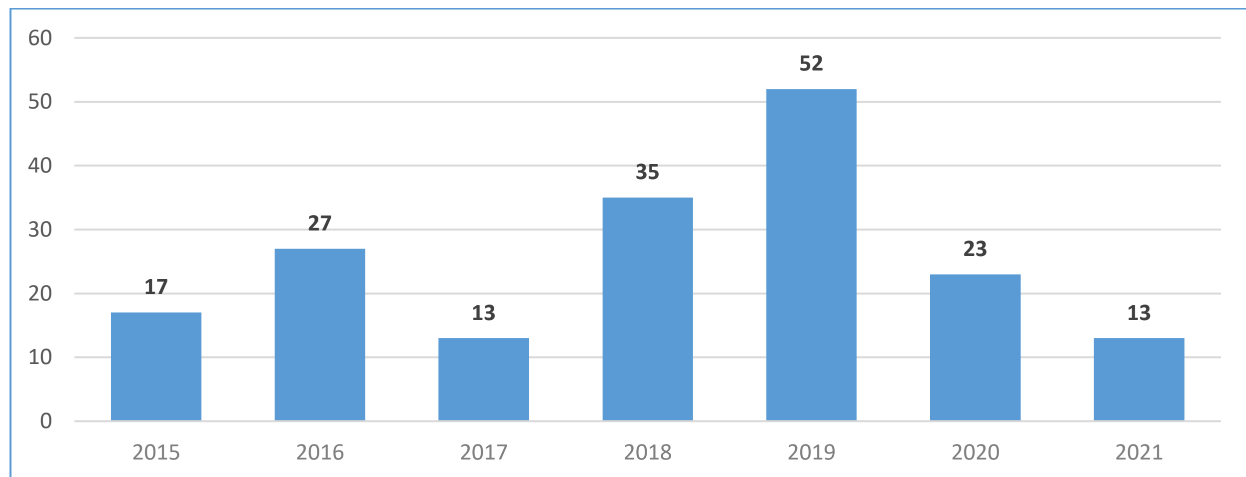
[215] *Id.* at 14.

listed in the S&P 500 were subject to a core federal filing, the lowest level since 2015.[216] Although filings against S&P 500 companies in the consumer staples, energy/materials, and telecommunications/IT sectors more than doubled from 2020, there were no filings against S&P 500 companies in the consumer discretionary, financials/real estate, health care, and utilities sectors.[217]

Core Securities Filings 2015 to 2021



State Court 1933 Act Filings 2015 to 2021



B. UPDATE ON STATE COURT PROCEEDINGS

As private securities litigation in state courts continues to decline, a recent development from the California Court of Appeal may reinforce this trend. Following a series of California trial court decisions upholding federal forum provisions (FFPs) that require 1933 Act claims to be brought in federal court, the California Court of Appeal issued its first decision on the enforceability of FFPs on April 28, 2022. In *Wong* v.

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216 *Id.* at 15.
217 *Id.*

Restoration Robotics, the Court of Appeal, First District, affirmed a trial court's grant of a motion to dismiss based on *forum non conveniens* where the defendant company's certificate of incorporation included an FFP.[218]

The fact that the 1933 Act contemplates suits in either federal or state court, the Court of Appeal reasoned, "does not *guarantee* suit in all competent courts, disabling the parties from adopting a reasonable forum-selection clause."[219] It rejected the plaintiff's arguments that this principle did not apply due to the 1933 Act's removal bar and anti-waiver provision. As to the removal bar, which provides that no case arising under the 1933 Act and brought in state court "shall be removed to any court of the United States,"[220] the Court of Appeal concluded that it does not extend further than "prevent[ing] a defendant from removing a civil case that has been filed in state court."[221] And the Court of Appeal determined that because the concurrent jurisdiction provision of the 1933 Act does not "impose any duty" on persons trading in securities, it may "be overridden by a forum selection agreement without violating the 1933 Act's anti-waiver provision,"[222] which provides that "[a]ny condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter . . . shall be void."[223] Analogizing to the U.S. Supreme Court's case law on arbitration provisions, the Court of Appeal could not "discern how resort to a federal court could undermine any of [the] rights" under the 1933 Act.[224]

In addition, the Court of Appeal held that Delaware corporate law permitting FFPs did not violate the U.S. Constitution's Commerce Clause or Supremacy Clause. It reasoned that "Delaware has a legitimate interest in allowing its corporations to include FFPs in their certificates of incorporation, and that any burden on interstate commerce . . . does not exceed the benefits provided by the statute."[225] And the Court of Appeal concluded that the Delaware General Corporations Law, including Section 115, which provides that Delaware companies may require that "internal corporate claims" be brought exclusively in Delaware state courts, "does not reflect any quarrel between Delaware and federal law over the content of the 1933 Act or the extent of the remedies available" thereunder.[226]

The Court of Appeal also determined that the FFP was not unenforceable under California law. It reasoned that the FFP did not contravene the reasonable expectations of an ordinary investor, as the provision was disclosed in the company's registration statement.[227] Nor was the FFP procedurally or substantively unconscionable.[228]

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[218] *Wong* v. *Restoration Robotics, Inc.*, 293 Cal. Rptr. 3d 226 (Ct. App. 2022).
[219] *Id.* at 237 (quoting *CompuCredit Corp.* v. *Greenwood*, 565 U.S. 95, 102 (2012)).
[220] 15 U.S.C. § 77v(a).
[221] *Wong*, 293 Cal. Rptr. at 237.
[222] *Id.* at 241.
[223] 15 U.S.C. § 77n.
[224] *Wong*, 293 Cal. Rptr. at 240.
[225] *Id.* at 243.
[226] *Id.* at 246.
[227] *Id.* at 249.
[228] *Id.* at 250-51.

