

November 2021 Securities Enforcement and Litigation Update

NOVEMBER 23, 2021

INTRODUCTION

The past year has brought a new presidential administration and leadership at the SEC. Gary Gensler, who served as Chairman of the CFTC from May 2009 to January 2014, succeeded Jay Clayton as Chairman of the SEC. Gurbir Grewal, a former New Jersey Attorney General, is now the Director of the SEC's Enforcement Division, and Renee Jones, a former Professor of Law and Associate Dean for Academic Affairs at Boston College Law School, is now the Director of the SEC's Corporation Finance Division. These changes in leadership have already had significant ramifications for SEC enforcement and will continue to shape SEC enforcement in the upcoming months and years.

The changes in SEC leadership have brought with them a focus on climate change and other environmental, social, and governance ("ESG") issues. The SEC is taking steps to more aggressively regulate climate change and other ESG-related disclosures. 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. Amid the record growth in special acquisition company or SPAC transactions, the SEC has begun to issue guidance and public statements about how it will regulate SPACs and to bring enforcement actions against SPACs and de-SPAC transactions. Parallel to the SEC's

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enforcement activity, shareholder suits related to ESG disclosures and SPACs significantly increased in the first half of 2021 and will likely continue to increase in the coming months and years as interest in ESG disclosures and SPACs continues to surge.

As in 2020, the first half of 2021 saw a reduction in private securities litigation class action filings, both in federal and state courts. On the heels of the Delaware Supreme Court's 2020 decision in *Salzberg v. Sciabacucchi*, claims under the Securities Act of 1933 ("1933 Act") in state court reached their lowest level since the U.S. Supreme Court's 2018 decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund* permitting such claims. Following *Sciabacucchi*, state courts in New York and California, where most state court 1933 Act claims were filed since *Cyan*, have enforced 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 first half of 2021. In May, the First Circuit considered the test set forth in the U.S. Supreme Court's *Morrison v. Australia National Bank* decision concerning the extraterritorial reach of Section 10(b) of the Securities Exchange Act of 1934 ("1934 Act"). The First Circuit adopted the "irrevocable liability" test for determining whether a transaction is "domestic" under the *Morrison* test. Then, in June, the U.S. Supreme Court issued an 8-1 ruling in *Goldman Sachs Group, Inc. v. Arkansas Teacher Retirement System*, holding that courts must consider the generic nature of alleged misstatements in determining whether defendants have rebutted the *Basic* presumption at class certification and that defendants bear the burden of persuasion in rebutting the *Basic* presumption at class certification. Finally, in September, the Ninth Circuit held in *Pirani v. Slack Technologies* that a purchaser of unregistered securities in a direct listing has standing to sue under Sections 11 and 12(a)(2) of the 1933 Act.

The effects of the ongoing COVID-19 pandemic on SEC enforcement and private securities litigation persist. The SEC has issued a variety of guidance on COVID-related disclosures and continued to bring enforcement actions against companies for allegedly making fraudulent COVID-related claims and for failing to fully disclose the impact of the

pandemic on continuing operations. As companies adapt to the COVID-19 pandemic and its challenges, private securities litigation has remained relatively modest in 2021.

This update discusses recent developments in both SEC enforcement and private securities litigation. With respect to SEC enforcement, the update addresses: (i) climate and ESG disclosures; (ii) cryptocurrency and digital asset regulation and enforcement; (iii) SPAC regulation and enforcement; (iv) the SEC's whistleblower program; (v) insider trading enforcement; and (vi) COVID-related developments. From the perspective of private securities litigation, the update discusses: (i) recent numerical trends; (ii) the Supreme Court's decision in *Goldman Sachs* on the standards for rebutting price impact at class certification; (iii) state court proceedings post-*Cyan*; (iv) the First Circuit's application of the *Morrison* test; (v) the Ninth Circuit's decision concerning 1933 Act standing for direct purchasers; (vi) shareholder suits related to ESG disclosures; (vii) shareholder suits related to SPACs; and (viii) the effects of COVID-19 on securities litigation.

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I. PART 1 – SECURITIES ENFORCEMENT

A. CLIMATE AND ESG DISCLOSURES

Since the change in administration earlier this year, the SEC has emphasized climate and other ESG issues. Although there is little notable enforcement activity relating to ESG issues to date, recent actions taken by the SEC, as well as statements made by SEC officials, suggest that this is an area to watch for enforcement developments. For example, on February 24, 2021, Commissioner and then-Acting Chair Allison Herren Lee stated that “[n]ow more than ever, investors are considering climate-related issues when making their investment decisions,” and officially directed the SEC’s Corporation Finance Division to “enhance its focus on climate-related disclosure in public company filings.”¹ This enhanced focus includes updating the SEC’s 2010 Climate Change Guidance, as well as “the extent to which public companies address the topics identified in the [2010 Climate Change Guidance], assess compliance with disclosure obligations under the federal securities laws, engage with public companies on these issues, and absorb critical lessons on how the market is currently managing climate-related risks.”²

Shortly thereafter, in March 2021, the SEC announced a new Climate and ESG Task Force within the SEC’s Enforcement Division. The Climate and ESG Task Force is tasked with “develop[ing] initiatives to proactively identify ESG-related misconduct,” “coordinat[ing] the effective use of [Enforcement] Division resources . . . to identify potential violations,” “identify[ing] any material gaps or misstatements in issuers’ disclosure of climate risks under existing rules,” “analyz[ing] disclosure and compliance issues relating to investment advisers’ and funds’ ESG strategies,” and “evaluat[ing] and pursu[ing] tips, referrals, and whistleblower complaints on ESG-related issues.”³ The Task Force is led by former Acting Deputy Director of Enforcement, Kelly L. Gibson, with more than 20 members of the Enforcement Division staff.⁴

The Climate and ESG Task Force will focus initially on ESG-related misconduct under existing rules. Recent SEC actions and statements by SEC officials, however, indicate that the SEC is preparing to announce new climate change disclosure rules by the end of the year or in 2022. On March 15, 2021, the SEC solicited “public input” from investors, registrants, and other market participants regarding the SEC’s regulation of climate change disclosures.⁵ A few days prior to the end of the comment period, on June 11, 2021, the SEC released its Spring 2021 Agency Rule List. The Spring 2021 Agency Rule List indicated that the SEC is considering issuing notices of proposed rulemaking for three climate- or ESG-disclosure

¹ Allison Herren Lee, *Statement on the Review of Climate-Related Disclosure*, SECURITIES AND EXCHANGE COMMISSION (Feb. 24, 2021), <https://www.sec.gov/news/public-statement/lee-statement-review-climate-related-disclosure>.

² *Id.*; see also *Commission Guidance Regarding Disclosure Related to Climate Change*, Securities Act Release No. 9106, Exchange Act Release No. 61469 (Feb. 2, 2010).

³ Press Release, *SEC Announces Enforcement Task Force Focused on Climate and ESG Issues*, SECURITIES AND EXCHANGE COMMISSION (Mar. 4, 2021), <https://www.sec.gov/news/press-release/2021-42>.

⁴ *Id.*

⁵ Allison Herren Lee, *Public Input Welcomed on Climate Change Disclosures*, SECURITIES AND EXCHANGE COMMISSION (Mar. 15, 2021), <https://www.sec.gov/news/public-statement/lee-climate-change-disclosures>.