The California Court of Appeal's decision gives greater confidence to corporate defendants that FFPs will be upheld in suits brought in California.

C. SECOND CIRCUIT GRANTS THIRD INTERLOCUTORY APPEAL IN *GOLDMAN SACHS*

Following remand from the U.S. Supreme Court in *Goldman Sachs Group, Inc.* v. *Arkansas Teacher Retirement System*,[229] Goldman Sachs and its former senior officers, represented by S&C, obtained a third discretionary Rule 23(f) appeal of class certification when the Second Circuit granted their petition for review on March 9, 2022.[230] Since Rule 23(f) was adopted in 1998, this is only the second case in which a federal appeals court has granted interlocutory review of class certification three times.

Last June, the Supreme Court ruled 8-1 in favor of Goldman Sachs, clarifying the standards for rebutting the "fraud-on-the-market" presumption of class-wide reliance.[231] The Court agreed with Goldman Sachs that the generic nature of challenged statements and any mismatch with the alleged corrective disclosures are important evidence in determining whether the statements impacted the stock price, which is a requirement for certifying a shareholder class.[232] On remand, the district court recertified a class.[233]

The petition for review was supported by multiple amici, including the U.S. Chamber of Commerce, the Bank Policy Institute, the Securities Industry and Financial Markets Association, the Society for Corporate Governance, the Washington Legal Foundation, a group of former SEC officials and law professors, and a group of financial economists.

D. SECOND CIRCUIT DECLINES TO EXPAND SECURITIES STANDING

On September 30, 2022, the Second Circuit clarified that purchasers of an acquiring firm's securities do not have standing under Section 10(b) of the 1934 Act to sue a target firm for misstatements the target allegedly made prior to a merger.[234]

International Flavors & Fragrances, Inc. (IFF) acquired Frutarom Industries Ltd. in 2018.[235] Plaintiffs alleged that in the lead-up to the merger, Frutarom made misleading statements about the source of its growth and its compliance with anti-bribery laws, which IFF incorporated into its Form S-4.[236] When the merger closed, making Frutarom IFF's wholly owned subsidiary, Plaintiffs sued IFF and Frutarom under Sections 10(b) and 20(a) of the 1934 Act in the Southern District of New York.[237] The district court

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229 141 S. Ct. 1951 (2021).
230 *See* Order, *Goldman Sachs Grp., Inc.* v. *Ark. Tchrs. Ret. Sys.*, No. 21-3105, Dkt. No. 102 (2d Cir. Mar. 9, 2022).
231 *Goldman*, 141 S. Ct. at 1963.
232 *Id.* at 1961.
233 *In re Goldman Sachs Grp. Inc. Sec. Litig.*, 579 F. Supp. 3d 520, 538-39 (S.D.N.Y. Dec. 8, 2021).
234 *Menora Mivtachim Ins. Ltd.* v. *Frutarom Indus. Ltd.*, 49 F.4th 790, 796 (2d Cir. 2022).
235 *Id.* at 791-92.
236 *Id.*
237 *Id.*

dismissed the suit as to both defendants, holding that the plaintiffs could not sue Frutarom for the alleged misstatements it had made about itself because they had purchased IFF shares, not Frutarom shares.[238]

In affirming the dismissal, the Second Circuit rejected the plaintiffs' attempt to expand the purchaser-seller rule set out in *Blue Chip Stamps* v. *Manor Drug Stores*[239] and *Birnbaum* v. *Newport Steel Corp.*[240] The plaintiffs argued that they had standing because there was a "direct relationship" between Frutarom's alleged misstatements about itself and the price of IFF's shares.[241] According to the plaintiffs, IFF and Frutarom were "inextricably linked"; Frutarom's misstatements were repeated by IFF, reached IFF's investors, and drove up IFF's share price.[242] The Second Circuit held that the purchaser-seller rule, which circumscribes the private right of action implied in Section 10(b), means no more than it says: only purchasers and sellers have standing to sue under 10(b).[243] Under that bright-line rule, the significance of the relationship between two companies is irrelevant for standing.[244] Indeed, the Court cautioned that adopting the plaintiffs' fact-bound "direct relationship" test would precipitate an "endless case-by-case erosion" of the purchaser-seller rule.[245]

In refusing to expand the scope of standing under Section 10(b), the Second Circuit answered a question it had left open since its decision in *Ontario Public Service Employees Union Pension Trust Fund* v. *Nortel Networks Corporation*[246] 18 years ago.[247] But in an opinion concurring in the judgement, Judge Perez wrote that the case could have been resolved using the "direct relationship" test the plaintiffs urged, potentially breathing continued life into similar claims.[248] Additionally, to avoid implying that "a target company and its officers are free to make misstatements or omissions as long as the company is acquired," the Second Circuit suggested in a footnote that recourse to state law may be appropriate.[249] Whether that suggestion will precipitate an increase of state law derivative actions—or whether state law would in fact support such actions—remains to be seen.

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238 *Menora Mivtachim Ins. Ltd.* v. *Int'l Flavors & Fragrances Inc.*, 2021 WL 1199035, at *29-30 (S.D.N.Y. Mar. 30, 2021), *aff'd sub nom. Menora Mivtachim Ins. Ltd.* v. *Frutarom Indus. Ltd.*, 49 F.4th 790 (2d Cir. 2022).

239 421 U.S. 723 (1975).

240 193 F.2d 461 (2d Cir. 1952).

241 *Menora Mivtachim Ins. Ltd.*, 49 F.4th at 794.

242 Brief and Special Appendix for Plaintiffs-Appellants, *Menora Mivtachim Ins. Ltd.* v. *Frutarom Indus. Ltd.*, 49 F.4th 790, Dkt. No. 54, 17-18 (2d Cir. 2022).

243 *Menora Mivtachim Ins. Ltd.*, 49 F.4th at 795-96.

244 *Id.*

245 *Id.* at 795.

246 *Ontario Pub. Serv. Emps. Union Pension Tr. Fund* v. *Nortel Networks Corp.*, 369 F.3d 27, 34 (2d Cir. 2004).

247 *Menora Mivtachim Ins. Ltd.*, 49 F.4th at 796 ("Plaintiffs argue that Nortel would have found standing if there had been a sufficiently 'direct relationship' between Nortel's statements and JDS's stock price. . . . [W]e said that was 'a question that we leave for another day and about which we express no opinion.' For the reasons explained above, we now answer that question . . . .").

248 *Id.* at 798 (Perez, J., concurring).

249 *Id.* at 796 n.9.

E. NINTH CIRCUIT CONFIRMS SECURITIES LAWS DO NOT REQUIRE REAL-TIME DISCLOSURES

In a March 23, 2022 decision in a securities class action against Twitter and its senior officers, the Ninth Circuit reaffirmed that the federal securities laws do not require real-time updates about business operations.[250] In May 2019, Twitter announced that it had discovered and fixed various data-privacy issues with its Mobile App Promotion (MAP) product, which it had highlighted as an important driver of revenue growth.[251] Three months later, the company again announced that it had discovered and fixed additional data-privacy issues with MAP.[252] The company did not disclose, however, that it "had stopped sharing user data for its MAP advertising program altogether," rather than "resolving the software bugs, which proved to be difficult."[253] As a result, the plaintiffs alleged that the defendants made false statements, in violation of Section 10(b) of the 1934 Act, by failing "to disclose the scope of the software bugs hindering MAP" and by "misleadingly suggest[ing] Twitter had solved the software bugs, not just the privacy leak."[254]

Affirming dismissal of the action, the Ninth Circuit observed that although "society may have become accustomed to being instantly in the loop about the latest news (thanks in part to Twitter), our securities laws do not impose a similar requirement."[255] It held that "companies do not have an obligation to offer an instantaneous update of every internal development, especially when it involves the oft-tortuous path of product development."[256] As the Ninth Circuit reasoned, a requirement of instantaneous disclosure "would inject instability into the securities market" and cause stocks to "wildly gyrate based on even fleeting developments."[257] Thus, it concluded that the securities laws "do not require real-time business updates or complete disclosure of all material information whenever a company speaks on a particular topic."[258]

Further, the Ninth Circuit ruled that the alleged misstatements merely "suggest[ed] a vaguely optimistic assessment that MAP, like almost all product developments, has had its ups and downs" and that Twitter did not issue any "specific or unqualified guidance" about MAP's development.[259] It disagreed with the plaintiffs' contention that Twitter's reference to "fix[ing]" problems "was referring to the fix of the software bugs, and not just a halt to the data sharing.[260] As a result, the Ninth Circuit affirmed the district court's ruling that the plaintiffs had failed to adequately allege falsity.[261]

Although not breaking new ground, the Ninth Circuit's decision provides further assurance to companies that the securities laws do not necessitate real-time disclosure of business updates and other material

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[250] *Weston Fam. P'ship LLLP* v. *Twitter, Inc.*, 29 F.4th 611 (9th Cir. 2022).
[251] *Id.* at 615-16.
[252] *Id.* at 616.
[253] *Id.*
[254] *Id.* at 616-17.
[255] *Id.* at 620.
[256] *Id.* (citing *In re Vantive Corp. Sec. Litig.*, 283 F.3d 1079, 1085 (9th Cir. 2002)).
[257] *Id.*
[258] *Id.* at 615.
[259] *Id.* at 620.
[260] *Id.* at 622.
[261] *Id.* at 623.

information in every circumstance. "To the contrary," the decision explains, "a company can speak selectively about its business so long as its statements do not paint a misleading picture."[262]

F. CRYPTOCURRENCY-RELATED SECURITIES LITIGATION

Over the past two years, cryptocurrency-related securities filings (*i.e.*, filings against blockchain or cryptocurrency companies engaged in the sale or exchange of tokens, cryptocurrency mining, cryptocurrency derivatives, or the design of blockchain software) have increased considerably, from four filings in 2019 to 12 filings in 2020 and 11 filings in 2021.[263] Although these cases are in varying stages, a number of private securities actions have raised the issue of whether certain digital tokens are "securities" for purposes of the securities laws. We highlight several noteworthy developments below.

Last April, a Southern District of New York court granted a motion to dismiss an action asserting claims under the 1933 and 1934 Acts against Bibox, alleging that it sold unregistered securities by offering six digital tokens for sale, that it sold securities on an unregistered exchange, and that it operated as an unregistered broker-dealer.[264] The court did not address the substantive issue of whether each token satisfied the definition of a "security," finding that the plaintiff lacked standing to bring claims regarding five of the six tokens because he never purchased them.[265] With respect to the remaining token, BIX, that the plaintiff did purchase, the court found that the claims were time-barred.[266]

Notably, the *Bibox* court held that the fact that all the tokens at issue "share[d] a technological feature" and were "fully functional technologies similar to Bitcoin," was "insufficient to permit a finding that the plaintiff has standing to represent a class composed not just of purchasers of BIX but also of purchasers of the other five tokens."[267] It also reasoned that because "the issue of whether a particular token is in fact a security has significant consequences . . . and that determination involves an application of the Supreme Court's *Howey* test," the plaintiff had not shown that the five tokens he did not purchase "raise[d] the same set of concerns as trading in BIX" as "[t]hat test is a fact-intensive inquiry and will reach a result that depends on the unique characteristics of each token."[268]