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rules: (i) requirements for investment companies and investment advisers related to ESG factors; (ii) rule amendments to enhance registrants' disclosures regarding climate-related risks and opportunities; and (iii) rule amendments to enhance registrants' disclosures regarding board diversity.⁶

While speaking at a "Climate and Global Financial Markets" webinar in July 2021, Chairman Gensler stated that he would like the SEC to develop a rule by the end of the year that would require mandatory disclosure of climate risks.⁷ Chairman Gensler added that "[i]nvestors are looking for consistent, comparable, and decision-useful disclosures so they can put their money in companies that fit their needs" and that "[c]ompanies and investors alike would benefit from clear rules of the road."⁸ He made similar comments about proposing a climate change disclosure rule during his testimony before the House Subcommittee on Financial Services and General Government in May 2021.⁹

In September 2021, the Division of Corporate Finance published a sample letter to companies, setting out "sample comments that the Division may issue to companies regarding their climate-related disclosure or the absence of such disclosure."¹⁰ The letter contained comments asking companies to advise "what consideration you gave to providing the same type of climate-related disclosure in your SEC filings as you provided in your [corporate social responsibility] report" and to "revise your disclosure to identify material pending or existing climate change-related legislation, regulations, and international accords and describe any material effect on your business, financial condition, and results of operations."¹¹ Since the Climate and ESG Task Force "will work closely with other SEC Divisions and Offices, including the Division[] of Corporation Finance,"¹² the Division's comments may shed some light on potential areas of interest for the Task Force.

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 likely come under closer scrutiny from both the SEC and investors, especially after the SEC promulgates its climate change disclosure rules.

B. 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. On August 3, 2021, Chairman Gensler

⁶ See *Securities and Exchange Commission Agency Rule List – Spring 2021*, OFFICE OF INFORMATION AND REGULATORY AFFAIRS (June 11, 2021),

https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST¤tPub=true&agencyCode=&showStage=active&agencyCd=3235 (listing rules 3235-AM96, 3235-AM87, and 3235-AL91).

⁷ Bob Pisani, *SEC Chair Gensler says investors want mandatory disclosure on climate risks*, CNBC (July 28, 2021), <https://www.cnbc.com/2021/07/28/sec-chair-gensler-says-investors-want-mandatory-disclosure-on-climate-risks.html>.

⁸ *Id.*

⁹ See Gary Gensler, *Testimony Before the Subcommittee on Financial Services and General Government, U.S. House Appropriations Committee*, SECURITIES AND EXCHANGE COMMISSION (May 26, 2021), <https://www.sec.gov/news/testimony/gensler-2021-05-26>.

¹⁰ *Sample Letter to Companies Regarding Climate Change Disclosures*, SECURITIES AND EXCHANGE COMMISSION (Sept. 22, 2021), <https://www.sec.gov/corpfin/sample-letter-climate-change-disclosures>.

¹¹ *Id.*

¹² Press Release, *SEC Announces Enforcement Task Force Focused on Climate and ESG Issues*, SECURITIES AND EXCHANGE COMMISSION (Mar. 4, 2021), <https://www.sec.gov/news/press-release/2021-42>.

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stated that the SEC needed from Congress additional “authorities to prevent [cryptocurrency] transactions, products, and platforms from falling between regulatory cracks” and “more resources to protect investors in this growing and volatile sector.”¹³ He further stated that the SEC has “taken and will continue to take our authorities as far as they go” in regards to cryptocurrency. Then, on September 14, 2021, before the Senate Banking Committee, Chairman Gensler stated that there is not “enough investor protection in crypto finance, issuance, trading, or lending,” and that he “believe[s] that the SEC, working with the CFTC and others, can stand up more robust oversight and investor protection around the field of crypto finance.”¹⁴ In keeping with those remarks, the SEC has continued to bring enforcement actions and prosecute cases related to digital asset offerings and distributions of digital tokens without registration or exemption. Four recent actions are noteworthy.

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.¹⁵ The SEC’s complaint sought injunctive relief, disgorgement, and civil penalties.¹⁶ 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.¹⁷ After Ripple and its executives allegedly ignored legal advice that XRP could be considered a security under the federal securities laws, they allegedly initiated a distribution of XRP to investors without filing a registration statement.¹⁸ Ripple’s CEO and the chairman of Ripple’s board of directors also allegedly personally profited approximately \$600 million from the unregistered sale of XRP at the time of the complaint’s filing.¹⁹ 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.²⁰

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.²¹ 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.²² The magistrate

¹³ Gary Gensler, *Remarks Before the Aspen Security Forum*, SECURITIES AND EXCHANGE COMMISSION (Aug. 3, 2021), <https://www.sec.gov/news/public-statement/gensler-aspen-security-forum-2021-08-03>.

¹⁴ Gary Gensler, *Testimony Before the United States Senate Committee on Banking, Housing, and Urban Affairs*, SECURITIES AND EXCHANGE COMMISSION (Sept. 14, 2021), <https://www.sec.gov/news/testimony/gensler-2021-09-14>.

¹⁵ Complaint, *SEC v. Ripple Labs, Inc.*, No. 20-cv-10832, Dkt. No. 46, ¶¶ 1–3 (S.D.N.Y. Feb. 18, 2021).

¹⁶ *Id.* at 78–79.

¹⁷ *Id.* ¶ 1.

¹⁸ *Id.* ¶¶ 2–4.

¹⁹ *Id.* ¶¶ 5–8.

²⁰ Answer, *SEC v. Ripple Labs, Inc.*, No. 20-cv-10832, Dkt. No. 51, ¶¶ 1–3 (S.D.N.Y. Mar. 4, 2021).

²¹ Defs.’ Mot. to Compel, *SEC v. Ripple Labs, Inc.*, No. 20-cv-10832, Dkt. No. 67, at 1 (S.D.N.Y. Mar. 15, 2021).

²² Transcript, *SEC v. Ripple Labs, Inc.*, No. 20-cv-10832, Dkt. No. 112, at 51 (S.D.N.Y. Apr. 12, 2021).

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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.”²³ The magistrate judge has also decided several subsequent motions to compel—including those pertaining to production of the SEC’s internal trading policies (granted),²⁴ SEC documents reflecting preclearance decisions regarding SEC employees’ trading in XRP and other digital assets (denied),²⁵ eight years of personal financial information for the two executive defendants (denied),²⁶ and Ripple’s internal Slack messages (granted).²⁷

Poloniex Enforcement Action. In August 2021, the SEC settled charges against Poloniex LLC, which allegedly operated a digital asset trading platform that facilitated the trading of unregistered digital assets that constituted investment contracts.²⁸ Although Poloniex informed Poloniex Trading Platform users that its company policy prohibited the listing of “any token that resemble[d] a security,” the SEC alleged that Poloniex internally discussed “be[ing] ‘aggressive’ in making available for trading new digital assets on the Poloniex Trading Platform, including digital assets that might be considered securities under *Howey*, in an effort to increase market share.”²⁹ This, according to the SEC, resulted in Poloniex Trading Platform users trading securities on Poloniex’s trading platform.³⁰ The SEC also alleged that the Poloniex trading platform constituted an unregistered “exchange” under Section 3(a) of the 1934 Act and Rule 3b-16 and did not “operate pursuant to any exemption from registration.”³¹ This conduct, the SEC contended, violated Section 5 of the 1934 Act.³² Without admitting or denying the SEC’s findings, Poloniex agreed to the entry of a cease-and-desist order, as well as approximately \$10.4 million in disgorgement, interest, and civil monetary penalties.³³

DeFi Money Market Enforcement Action. In another enforcement action in August 2021, the SEC settled charges against a digital token trading platform, known as DeFi Money Market, and its individual promoters.³⁴ The SEC alleged that the respondents failed to register their offering, which had raised \$30 million by using smart contracts and decentralized finance technology to sell digital tokens between February 2020 and February 2021.³⁵ The cease-and-desist order asserts that the tokens sold “were securities because they were notes and also because they were offered and sold as investment contracts”

²³ *Id.* at 52.

²⁴ See Order, *SEC v. Ripple Labs, Inc.*, No. 20-cv-10832, Dkt. No. 253, at 1 (S.D.N.Y. June 23, 2021).

²⁵ See Order, *SEC v. Ripple Labs, Inc.*, No. 20-cv-10832, Dkt. No. 354, at 1 (S.D.N.Y. Sept. 21, 2021).

²⁶ See Order, *SEC v. Ripple Labs, Inc.*, No. 20-cv-10832, Dkt. No. 103, at 1 (S.D.N.Y. Apr. 9, 2021).