Disputes over whether digital tokens qualify as "securities" have arisen more prominently in a putative securities class action against Coinbase. In March 2022, the plaintiffs filed a consolidated complaint against Coinbase and its CEO, alleging that 79 of the tokens listed on its platform were unregistered securities, and claiming that Coinbase sold unregistered securities and operated as an unregistered exchange and broker-dealer in violation of the 1933 Act, the 1934 Act, and state Blue Sky laws.[269] In May 2022, the defendants

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[262] *Id.* at 615.
[263] SECURITIES CLASS ACTION FILINGS 2021, at 5, 36.
[264] *In re Bibox Grp. Holdings Ltd. Sec. Litig.*, 534 F. Supp. 3d 326 (S.D.N.Y. 2021).
[265] *Id.* at 334.
[266] *Id.* at 338-41.
[267] *Id.* at 335-36.
[268] *Id.* at 336.
[269] Amended Complaint, *Underwood* v. *Coinbase Global, Inc.*, No. 21-cv-08353, Dkt. No. 43 (S.D.N.Y. Mar. 11, 2022).

filed a motion to dismiss, arguing that the plaintiffs failed to plead that Coinbase passed title to or successfully solicited the plaintiffs' purchases of any alleged securities, among other things.[270] The *Coinbase* litigation highlights the potential role of private securities litigation in resolving the legal status of various digital tokens under the securities laws.

Another private action raises the prospect of a court adjudicating for the first time whether non-fungible tokens (NFTs) are "securities." NFTs have been described as "units of data stored on a blockchain that are created to transfer ownership of either physical things or digital media."[271] In a putative securities class action filed in May 2021 against Dapper Labs, a blockchain consumer product company, in a New York trial court, the plaintiff alleged that Dapper Labs' sale of NFTs constituted the sale of "securities" in violation of Sections 5 and 12(a)(1) of the 1933 Act.[272] Specifically, the complaint alleges that Dapper Labs operated a "NBA Top Shot" application and promoted, sold, and offered "NBA Top Shot Moments," which were collectible NFTs depicting video clips of highlights from NBA basketball games that used blockchain technology.[273] It alleges that purchasers of the NBA Moments "were denied the information that would have been contained in the materials required for the registration of the Moments."[274] The defendants removed the case to the Southern District of New York in July 2021.[275] In a pre-conference letter filed in February 2022, the defendants signaled that the parties were unable to reach agreement on whether the NBA Moments constituted "securities."[276] As a result, defendants requested full briefing on a motion to dismiss.[277] Should the litigation continue to progress, it is likely that the court will be confronted with the question of whether collectible NFTs are securities under the federal securities laws.

G. SHAREHOLDER SUITS RELATED TO ESG DISCLOSURES

Securities filings regarding ESG disclosures continued to surge in the first half of 2022, with increased scrutiny of companies' public statements and actions prompting shareholder derivative and securities fraud suits. Several high-profile ESG cases have been filed in the past year, and a number of cases have resulted in judicial decisions offering critical insights into how courts are addressing such claims. Although many recent ESG-related suits have not survived the pleading stage, new legal theories and trends continue to emerge. The pace of ESG-related litigation is expected to continue to increase, with diversity and inclusion and greenwashing claims taking center stage.

Diversity-Related Suits. In 2021 and 2022, a number of derivative and securities suits were filed against a range of companies, seeking to hold directors and officers liable for alleged misrepresentations related

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[270] Defendants' Memorandum of Law in Support of Their Motion to Dismiss the Amended Complaint, *Underwood* v. *Coinbase Global, Inc.*, No. 21-cv-08353, Dkt. No. 59 (S.D.N.Y. May 10, 2022).
[271] *Hermes Int'l* v. *Rothschild*, 2022 WL 1564597, at *1 (S.D.N.Y. May 18, 2022).
[272] *Friel* v. *Dapper Labs, Inc.*, No. 0653134/2021 (N.Y. Sup. Ct. N.Y. Cnty. May 12, 2021).
[273] Amended Complaint ¶¶ 1-3, *Friel* v. *Dapper Labs, Inc.*, No. 21-cv-05837, Dkt. No. 27 (S.D.N.Y. Dec. 27, 2021).
[274] *Id.* ¶ 113.
[275] Notice of Removal, *Friel* v. *Dapper Labs, Inc.*, No. 21-cv-05837, Dkt. No. 4 (S.D.N.Y. July 7, 2021).
[276] Letter addressed to Judge Victor Marrero, *Friel* v. *Dapper Labs, Inc.*, No. 21-cv-05837. Dkt. No. 32 (S.D.N.Y. Feb. 22, 2022).
[277] *Id.*

to the companies' commitments to diversity and inclusion. Those suits have not fared well. Most claims have not survived motions to dismiss, with courts repeatedly holding that the plaintiffs failed to clear the high bar for pleading demand futility.

A derivative suit launched by a Facebook shareholder marked the first in a string of pleading-stage losses for plaintiffs challenging board diversity, calling into question the viability of such suits as a vehicle for challenging corporate commitments to diversity.[278] This trend has continued, exemplified by a pair of decisions in late 2021, in which courts expressed skepticism about claims based on companies' generic or aspirational commitments to board diversity.

In *Lee* v. *Frost*, shareholders of a healthcare company filed a derivative action, alleging breach of fiduciary duty and violations of Section 14(a) of the 1934 Act based on a purported failure to diversify the company's board and senior executives.[279] The plaintiffs cited statements in the company's annual proxy statements, including that the company's code of conduct, which prohibited discrimination, applied to all employees, officers, and directors of the company, and that the board valued "diversity of knowledge base, professional experience and skills" and "takes these qualities into account when considering director nominees."[280] The plaintiffs alleged that the defendants had refused to hire or nominate diverse candidates to the board or the executive team, failed to disclose a lack of director term limits "due to a racist desire to keep Black, Latinx, and other underrepresented individuals off the Board," and failed to disclose that the company's internal controls were inadequate to protect underrepresented individuals from discrimination in board and executive selection processes.[281]

A Southern District of Florida court granted the defendants' motion to dismiss, holding that the plaintiffs failed to plead demand futility. The court reasoned that the complaint was "replete with conclusory allegations" and that the plaintiffs had "offer[ed] no particularized facts to animate [their] accusations" that defendants "violated unspecified anti-discrimination laws and [the company's] Code of Conduct by refusing to nominate Black, Latinx, or other underrepresented individuals to the Board."[282] In dismissing the Section 14(a) claim, the court observed that other "courts have repeatedly held that statements concerning a company's commitment to diversity are unactionable puffery."[283]

In another derivative suit against the directors of Qualcomm, the plaintiffs alleged that the defendants breached their fiduciary duties and violated Section 14(a) "by allowing unlawful and discriminatory practices to proliferate at the Company."[284] Among other things, the plaintiffs alleged that statements in the

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278 *See, e.g.*, *Ocegueda ex rel. Facebook* v. *Zuckerberg*, 526 F. Supp. 3d 637 (N.D. Cal. 2021); *Lee* v. *Fisher*, 2021 WL 1659842 (N.D. Cal. April 27, 2021); *Klein* v. *Ellison*, 2021 WL 2075591 (N.D. Cal. May 21, 2021); *Esa* v. *NortonLifeLock, Inc.*, 2021 WL 3861434 (N.D. Cal. Aug. 30, 2021); *In re Danaher Corp. S'holder Derivative Litig.*, 549. F Supp. 3d 59 (D.D.C. 2021).
279 2021 WL 3912651, at *1 (S.D. Fla. Sept. 1, 2021).
280 *Id.* at *2-3.
281 *Id.* at *2.
282 *Id.* at *8.
283 *Id.* at *12.
284 *Kiger* v. *Mollenkopf*, 2021 WL 5299581, at *1 (D. Del. Nov. 15, 2021).

company's annual proxy statements that its governance committee aimed "to assemble a board of directors that brings to us a diversity of perspectives and skills" and would "instruct any search firm it engages to include women and racially/ethnically diverse candidates in the pool" for director nominees were false.[285] The court held that "[s]tatements about a board's or a company's goals are inactionable puffery" and that plaintiffs had failed to adequately allege any facts indicating that the board did not instruct a search firm to pursue diverse candidates.[286] Further, the court dismissed the breach-of-fiduciary-duty claim for failure to plead demand futility because the plaintiffs had "never identif[ied] any specific laws governing racial/ethnic diversity or discrimination that were violated" or any "particularized facts regarding either the decision or the strategy" to allegedly "circumvent federal and state laws prohibiting racial discrimination."[287]

The decisions in *Frost* and *Kiger* reflect the broader trend of courts' unwillingness to find more than mere puffery in aspirational statements regarding diversity and inclusion. More recently, in March 2022, a Middle District of Tennessee court largely followed this path in dismissing a shareholder derivative suit against the directors of Tractor Supply Company, alleging breach of fiduciary duty and violations of Section 14(a) based on the defendants' representations that the company "promotes diversity with respect to leadership roles."[288] The court concluded that the plaintiffs had failed to allege any facts indicating that the defendants were not committed "to actively seeking highly qualified women and individuals from minority groups."[289] It also noted that "statements regarding diversity are often viewed by the Courts to be mere statements of corporate aspiration that are immaterial."[290]

Greenwashing Suits. Beyond private securities litigation focusing on statements about diversity and inclusion, so-called "greenwashing" claims are also expected to grow as companies increasingly make statements about the environmental impacts of their businesses and their commitments to sustainability. In the past few years, plaintiffs have initiated a number of actions asserting greenwashing claims, with the focus to date on allegations that companies made misleading claims about the climate-friendliness of their operations or products.[291] Many of these greenwashing claims, however, are still pending and have yet to be considered by a court.[292]

One recent case underscores plaintiffs' challenges in bringing securities claims based on broad statements about environmental practices and sustainability. In a securities class action filed in March 2022 against

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[285] *Id.* at *2-3.
[286] *Id.* at *3.
[287] *Id.* at *7.
[288] *City of Pontiac Police & Fire Ret. Sys.* v. *Jamison*, 2022 WL 884618, at *1-2 (M.D. Tenn. Mar. 24, 2022).
[289] *Id.* at *15.
[290] *Id.* at *16.
[291] *See, e.g.*, *In re Vale S.A. Sec. Litig.*, 2020 WL 2610979, at *9 (E.D.N.Y. May 20, 2020) (alleging securities law claims that a mining accident demonstrated a Brazilian mining company's sustainability and safety claims were misleading); *Ramirez* v. *Exxon Mobil Corp.*, 334 F. Supp. 3d 832 (N.D. Tex. 2018) (denying a motion to dismiss claims that Exxon made material misstatements about proxy costs for carbon).
[292] *See, e.g.*, Third Amended Consolidated Class Action Complaint, *In re PG&E Corp. Sec. Litig.*, No. 18-cv-03509, Dkt. No. 121, ¶ 633 (N.D. Cal. May 28, 2019) (alleging that climate change risk disclosures were misleading); Amended Complaint, *In re Danimer Scientific, Inc. Sec. Litig.*, No. 21-cv-02708, Dkt. No. 44, ¶ 11 (E.D.N.Y. Jan. 19, 2022) (alleging greenwashing in relation to biodegradability of company's plastics products).