²⁷ See Order, *SEC v. Ripple Labs, Inc.*, No. 20-cv-10832, Dkt. No. 327, at 1 (S.D.N.Y. Sept. 1, 2021).

²⁸ Order, *In re Poloniex, LLC*, No. 3-20455, ¶ 1 (Sec. Exch. Comm’n Aug. 9, 2021).

²⁹ *Id.* ¶¶ 18–21.

³⁰ *Id.* ¶¶ 21, 24.

³¹ *Id.* ¶¶ 1, 3–4, 26–29.

³² *Id.* ¶¶ 4, 26, 30.

³³ *Id.* at 7–8.

³⁴ Order Instituting Cease and Desist Proceedings, *In re Blockchain Credit Partners*, No. 3-20453 (Sec. Exch. Comm’n Aug. 6, 2021).

³⁵ *Id.* ¶¶ 1, 12–44.

and that the respondents violated Sections 5(a), 5(b), and 17(a) of the 1933 Act and Section 10(b) of the 1934 Act.³⁶

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.³⁷ 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.³⁸ Specifically, the SEC claimed that the five promoters touted investing in BitConnect’s “lending program” by creating “testimonial” videos and publishing them on YouTube.³⁹ 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 as broker-dealers with the SEC.⁴⁰ The SEC’s complaint contends that defendants violated Section 5 of the 1933 Act and Section 15(a) of the 1934 Act and seeks injunctive relief, disgorgement plus interest, and civil monetary penalties.⁴¹ The SEC reached settlements with two of the five promoters.⁴²

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.⁴³ In its complaint, the SEC alleges that defendants allegedly “conducted a fraudulent and unregistered offering and sale of securities in the form of investments” in BitConnect’s “Lending Program.”⁴⁴ 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.⁴⁵ 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.⁴⁶ Instead, according to the SEC, the defendants “siphoned” the investors’ funds and used the funds for their own benefit, including by “transferring [the] funds to digital wallet[s] [] controlled by the defendants.”⁴⁷ 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.”⁴⁸ The SEC contends that this conduct violated Sections 10(b) and 15(a) of the 1934 Act and Sections 5 and

³⁶ *Id.* ¶¶ 4, 7.

³⁷ See Press Release, *SEC Charges U.S. Promoters of \$2 Billion Global Crypto Lending Securities Offering*, SECURITIES AND EXCHANGE COMMISSION (May 28, 2021), <https://www.sec.gov/news/press-release/2021-90>.

³⁸ Complaint, *SEC v. Brown*, No. 21-cv-04791, Dkt. No. 1, ¶ 1 (S.D.N.Y. May 28, 2021).

³⁹ *Id.* ¶ 4.

⁴⁰ *Id.* ¶¶ 2, 5–6.

⁴¹ *Id.* ¶¶ 10–13.

⁴² See Press Release, *SEC Charges Global Crypto Lending Platform and Top Executives in \$2 Billion Fraud*, SECURITIES AND EXCHANGE COMMISSION (Sept. 1, 2021), <https://www.sec.gov/news/press-release/2021-172>.

⁴³ *Id.*

⁴⁴ Complaint, *SEC v. BitConnect*, No. 21-cv-07349, Dkt. No. 1, ¶ 1 (S.D.N.Y. Sept. 1, 2021).

⁴⁵ *Id.* ¶¶ 2–4.

⁴⁶ *Id.* ¶ 5.

⁴⁷ *Id.* ¶ 6.

⁴⁸ *Id.* ¶ 7.

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17(a) of the 1933 Act.⁴⁹ The SEC’s complaint seeks injunctive relief, disgorgement plus interest, and civil monetary penalties.⁵⁰

The BitConnect enforcement action, along with the Poloniex and Ripple enforcement actions, suggests that the SEC will continue to scrutinize whether digital asset offerings meet the definition of a security, which requires filing a registration statement or applying an exemption. These cases indicate that the SEC will consider digital assets securities when the digital assets involve instruments, schemes, or transactions through which a person invests money in a common enterprise and reasonably expects profits or returns derived from the entrepreneurial or managerial efforts of others.⁵¹ Further, the SEC will likely continue to initiate enforcement actions where offerings meet the definition of a security and lack registration or exemption. In addition to actions against issuers, the Poloniex and DeFi Money Market settlements indicate that the SEC is pursuing enforcement actions against digital trading venues and platforms that the SEC believes permit trading of digital tokens as unregistered securities.

C. SPECIAL PURPOSE ACQUISITION COMPANY (“SPAC”) REGULATION AND ENFORCEMENT

Earlier this year, the SEC issued a number of widely reported on statements regarding accounting, financial reporting, and governance issues that should be considered in SPAC transactions that are likely to affect both SEC enforcement and private securities litigation relating to SPACs.⁵² Most notably, on April 12, 2021, Acting Director Coates and Acting Chief Accountant Paul Munter issued a joint public statement on behalf of the SEC Staff about “Accounting and Reporting Considerations for Warrants Issued” by SPACs, which highlighted a number of important financial reporting considerations for SPACs and challenges associated with accounting for complex financial instruments that are common in SPACs.⁵³

The statement suggested that SPAC warrants should be classified as liabilities measured at fair value instead of equity instruments.⁵⁴ To support this conclusion, the statement noted that GAAP guidance indicates that a contract should be classified as an asset or liability rather than an equity instrument when a contract cannot be indexed to an entity’s own stock or when an event outside the entity’s control may require net cash settlement.⁵⁵ SPAC warrants, according to the statement, may contain provisions

⁴⁹ *Id.* ¶ 12.

⁵⁰ *Id.* ¶ 15.

⁵¹ Complaint, *SEC v. BitConnect*, No. 21-cv-07349, Dkt. No. 1, ¶¶ 29, 49, 53–56 (S.D.N.Y. Sept. 1, 2021); Order, *In re Poloniex, LLC*, No. 3-20455, ¶ 3 (Sec. Exch. Comm’n Aug. 9, 2021); Complaint, *SEC v. Ripple Labs, Inc.*, No. 20-cv-10832, Dkt. No. 46, ¶¶ 31, 230–31, 238, 241 (S.D.N.Y. Feb. 18, 2021).

⁵² See Statement, *Staff Statement on Select Issues Pertaining to Special Purpose Acquisition Companies*, SECURITIES AND EXCHANGE COMMISSION (Mar. 31, 2021), <https://www.sec.gov/news/public-statement/division-cf-spac-2021-03-31>; Paul Munter, *Financial Reporting and Auditing Considerations of Companies Merging with SPACs*, SECURITIES AND EXCHANGE COMMISSION (Mar. 31, 2021), <https://www.sec.gov/news/public-statement/munter-spac-20200331>; John Coates, *SPACs, IPOs and Liability Risk under the Securities Laws*, SECURITIES AND EXCHANGE COMMISSION (Apr. 8, 2021), <https://www.sec.gov/news/public-statement/spacs-ipos-liability-risk-under-securities-laws>; John Coates & Paul Munter, *Staff Statement on Accounting and Reporting Considerations for Warrants Issued by Special Purpose Acquisition Companies (“SPACs”)*, SECURITIES AND EXCHANGE COMMISSION (Apr. 12, 2021), <https://www.sec.gov/news/public-statement/accounting-reporting-warrants-issued-spacs>.

⁵³ John Coates & Paul Munter, *Staff Statement on Accounting and Reporting Considerations for Warrants Issued by Special Purpose Acquisition Companies (“SPACs”)*, SECURITIES AND EXCHANGE COMMISSION (Apr. 12, 2021), <https://www.sec.gov/news/public-statement/accounting-reporting-warrants-issued-spacs>.