Oatly Group, an oat milk company, the plaintiffs claimed violations of Sections 11, 12(a), and 15 of the 1933 Act and Sections 10(b) and 20(a) of the 1934 Act, based on alleged misstatements about Oatly's environmental practices, among other things.[293] The plaintiffs focused on Oatly's statements that "[s]ustainability is at the core of our business," that sustainability "is a mindset that helps us navigate business decisions and build a culture that is singularly focused on pushing the boundaries of the plant-based movement," and that "[w]ith every liter of Oatly we produce, our positive environmental and societal impact increases."[294] The complaint alleged that these statements were false because there were "very high concentrations" of certain wastewater products from the company's manufacturing facility in New Jersey.[295] After defendants filed a motion to dismiss in which they contended that the statements were inactionable,[296] the parties conferred and agreed to allow the plaintiffs to file an amended complaint, which omitted the environment-related claims.[297]

As ESG matters increase in importance, so too must companies be mindful of their ESG-related disclosures and continue to mitigate the risk of litigation. To that end, boards of directors and senior management should conscientiously develop their ESG strategies and examine mitigation measures and stakeholder engagement strategies to address ESG litigation risk.

H. EFFECTS OF COVID-19 ON SECURITIES LITIGATION

Pandemic-related securities class action filings decreased in the latter half of 2021, with seven new filings compared to ten in the first half of the year.[298] Of the seven actions filed in the second half of 2021, five allege that the defendant companies misrepresented pandemic-related increases in demand.[299] For example, in November 2021, a shareholder filed a complaint against Citrix Systems, a software company, alleging violations of Sections 10(b) and 20(a) of the 1934 Act over Citrix's statements about its transition to long-term cloud contracts.[300] According to the complaint, "the need for secure remote access to computer networks skyrocketed as a result of the COVID-19 pandemic," but customers adopted short-term licenses "citing the ongoing COVID-19 pandemic," and it was later revealed "that, despite prior assurances, the transition to cloud was not as successful as the Company had led investors to believe."[301]

Such allegations that defendants have misstated or overstated consumer demand for their products or services have become more prominent as the pandemic begins to recede and companies adjust their forecasts and consumers modify their behaviors. Similar actions have been filed against other companies

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[293] Consolidated Amended Complaint, *In re Oatly Grp. AB Sec. Litig.*, No. 21-cv-06360, Dkt. No. 64 (S.D.N.Y. Mar. 4, 2022).

[294] *Id.* ¶¶ 59-61.

[295] *Id.* ¶¶ 61, 82.

[296] *See* Memorandum of Law in Support of Motion to Dismiss at 12-13, 24, *In re Oatly Grp. AB Sec. Litig.*, No. 21-cv-06360, Dkt. No. 70 (S.D.N.Y. Apr. 8, 2022).

[297] *See* Lead Plaintiffs' Unopposed Motion for Leave to File Second Consolidated Complaint, *In re Oatly Grp. AB Sec. Litig.*, No. 21-cv-06360, Dkt. No. 74 (S.D.N.Y. May 6, 2022); [Proposed] Second Consolidated Complaint, *In re Oatly Grp. AB Sec. Litig.*, No. 21-cv-06360, Dkt. No. 74-1 (S.D.N.Y. May. 6, 2022).

[298] SECURITIES CLASS ACTION FILINGS 2021, at 5.

[299] *Id.*

[300] Complaint, *City of Hollywood Police Officers' Ret. Sys.* v. *Citrix Sys.*, No. 21-cv-62380, Dkt. No. 1 (S.D. Fla. Nov. 19, 2021).

[301] *Id.* ¶¶ 21, 37-38.

in recent months, including an exercise equipment company,[302] a provider of educational services and resources,[303] and cloud-based technology firms.[304] As pandemic-influenced demand for products and services decreases, plaintiffs will likely bring additional securities litigation against companies affected by such changes in demand.

A number of courts have also recently decided motions to dismiss in actions filed against life sciences companies earlier in the pandemic. As these decisions demonstrate, plaintiffs have had a mixed track record in such litigation. On November 18, 2021, a Southern District of California court dismissed a securities class action against Sorrento Therapeutics, a clinical-stage biopharmaceutical company, and its officers, challenging statements about the company's monoclonal antibody product for treating COVID-19.[305] Among other things, the plaintiffs had alleged that an individual defendant's statement during a media interview that "there is a cure [to COVID-19] . . . [t]here is a solution that works 100 percent," was false.[306] The court, however, concluded that this and other alleged misstatements "amount to no more than generalized assertions of corporate optimism as to the initial success of [the antibody product] against COVID-19."[307] Further, the court determined that the plaintiffs had not pleaded sufficient facts to "adequately allege[] a strong inference of scienter," emphasizing that the company had disclosed that its product "was still in preclinical stages and had not yet received FDA approval."[308]

By contrast, in a December 22, 2021 decision in "an unusual securities fraud case," another Southern District of California court largely denied a motion to dismiss a securities fraud class action against Vaxart, a vaccine company, and its officers.[309] The plaintiffs had alleged that "Vaxart ha[d] long struggled to bring a product to market" and "seized on public uncertainty as to the [COVID-19] vaccine candidates to artificially bolster its share price."[310] Among other things, the company purportedly announced in a press release that its vaccine candidate had been selected by the government's "Operation Warp Speed," with "small print" stating that it had only "been selected to participate in a non-human primate (NHP) challenge study."[311]

Observing that the complaint "easily satisfies" the scienter requirement and "cogently alleges" a series of misstatements, the court nonetheless found it "somewhat challenging" to determine whether Vaxart's statements "were materially misleading."[312] This "unusual" situation arose because "the company's press releases and other statements included several accurate passages alongside highly misleading ones, thus

[302] Complaint, *City of Hialeah Emps.' Ret. Sys.* v. *Peloton Interactive, Inc.*, No. 21-cv-09582, Dkt. No. 1 (S.D.N.Y. Nov. 18, 2021).
[303] Complaint, *Leventhal* v. *Chegg, Inc.*, No. 21-cv-09953, Dkt. No. 1 (N.D. Cal. Dec. 22, 2021).
[304] Complaint, *Douvia* v. *ON24, Inc.*, No. 21-cv-08578, Dkt. No. 1 (N.D. Cal. Nov. 3, 2021); Complaint, *Collins* v. *DocuSign, Inc.*, No. 21-cv-07071, Dkt No. 1 (E.D.N.Y. Dec. 22, 2021).
[305] *In re Sorrento Therapeutics, Inc. Sec. Litig.*, 2021 WL 6062943 (S.D. Cal. Nov. 18, 2021).
[306] *Id.* at *6.
[307] *Id.* at *7.
[308] *Id.* at *8.
[309] *In re Vaxart, Inc. Sec. Litig.*, 2021 WL 6061518, at *1 (N.D. Cal. Dec. 22, 2021).
[310] *Id.* at *1-2.
[311] *Id.* at *2.
[312] *Id.* at *1.

potentially allowing an investor to sift through the statements" and discern that they were untrustworthy.[313] The court ultimately held that it was inappropriate to dismiss the claims against Vaxart, as the plaintiffs had identified "specific statements that plausibly would have misled the investing public."[314]

The court emphasized that Vaxart's challenged "press release must be considered in context," which included that investors were aware of five Operation Warp Speed funding recipients but were "eager to learn the identity of the remaining Warp Speed recipients," allowing Vaxart to "capitalize[] on hype it had generated around its vaccine candidate."[315] As the *Vaxart* decision suggests, courts considering securities fraud claims are likely to take into account the unique factual circumstances surrounding the COVID-19 pandemic in determining reasonable investor expectations.[316]

In a mixed decision for the defendants, on February 23, 2022, an Eastern District of New York court granted a motion to dismiss a securities fraud class action against Chembio Diagnostics and its senior officers and directors, in which the plaintiffs alleged that the defendants misrepresented the performance of the company's COVID-19 antibody test.[317] The court concluded that the plaintiffs failed to adequately allege scienter because the complaint lacked concrete allegations of a motive to defraud or knowledge of "contradictory data" regarding the antibody test.[318] The court, however, determined that the plaintiffs had sufficiently pled an actionable failure by the underwriter defendants to disclose the contradictory data because any cautionary language in Chembio's registration statement did not address the "particular reason to be concerned that the [emergency use authorization for the antibody test] might be revoked."[319]

I. SHAREHOLDER SUITS RELATED TO CYBERSECURITY

Reflecting the widespread reliance on remote work and virtual technologies during the COVID-19 pandemic, a substantial amount of recent securities litigation has focused on technology companies and companies that have suffered cybersecurity incidents. Since 2021, securities suits have been filed against computer technology,[320] telecommunications,[321] and digital infrastructure companies,[322] alleging incomplete, false, or misleading disclosures about the companies' responses to cybersecurity incidents or the impact of such incidents on their finances or operations.

Over the past six months, several courts have issued decisions in cybersecurity-related securities fraud class actions. In February 2022, a Northern District of California court granted a motion to dismiss in a securities fraud class action against Zoom Video Communications and its CEO and CFO as to all but one

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313 *Id.*
314 *Id.* at *5.
315 *Id.* at *4.
316 *See id.* at *7.
317 *In re Chembio Diagnostics, Inc. Sec. Litig.*, 2022 WL 541891, at *1-4 (E.D.N.Y. Feb. 23, 2022).
318 *Id.* at *9-11.
319 *Id.* at *17.
320 Complaint, *Firemen's Ret. Sys. of St. Louis* v. *Telos Corp.*, No. 22-cv-00135, Dkt. No. 1 (E.D. Va. Feb. 7, 2022).
321 Complaint, *Litwin* v. *Sievert*, No. 21-cv-01599, Dkt. No. 1 (W.D. Wash. Nov. 29, 2021).
322 Complaint, *Bremer* v. *SolarWinds Corp.*, No. 21-cv-00002, Dkt. No. 1 (W.D. Tex. Jan. 4, 2021).

alleged misstatement.[323] The plaintiffs had alleged that the defendants made 15 misleading statements about Zoom's security capabilities, encryption measures, and data privacy policies.[324] The court agreed with the defendants on all of the challenged statements except the statement that Zoom "offer[ed] robust security capabilities, including end-to-end encryption."[325] Rejecting the defendants' arguments that they used the term "end-to-end encryption" in a different sense than that perceived by the plaintiffs,[326] the decision suggests that courts will carefully scrutinize such terms of art in the cybersecurity context, where they may have a special bearing on a company's business, image, or reputation.