⁵⁴ *Id.*

⁵⁵ *Id.*

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providing for “potential changes to the settlement amounts” based on the holder of the warrant and may not be indexed to the entity’s stock, both of which suggest that SPAC warrants should be classified as assets or liabilities.⁵⁶ Additionally, SPAC warrants may also contain provisions entitling warrant holders to cash in the event of a qualifying cash tender offer—which would be outside the entity’s control—whereas holders of common stock may or may not be entitled to cash.⁵⁷ If SPACs incorrectly classified their warrants, the statement added, SPACs may be required to file various restatements to correct the error.⁵⁸ This development has formed the basis of at least one securities fraud claim in private shareholder litigation, and it remains to be seen the extent to which the SEC and private plaintiffs will focus on accounting issues in bringing further claims relating to SPACs.⁵⁹

Also in April 2021, the Corporation Finance Division’s then Acting Director, John Coates, issued a public statement about “SPACs, IPOs and Liability Risk under the Securities Laws,” which discussed the legal liability that attaches to disclosures in the de-SPAC transaction.⁶⁰ While acknowledging that some SPAC participants view de-SPAC transactions as involving less exposure to securities law liability, Acting Director Coates stated that “[a]ny simple claim about reduced liability exposure for SPAC participants is overstated at best, and potentially seriously misleading at worst,” and “in some ways, liability risks for those involved [in de-SPAC transactions] are higher, not lower, than in conventional IPOs.”⁶¹ He further noted that material misstatements or omissions in connection with registration statements, proxy solicitations, or tender offers are still subject to Section 11 of the 1933 Act and Section 14 and Rule 14a-9 of the 1934 Act.⁶² On the PSLRA’s safe harbor, Acting Director Coates stated that the law applies only to private litigation, not SEC enforcement actions, and that the theory that the PSLRA’s safe harbor applies to de-SPAC transactions but not traditional IPOs is “uncertain at best.”⁶³ Finally, he added that de-SPAC transactions may also give rise to exposure and liability under state law, including duties of candor and other fiduciary duties.⁶⁴

In addition to its guidance and statements, the SEC has also shown a willingness to initiate enforcement actions against SPACs. In July 2021, the SEC filed an enforcement action under Section 17(a) of the 1933 Act and Sections 10(b) and 14(a) of the 1934 Act against Stable Road Acquisition Company, a SPAC; SRC-NI, Stable Road’s sponsor; Stable Road’s CEO; Momentus Inc., a space infrastructure services company and the proposed merger target; and Momentus’s founder and former CEO.⁶⁵ The SEC alleged that, while both companies undertook a business combination, Momentus and Stable Road made materially false statements and omissions concerning the development of commercially viable technology for

⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ See discussion below, at p. 28.

⁶⁰ John Coates, *SPACs, IPOs and Liability Risk under the Securities Laws*, SECURITIES AND EXCHANGE COMMISSION (Apr. 8, 2021), <https://www.sec.gov/news/public-statement/spacs-ipos-liability-risk-under-securities-laws>.

⁶¹ *Id.*

⁶² *Id.*

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ See Press Release, *SEC Charges SPAC, Sponsor, Merger Target, and CEOs for Misleading Disclosures Ahead of Proposed Business Combination*, SECURITIES AND EXCHANGE COMMISSION (July 13, 2021), <https://www.sec.gov/news/press-release/2021-124>.

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providing commercial space services and the U.S. government's concerns about the national security risk that Momentus's CEO, a foreign national, posed.⁶⁶ The SEC further alleged that Stable Road conducted insufficient due diligence, failing to evaluate the basis for Momentus's representations regarding its space technology and to investigate "red flags" concerning the national security and foreign ownership risks posed by Momentus's CEO.⁶⁷

The SEC settled its claims against Stable Road, SRC-NI, Momentus, and Momentus's former CEO for a total of \$8 million in monetary penalties and an agreement to cease-and-desist from future violations of the federal securities laws.⁶⁸ Further, Stable Road agreed to implement various investor protection undertakings, and SRC-NI and its former CEO agreed to forfeit the shares they received upon the merger's approval.⁶⁹ The SEC is proceeding with its enforcement action against Momentus's former CEO in federal court.⁷⁰

D. SEC WHISTLEBLOWER PROGRAM

Following a "record-breaking" 2020, the 10-year anniversary of the creation of the SEC's whistleblower program,⁷¹ the SEC continues to issue significant awards to "whistleblowers whose information and assistance [lead] to successful SEC and related actions" in 2021.⁷² In September 2021, the SEC's whistleblower program surpassed \$1 billion in awards to whistleblowers since the program's creation, including over \$500 million in 2021 alone.⁷³

In particular, the SEC awarded \$110 million, the second-highest award in the program's history, to a whistleblower who "provided significant independent analysis that substantially advanced the SEC's and [another] agency's investigations."⁷⁴ The SEC has indicated that "[w]histleblowers may be eligible for an award when they voluntarily provide the SEC with original, timely, and credible information that leads to a successful enforcement action," and that "[w]histleblower awards can range from 10-30% of the money collected when the monetary sanctions exceed \$1 million."⁷⁵

In September 2020, the SEC adopted amendments to "provide greater clarity to whistleblowers," "increase the program's efficiency and transparency," and ensure whistleblowers are properly incentivized.⁷⁶ The amendments went into effect in December 2020.⁷⁷ On August 2, 2021, Chairman Gensler stated that the

⁶⁶ Order, *In re Momentus, Inc.*, No. 3-20393, ¶¶ 1–5 (Sec. Exch. Comm'n July 13, 2021).

⁶⁷ *Id.* ¶ 6.

⁶⁸ Order, *In re Momentus, Inc.*, No. 3-20393, at 16–17 (Sec. Exch. Comm'n July 13, 2021).

⁶⁹ *Id.* at 12–17.

⁷⁰ Press Release, *SEC Charges SPAC, Sponsor, Merger Target, and CEOs for Misleading Disclosures Ahead of Proposed Business Combination*, SECURITIES AND EXCHANGE COMMISSION (July 13, 2021), <https://www.sec.gov/news/press-release/2021-124>; see also Complaint, *SEC v. Kokorich*, No. 21-cv-01869, Dkt. No. 1 (D.D.C. July 13, 2021).

⁷¹ SECURITIES AND EXCHANGE COMMISSION, 2020 ANNUAL REPORT TO CONGRESS: WHISTLEBLOWER PROGRAM 1–2 (2020).

⁷² Press Release, *SEC Surpasses \$1 Billion in Awards to Whistleblowers with Two Awards Totaling \$114 Million*, SECURITIES AND EXCHANGE COMMISSION (Sept. 15, 2021), <https://www.sec.gov/news/press-release/2021-177>.

⁷³ *Id.*

⁷⁴ *Id.*

⁷⁵ *Id.*

⁷⁶ SECURITIES AND EXCHANGE COMMISSION, 2020 ANNUAL REPORT TO CONGRESS: WHISTLEBLOWER PROGRAM, at 33.

⁷⁷ *Id.*

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SEC will consider “potential revisions to . . . two rules that would address the concerns that [the September 2020] amendments would discourage whistleblowers from coming forward.”⁷⁸ 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 action,” and “could be used by a future Commission to lower an award because of the size of the award in absolute terms,” respectively.⁷⁹ In response to concerns about these amendments, the SEC “is considering whether [the SEC’s] rules should be revised to permit the [SEC] to make awards for related actions that might otherwise be covered by an alternative whistleblower program that is not comparable to the SEC’s own program, and to clarify that the [SEC] will not lower an award based on its dollar amount.”⁸⁰

E. INSIDER TRADING ENFORCEMENT

The SEC continues to vigorously investigate insider trading and file 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.*, an insider with material, non-public information about a company may not trade on that information.⁸¹

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 in Medivation’s competitor, Incyte Corp., “within minutes” of learning that Medivation would be acquired by Pfizer Inc.⁸² Incyte’s stock price rose following the public announcement that Pfizer would acquire Medivation, allegedly resulting in “illicit profits of \$107,066” for Panuwat.⁸³ 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.⁸⁴ 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.”⁸⁵

Commenting on the case, Gurbir Grewal, Director of the Enforcement Division, stated, “[b]iopharmaceutical industry insiders frequently have access to material nonpublic information about mergers, drug trials, or

⁷⁸ Gary Gensler, *Statement in Connection with the SEC’s Whistleblower Program*, SECURITIES AND EXCHANGE COMMISSION (Aug. 2, 2021), <https://www.sec.gov/news/public-statement/gensler-sec-whistleblower-program-2021-08-02>.