The following month, in March, a Western District of Texas court largely denied a motion to dismiss a securities fraud class action against SolarWinds Corporation and its senior officers.[327] After it came to light that SolarWinds suffered a security breach in late 2021, the plaintiffs alleged that the defendants had falsely represented to investors that SolarWinds had robust cybersecurity systems and practices, including through its "Security Statement" and statements by its VP of Security Architecture that he was "focused on . . . heavy-duty hygiene."[328] The plaintiffs also pointed to a separate incident in which a password for SolarWinds's updated server had been "publicly available . . . for around one-and-a-half years."[329]

The court dismissed the claims against SolarWinds's CEO for failure to plead scienter, but allowed the claims to proceed against the remaining defendants.[330] The court concluded that the plaintiffs had pled at least "severe recklessness" as to SolarWinds's VP, owing to his remarks on security "hygiene," and that "the alleged severity of the [password] breach coupled with Plaintiffs' allegations that a password policy did not exist leads to an inference in favor of Plaintiffs" with regard to scienter.[331] Although the court recognized that "generalized positive statements about a company's progress are not a basis for liability," it noted that "when there are differences between the image projected by the speaker and the reality on the ground, especially when an utterance is repeated, the alleged misstatement can be considered misleading."[332] Notwithstanding the defendants' warnings about the risks of cybersecurity attacks, the court also concluded that the plaintiffs had adequately alleged material misstatements in SolarWinds's Security Statement.[333]

Importantly, the court distinguished a case in which plaintiffs "claim that *because* the Defendant had suffered a security breach, Defendant must have been lying about the emphasis it placed on a high level of security," which is not sufficient to plead securities fraud, from a case, such as this one, where plaintiffs

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[323] *In re Zoom Sec. Litig.*, 2022 WL 484974 (N.D. Cal. Feb. 16, 2022).
[324] Consolidated Class Action Complaint, *In re Zoom Sec. Litig.*, No. 20-cv-02353, Dkt. No. 63, ¶ 9 (N.D. Cal. Dec. 23, 2020).
[325] *In re Zoom Sec. Litig.*, 2022 WL 484974, at *2-3.
[326] *Id.* at *3.
[327] *In re SolarWinds Corp. Sec. Litig.*, 2022 WL 958385 (W.D. Tex. Mar. 30, 2022).
[328] *Id.* at *2, *6.
[329] *Id.*
[330] *Id.* at *12-13.
[331] *Id.* at *6.
[332] *Id.* at *8 (quoting *Nathanson* v. *Zonagen Inc.*, 267 F.3d 400, 419 (5th Cir. 2001)).
[333] *Id.* at *9.

"have alleged separate facts that the cybersecurity measures at the company were not as they were portrayed."[334]

Finally, in a pair of recent decisions in cybersecurity-related securities fraud class actions against the hotel company Marriott International and technology company Zendesk, the Fourth and Ninth Circuits, respectively, affirmed dismissals of the complaints for failure to state a claim. In *Marriott*, in the aftermath of a data breach, the plaintiffs filed a class action alleging that Marriott and its senior executives had omitted material information about data vulnerabilities in their public statements.[335] The district court dismissed the claims, and the Fourth Circuit affirmed on the basis that none of the plaintiffs' "three categories of statements," including "statements about the importance of protecting customer data, privacy statements on Marriott's website, and cybersecurity-related risk disclosures," were adequately pled as false or misleading.[336] *First*, the Fourth Circuit concluded that Marriott's statements about the importance of data protection did not constitute representations about the "quality [of] Marriott's cybersecurity" and did not over-represent the extent to which it was securing customer data.[337] *Second*, the Fourth Circuit reasoned that Marriott's privacy statements "were accompanied by such sweeping caveats that no reasonable investor could have been misled by them."[338] *Finally*, the Fourth Circuit observed that although "Marriott certainly could have provided more information to the public about its experience with or vulnerability to cyberattacks, [] the federal securities laws did not require it to do so."[339] Indeed, the court added, "the SEC advises companies against 'mak[ing] detailed disclosures that could compromise [their] cybersecurity efforts.'"[340]

In *Zendesk*, the plaintiffs alleged that the company's statement that it "maintain[s] a comprehensive security program" and its risk disclosures were false because Zendesk had not implemented certain data security practices at the time of the statements and because the statements "created the impression that it was unlikely that Zendesk had suffered an undetected data breach in the past."[341] The Ninth Circuit held that the plaintiffs failed to adequately plead falsity and scienter because, among other things, Zendesk's risk disclosures made no "assertions as to the likelihood of [an undetected data breach] occurring" and did not "give an ordinary investor reason to believe that Zendesk was asserting that the risk that an undetected breach had occurred was particularly high or low, or that it had changed over time."[342]

Taken together, these recent decisions provide a mixed picture of the cybersecurity-related securities litigation landscape. On the one hand, the Fourth and Ninth Circuits' opinions show the importance of companies' disclosures of cybersecurity risks in defending against securities fraud claims, highlighting that

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[334] *Id.* at *8.
[335] *In re Marriott Int'l Inc.*, 31 F.4th 898, 901 (4th Cir. 2022).
[336] *Id.* at 902.
[337] *Id.* at 903.
[338] *Id.*
[339] *Id.* at 905.
[340] *Id.* (quoting SEC Statement and Guidance on Public Company Cybersecurity Disclosures, 83 Fed. Reg. 8166, 8169 (Feb. 26, 2018)).
[341] *Local 353, I.B.E.W. Pension Fund* v. *Zendesk, Inc.*, 2022 WL 614235, at *1 (9th Cir. Mar. 2, 2022).
[342] *Id.*

"companies can control what they have to disclose" and the danger of overly detailed disclosures in the cybersecurity context.[343] On the other hand, the *Zoom* and *SolarWinds* litigations illustrate that courts may place significant emphasis on perceived terms of art or special expertise when analyzing cybersecurity-related securities fraud claims.

[343] *Marriott*, 31 F.4th at 901 (quoting *Matrixx Initiatives, Inc.* v. *Siracusano*, 563 U.S. 27, 45 (2011)).

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