⁷⁹ *Id.* (citing 17 C.F.R. § 240.21F-3(b)(3) and 17 CFR § 240.21F-6).

⁸⁰ *Id.*

⁸¹ See Complaint, *SEC v. Panuwat*, No. 21-cv-06322, Dkt. No. 1, at 3–4 (N.D. Cal. Aug. 17, 2021).

⁸² *Id.* ¶¶ 1–2, 4.

⁸³ *Id.* ¶ 5.

⁸⁴ *Id.* ¶¶ 21–25.

⁸⁵ *Id.* ¶ 22.

regulatory approvals that impacts the stock price of not only their company, but also other companies in the industry. . . . The SEC is committed to detecting and pursuing illegal trading in all forms.”⁸⁶

F. COVID-19 RELATED DEVELOPMENTS

The COVID-19 pandemic continues to affect the SEC’s enforcement priorities. Throughout 2020, the SEC’s Division of Corporation Finance issued guidance to companies on disclosures during the COVID-19 pandemic.⁸⁷ The guidance explained that the SEC is “monitoring how companies are reporting the effects and risks of COVID-19 on their businesses” and urged companies to make “disclosures that allow investors to evaluate the current and expected impact of COVID-19 through the eyes of management” and to “proactively revise and update disclosures as facts and circumstances change.”⁸⁸ The SEC has since reaffirmed that it will closely monitor companies’ coronavirus-related disclosures and recommend actions against companies that make inadequate or misleading disclosures.⁸⁹

For example, in July 2021, the SEC announced that it had settled charges under Section 17 of the 1933 Act and Section 10(b) of the 1934 Act, against Parallax Health Sciences Inc. and two executives for making misleading statements about Parallax’s efforts to capitalize on COVID-19.⁹⁰ The SEC alleged that Parallax and its executives made several false representations—including that a Parallax-developed COVID-19 screening test would be “available soon” and that Parallax had PPE, ventilators, and other medical equipment for “immediate sale”—in a series of press releases in March and April 2020.⁹¹ At the time Parallax made these representations, the SEC alleged, the company was insolvent, lacked the capital to develop a COVID-19 screening test, and had projections showing that it would take over a year to develop such a test.⁹² Additionally, the SEC alleged that Parallax did not possess PPE, ventilators, or other medical equipment, and lacked the capital and FDA registrations required to acquire the equipment.⁹³ Without admitting or denying the SEC’s allegations, Parallax and its executives agreed to pay a total of \$185,000 in monetary penalties, judgments permanently enjoining them from further violations of the federal securities laws, and prohibitions from acting as officers or directors of a public company for a number of years.⁹⁴

⁸⁶ Press Release, *SEC Charges Biopharmaceutical Company Employee with Insider Trading*, SECURITIES AND EXCHANGE COMMISSION (Aug. 17, 2021), <https://www.sec.gov/news/press-release/2021-155>.

⁸⁷ See, e.g., Division of Corporation Finance, *Coronavirus (COVID-19)*, SECURITIES AND EXCHANGE COMMISSION (Mar. 25, 2020), <https://www.sec.gov/corpfin/coronavirus-covid-19>.

⁸⁸ *Id.*; Division of Corporation Finance, *Coronavirus (COVID-19)—Disclosure Considerations Regarding Operations, Liquidity, and Capital Resource*, SECURITIES AND EXCHANGE COMMISSION (June 23, 2020), <https://www.sec.gov/corpfin/covid-19-disclosure-considerations>.

⁸⁹ See, e.g., Press Release, *SEC Charges The Cheesecake Factory For Misleading COVID-19 Disclosures*, SECURITIES AND EXCHANGE COMMISSION (Dec. 4, 2020), <https://www.sec.gov/news/press-release/2020-306>.

⁹⁰ See Press Release, *SEC Charges Company and Two Executives for Misleading COVID-19 Disclosures*, SECURITIES AND EXCHANGE COMMISSION (July 7, 2021), <https://www.sec.gov/news/press-release/2021-120>.

⁹¹ Complaint, *SEC v. Parallax Health Scis., Inc.*, No. 21-cv-05812, Dkt. No. 1, ¶ 1 (S.D.N.Y. July 7, 2021).

⁹² *Id.*

⁹³ *Id.*

⁹⁴ Final Judgment, *SEC v. Parallax Health Scis., Inc.*, No. 21-cv-05812, Dkt. No. 4, at 1–4 (S.D.N.Y. July 9, 2021).

II. PART 2 – PRIVATE SECURITIES LITIGATION

A. NUMERICAL TRENDS IN PRIVATE SECURITIES LITIGATION

Continuing a trend that began with the onset of the COVID-19 pandemic, securities class action filings again slowed in the first half of 2021, driven partly by reduced levels of M&A-related litigation. In the first half of 2021, there were 112 filings in federal and state courts, down from 150 in the second half of 2020.⁹⁵ “Core” filings (*i.e.*, excluding M&A-related litigation) fell from 115 in the second half of 2020 to 100 in the first half of 2021. Federal M&A-related filings declined to 12 in the first half of 2021, a 66% decline from 35 filings in the second half of 2020 and an 83% decline from the average over the last five years.⁹⁶ Core filings against non-U.S. issuers reached their lowest levels since 2014, at 15 filings, and their lowest proportion since 2009, down from 33% in 2020 to 16%.⁹⁷ Sixty percent of filings against non-U.S. issuers in the first half of 2021 targeted Asia-based firms, the largest proportion since 2015.⁹⁸

Following the Delaware Supreme Court’s 2020 ruling in *Sciabacucchi* (discussed below), 1933 Act filings in state court have continued to fall, reaching their lowest levels since 2018, the year the Supreme Court decided *Cyan* (discussed below). In the first half of 2021, only 5 state 1933 Act actions were filed, all of which were in New York courts.⁹⁹ The combined number of federal and state court 1933 Act filings also decreased by 27% from 15 filings in the second half of 2020 to 11 filings in the first half of 2021.¹⁰⁰ In the first half of 2021, plaintiffs increasingly favored federal courts, with federal-only filings constituting 43% of all federal and state court 1933 Act filings, up from 21% between the start of 2018 and the end of 2019.¹⁰¹

Consistent with the increase in SPAC activity, securities class actions involving SPACs have risen significantly. In the first half of 2021, there were 14 SPAC-related filings—double the number in all of 2020.¹⁰² All 14 filings alleged violations of Section 10(b) of the 1934 Act, and 10 filings involved companies in the consumer sector.¹⁰³

⁹⁵ Cornerstone Research, *Securities Class Action Filings: 2021 Midyear Assessment*, at 1, available at <https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2021-Midyear-Assessment>.

⁹⁶ *Id.* at 4.

⁹⁷ *Id.* at 16.

⁹⁸ *Id.* at 17.

⁹⁹ *Id.* at 12.

¹⁰⁰ *Id.* at 14.

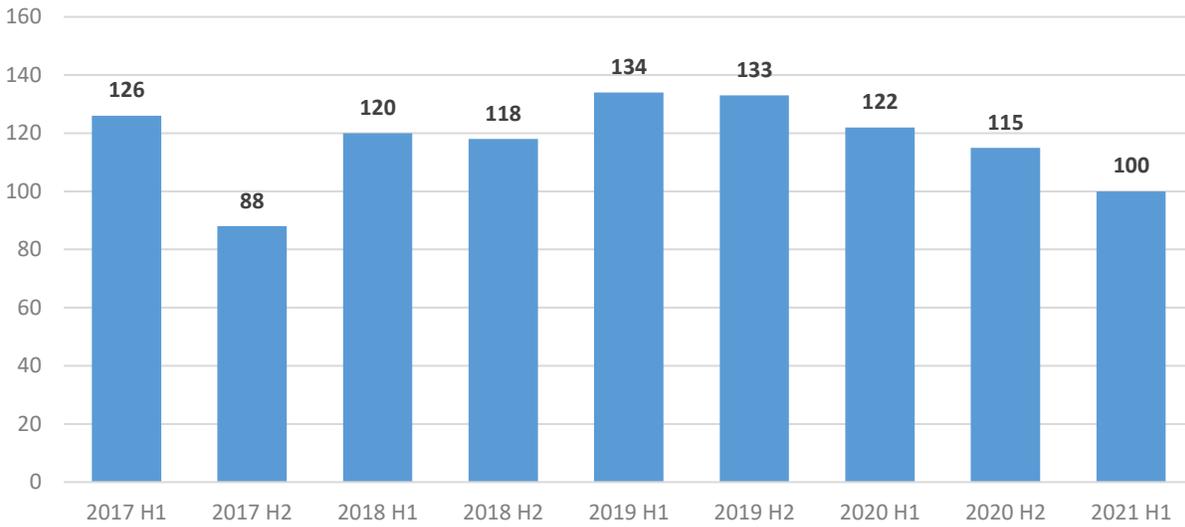
¹⁰¹ *Id.*

¹⁰² *Id.* at 5.

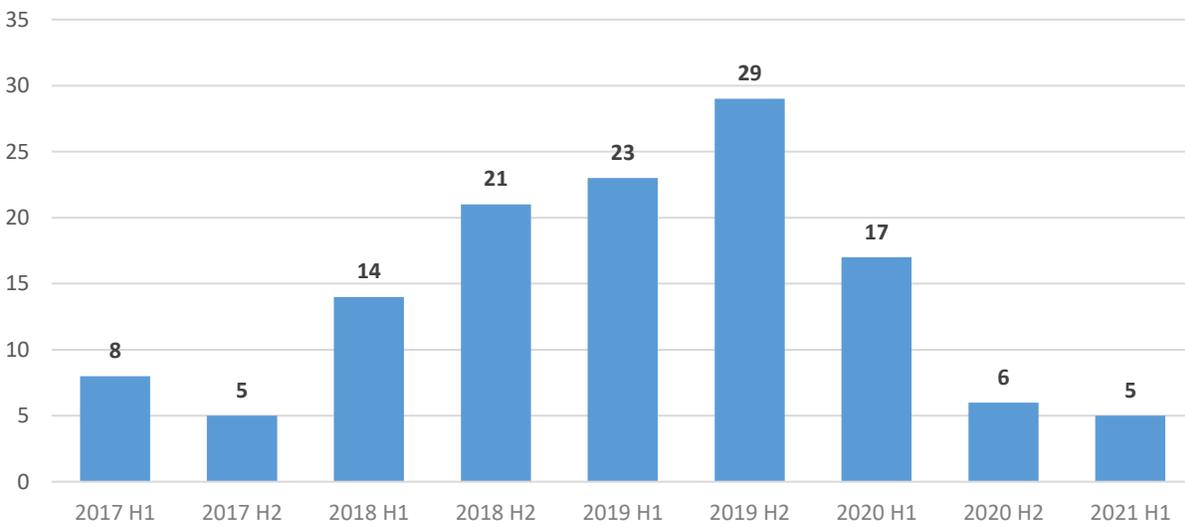
¹⁰³ *Id.* at 6, 8.

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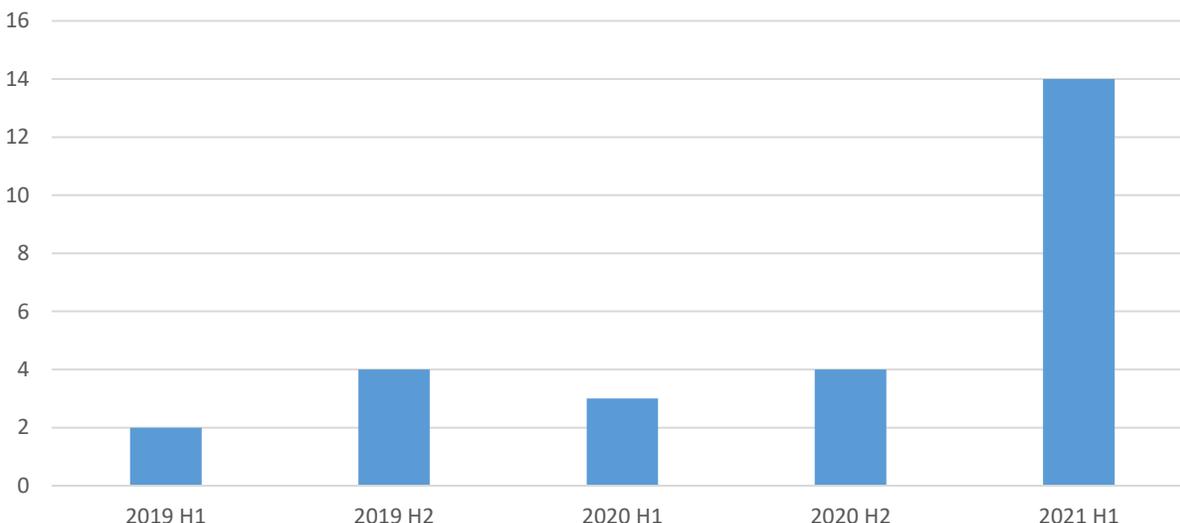
Core Securities Class Action Filings First Half of 2017 to First Half of 2021



State Court 1933 Act Class Action Filings First Half of 2017 to First Half of 2021



Federal SPAC Filings First Half of 2019 to First Half of 2021



B. THE SUPREME COURT’S DECISION IN *GOLDMAN SACHS GROUP, INC. V. ARKANSAS TEACHER RETIREMENT SYSTEM*

On June 21, 2021, the U.S. Supreme Court issued an 8-1 ruling in favor of Goldman Sachs and its former senior officers, represented by S&C, in one of the most closely watched securities class actions in recent years. In *Goldman Sachs Group, Inc. v. Arkansas Teacher Retirement System*, the Supreme Court considered two issues: (i) whether a defendant in a securities class action may rebut the *Basic* presumption of class-wide reliance by pointing to the generic nature of the alleged misstatements in showing that the statements had no price impact, even though that evidence is also relevant to the substantive element of materiality; and (ii) whether a defendant seeking to rebut the *Basic* presumption has only a burden of production or also the ultimate burden of persuasion.¹⁰⁴ In an opinion authored by Justice Barrett, the Supreme Court agreed with Goldman Sachs that the Second Circuit should have considered the generic nature of Goldman Sachs’ alleged misstatements in determining whether those statements impacted the price of Goldman Sachs’ stock.

First, the Supreme Court held that the generic nature of a challenged statement “often is important evidence of price impact that courts should consider at class certification,” even if such evidence “overlaps with materiality or any other merits issue.”¹⁰⁵ Further, the Court emphasized that the generic nature of a statement is “particularly” important in cases, such as *Goldman Sachs*, where plaintiffs rely on the “inflation-maintenance” theory to argue that the statements maintained an artificially inflated stock price even though they did not increase the stock price when made.¹⁰⁶ Although expressly refusing to consider the validity of the inflation-maintenance theory, the Court noted that there may be a “mismatch” between a generic

¹⁰⁴ 141 S. Ct. 1951 (2021).

¹⁰⁵ *Id.* at 1958, 1961.

¹⁰⁶ *Id.* at 1961.

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challenged statement and a specific corrective disclosure, causing the assumptions behind that theory to “break down” and providing “less reason to infer” price impact.¹⁰⁷ The Court also directed lower courts to “use their common sense in assessing whether a generic misrepresentation had a price impact.”¹⁰⁸

Second, the Supreme Court held that defendants bear the burden of persuasion and must establish a lack of price impact by a preponderance of the evidence.¹⁰⁹ The Court observed, however, that “the allocation of the burden is unlikely to make much difference on the ground” because “[t]he defendant’s burden of persuasion will have bite only when the court finds the evidence in equipoise—a situation that should rarely arise.”¹¹⁰

Goldman Sachs provides an important clarification of the standards for rebutting price impact. Prior to the Supreme Court’s decision, plaintiffs had often argued that lower courts could not consider price-impact evidence because it overlapped with a merits element, like materiality or loss causation.¹¹¹ The Supreme Court’s decision squarely forecloses that argument, making clear that lower courts “should be open to *all* probative evidence . . . aided by a good dose of common sense.”¹¹² Moreover, although declining to express a “view on [the] validity or [the] contours” of the inflation-maintenance theory increasingly relied on by plaintiffs in securities class actions, the Supreme Court placed a significant limitation on that theory, requiring a “match” between the alleged misstatements and the claimed corrective disclosures.¹¹³

C. UPDATE ON STATE COURT PROCEEDINGS

In 2020, the Delaware Supreme Court held in *Salzberg v. Sciabacucchi* that federal forum provisions in corporate charters or bylaws for securities claims are facially valid under Delaware law.¹¹⁴ Since then, courts around the country have continued to enforce federal forum provisions. Additionally, there is some new authority to support application of state forum provisions in corporate charters or bylaws for derivative claims based on federal causes of action.

Enforcement of Federal Forum Selection Provisions. In the wake of the Supreme Court’s *Cyan* decision permitting 1933 Act claims to be brought in state courts,¹¹⁵ some companies have adopted federal forum selection provision (“FFPs”) in corporate charters or bylaws requiring that all 1933 Act claims against them be brought in federal court. In 2020, following the Delaware Supreme Court’s decision in *Sciabacucchi*,¹¹⁶ several California trial courts held that FFPs are generally enforceable and preclude litigation of securities

¹⁰⁷ *Id.*

¹⁰⁸ *Id.* at 1960.

¹⁰⁹ *Id.* at 1962.

¹¹⁰ *Id.* at 1963.

¹¹¹ See, e.g., *In re Allstate Corp. Sec. Litig.*, 966 F.3d 595, 600 (7th Cir. 2020).

¹¹² *Goldman*, 141 S. Ct. at 1960.

¹¹³ *Id.* at 1959 n.1, 1961.

¹¹⁴ *Salzberg v. Sciabacucchi*, 227 A.3d 102 (Del. 2020).

¹¹⁵ *Cyan, Inc. v. Beaver Cty. Emps. Ret. Fund*, 138 S. Ct. 1061 (2018).

¹¹⁶ 227 A.3d at 109.

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claims in state court.¹¹⁷ Following these decisions, no 1933 Act class action claims were filed in the first half of 2021 in state court in California, traditionally one of the main venues, along with New York, for state court securities litigation.¹¹⁸

In August 2021, a New York trial court issued the first decision on FFPs under New York law. In *Hook v. Casa Systems, Inc.*, the plaintiffs brought claims in New York state court against Casa Systems, a Delaware corporation, its directors and officers, and its underwriters, under Sections 11 and 15 of the 1933 Act.¹¹⁹ The court dismissed the plaintiffs' claims because Casa Systems' charter contained a FFP, explaining that "issues of internal corporate governance are determined by the law [of] Delaware as the state where Casa is chartered" and that it would therefore follow *Sciabacucchi* and enforce the FFP.¹²⁰ Notably, the court reasoned that even if the internal affairs doctrine did not apply, "the application of New York law would not result in a different outcome."¹²¹ Because forum selection clauses are "prima facie valid unless shown by the resisting party to be unreasonable," unjust, or invalid due to fraud or overreaching under New York public policy, the court reasoned that the FFP was enforceable under New York law.¹²² If other New York courts follow the same approach, there will likely be further constriction of 1933 Act filings in state courts, considering New York's traditional prominence as a venue.

Enforcement of Forum Selection Clauses in Favor of State Court. Conversely, companies often include forum selection clauses in their bylaws providing that derivative actions must be brought in state court in the company's state of incorporation. Under the 1934 Act, federal courts "have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder."¹²³ Further, the anti-waiver provision of the 1934 Act voids "[a]ny condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder."¹²⁴ Recent decisions from California federal courts, however, have enforced forum selection clauses requiring the filing of all derivative suits in Delaware state court, including for claims under Section 14(a) of the 1934 Act.

Earlier this year, in *Ocegueda ex rel. Facebook v. Zuckerberg*, a Northern District of California court granted Facebook's motion to dismiss a shareholder derivative action alleging breaches of fiduciary duty and violations of Section 14(a) on the basis that, *inter alia*, a forum selection clause in Facebook's certificate of incorporation required derivative suits to be filed in the Delaware Court of Chancery.¹²⁵ After concluding that the forum selection clause precluded litigating the state-law breach-of-fiduciary-duty claims in federal court, the court suggested, without reaching the issue, that "[t]he forum-selection clause may bar the § 14(a)

¹¹⁷ See *Wong v. Restoration Robotics*, 2020 Cal. Super. LEXIS 227 (Cal. Super. Ct. Sept. 1, 2020); *In re Uber Techs., Inc. Sec. Litig.*, No. CGC-19-579544 (Cal. Super. Ct. Nov. 16, 2020); *In re Dropbox, Inc. Sec. Litig.*, No. 19-civ-05089 (Cal. Super. Ct. Dec. 4, 2020); *In re Sonim Tech., Inc. Sec. Litig.*, No. 19-civ-05564 (Cal. Super. Ct. Dec. 4, 2020).

¹¹⁸ Cornerstone Research, *Securities Class Action Filings: 2021 Midyear Assessment*, at 12.

¹¹⁹ 2021 WL 3884063, at *1–2 (N.Y. Sup. Ct., N.Y. Cty. Aug. 30, 2021).

¹²⁰ *Id.* at *3.

¹²¹ *Id.*

¹²² *Id.*

¹²³ 15 U.S.C. § 78aa(a).

¹²⁴ *Id.* § 78cc(a).

¹²⁵ 526 F. Supp. 3d 637, 646, 648–49 (N.D. Cal. 2021).

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claim too” because public policy favors the enforcement of such clauses “unless the contractually selected forum affords the plaintiffs no remedies whatsoever.”¹²⁶

Subsequently, in *Lee v. Fisher*, another derivative suit alleging breach of fiduciary duty and Section 14(a) claims against the board of directors of the Gap, a California district court granted a motion to dismiss based on a forum selection clause in the Gap’s bylaws requiring all derivative claims to be brought in the Delaware Court of Chancery.¹²⁷ Citing Ninth Circuit authority holding that “the strong federal policy in favor of enforcing forum-selection clauses supersedes the anti-waiver provisions in state and federal statutes,” the court concluded that the plaintiff failed to show that the “lost opportunity to bring a Section 14(a) claim violates the strong public policy of the forum in which she filed this lawsuit.”¹²⁸ Irrespective of whether the plaintiff’s Section 14(a) claim is “substantially similar” to her Delaware state law claims, the court reasoned, “[i]t is the *availability* of a remedy that matters,” rather than “the fact that *certain types of remedies* are unavailable” in the chosen forum.¹²⁹

These recent rulings stand in contrast to those of other federal district courts, which have declined to enforce forum selection clauses in such a manner that would prevent 1934 Act from being brought in federal court.¹³⁰ Whether in favor of federal or state court, forum selection clauses are an important tool for companies to consolidate cases and limit their exposure to duplicative actions in multiple venues, which can impose discovery burdens and heightened litigation costs. The enforceability of such clauses continues to be an evolving area in both federal and state courts.

Supreme Court Grants Certiorari in Case Concerning PSLRA Discovery Stay. The PSLRA provides that “[i]n any private action arising under [the Securities Act of 1933], all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss, unless the court finds, upon the motion of any party, that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to that party.”¹³¹ Although federal courts have consistently applied this provision to 1933 Act claims, state courts have adopted divergent approaches to whether the provision applies to such claims following the Supreme Court’s decision in *Cyan*.¹³²

Supported by *amici* including the Securities Industry and Financial Markets Association, the U.S. Chamber of Commerce, the Society for Corporate Governance, and the Washington Legal Foundation, defendants in *Pivotal Software v. Tran* filed a petition for certiorari, raising the question of whether “the [PSLRA]’s

¹²⁶ *Id.* at 650 (quoting *Yei A. Sun v. Adv. China Healthcare, Inc.*, 901 F.3d 1081, 1092 (9th Cir. 2018)).

¹²⁷ 2021 WL 1659842, at *2 (N.D. Cal. Apr. 27, 2021).

¹²⁸ *Id.* at *3.

¹²⁹ *Id.* at *5 (quoting *Yei A. Sun*, 901 F.3d at 1092; then quoting *Weber v. PACT XPP Techs., AG*, 811 F.3d 758, 774 (5th Cir. 2016)).

¹³⁰ See, e.g., *Butorin ex rel. KBR Inc. v. Blount*, 106 F. Supp. 3d 833, 837–38 (S.D. Tex. 2015); *In re Facebook, Inc. S’holder Privacy Litig.*, 367 F. Supp. 3d 1108, 1120 (N.D. Cal. 2019); *Klein v. Ellison*, 2021 WL 2075591, at *9 (N.D. Cal. May 24, 2021); *Esa v. NortonLifeLock Inc.*, 2021 WL 3861434, at *3 (N.D. Cal. Aug. 30, 2021).

¹³¹ 15 U.S.C. § 77z–1(b)(1).

¹³² See, e.g., *In re Everquote, Inc. Sec. Litig.*, 65 Misc. 3d 226, 236 (N.Y. Sup. Ct., N.Y. Cty. 2019); *In re PPDAl Grp. Sec. Litig.*, 64 Misc. 3d 1208(A) (N.Y. Sup. Ct., N.Y. Cty. July 1, 2019); *In re Dentsply Sirona, Inc. S’holders Litig.*, 2019 WL 3526142 (N.Y. Sup. Ct., N.Y. Cty. Aug. 2, 2019).

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discovery-stay provision applies to a private action under the Securities Act in state or federal court, or solely to a private action in federal court.”¹³³ On July 2, 2021, the U.S. Supreme Court granted certiorari.¹³⁴ After certiorari was granted, however, the parties reached an agreement in principle to settle the case and jointly moved to hold proceedings in abeyance.¹³⁵ On September 2, 2021, the Court granted the motion and removed the case from the November 2021 argument calendar.

Should the settlement between the parties be finalized, resolution of the controversy over application of the PSLRA’s discovery stay in state court will need to await another case. Nevertheless, the grant of *certiorari* reflects the Supreme Court’s awareness of the conflicting rulings on this question and may signal its willingness to consider the issue in another appropriate case.

D. FIRST CIRCUIT OPINES ON APPLICATION OF THE *MORRISON* TEST

Following the U.S. Supreme Court’s *Morrison* decision, courts have grappled with interpreting and applying its “transactional test” for the extraterritorial reach of Section 10(b) of the 1934 Act.¹³⁶ In *Morrison*, the Supreme Court held that Section 10(b) applies only to (i) “transactions in securities listed on domestic exchanges” and (ii) “domestic transactions in other securities.”¹³⁷ Federal courts of appeal have elaborated on the more contentious second prong of this transactional test, with the Second, Third, and Ninth Circuits holding that “transactions involving securities that are not traded on a domestic exchange are domestic if *irrevocable liability is incurred or title passes within the United States*.”¹³⁸

In an opinion issued on May 10, 2021, in *SEC v. Morrone*, the First Circuit adopted the “irrevocable liability” test for determining whether a transaction is “domestic” under the second prong of *Morrison*.¹³⁹ In *Morrone*, the defendants included a Delaware corporation, Bio Defense, and its directors and officers, who solicited investments from U.S. and non-U.S. investors.¹⁴⁰ As part of their international fundraising efforts, the defendants worked with a foreign entity, Agile Consulting, to raise money from foreign investors, agreeing to pay a 75% fee for any investor funds it raised.¹⁴¹ Under the arrangement, Agile solicited foreign investors from call centers in Europe and would send the contact information of interested investors to the U.S.-based defendants, who would send subscription agreements to the potential investors. Those agreements were then countersigned in the United States.¹⁴² In 2012, the SEC filed a complaint against the defendants, alleging numerous violations of the 1933 and 1934 Acts.

¹³³ Petition for a Writ of Certiorari, *Pivotal Software, Inc. v. Super. Ct. of California*, No. 20-1541, 2021 WL 1816827, at *i (U.S. May 2021).

¹³⁴ *Pivotal Software, Inc. v. Super. Ct. of California*, No. 20-1541, 2021 WL 2742794 (U.S. July 2, 2021).

¹³⁵ Joint Motion to Recalendar Argument and Hold Proceedings in Abeyance, *Pivotal Software, Inc. v. Super. Ct. of California*, No. 20-1541 (U.S. Aug. 27, 2021).

¹³⁶ *Morrison v. Australia Nat’l Bank Ltd.*, 561 U.S. 247, 269 (2010).

¹³⁷ *Id.* at 267.

¹³⁸ *Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60, 67 (2d Cir. 2012) (emphasis added). See *United States v. Georgiou*, 777 F.3d 125, 135–36 (3d Cir. 2015); *SEC v. World Cap. Mkt., Inc.*, 864 F.3d 996, 1008 (9th Cir. 2017).

¹³⁹ *SEC v. Morrone*, 997 F.3d 52, 59–60 (1st Cir. 2021).

¹⁴⁰ *Id.* at 54–55.

¹⁴¹ *Id.* at 56.

¹⁴² *Id.* at 57.

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The district court rejected the defendants' argument that the securities laws did not apply to "foreign transactions involving foreign investors solicited by foreign brokerage firms," and the First Circuit affirmed.¹⁴³ In its opinion, the First Circuit expressed agreement with "the reasoning of the Second, Third, and Ninth Circuits . . . that a transaction is domestic under *Morrison* if irrevocable liability occurs in the United States."¹⁴⁴ Because the subscription agreements for Bio Defense stock had "no obligation" under them until executed, and these agreements were executed in the United States, the First Circuit found that irrevocable liability occurred in the United States.¹⁴⁵ The First Circuit's approach aligns with the holdings of other circuits as to the "irrevocable liability" test, providing greater certainty in this regard.

The First Circuit, however, departed from the Second Circuit on whether irrevocable liability alone suffices under *Morrison*. In 2014, the Second Circuit held in *Parkcentral* that a claim involving a domestic transaction may nevertheless be "so predominantly foreign as to be impermissibly extraterritorial" for purposes of the federal securities laws—holding, in effect, that something beyond mere irrevocable liability in the United States is needed to apply the federal securities laws to a foreign transaction.¹⁴⁶ By contrast, the Ninth Circuit has rejected this additional requirement, reasoning that the "predominantly foreign" test "is contrary to Section 10(b) and *Morrison* itself."¹⁴⁷

In *Morrone*, the defendants contended that "even if a transaction is domestic because irrevocable liability occurred in the United States," the First Circuit should "adopt the Second Circuit's holding in *Parkcentral*" that the federal securities laws do not apply to "predominantly foreign" claims.¹⁴⁸ The First Circuit rejected this position and followed the Ninth Circuit in holding that "[t]he existence of a domestic transaction suffices to apply the federal securities laws under *Morrison*."¹⁴⁹ As a result, *Morrone* adds to the tension between the Second and Ninth Circuits on the proper approach to *Morrison*'s second prong and the circumstances under which conduct with extraterritorial elements falls within the ambit of the federal securities laws.

E. NINTH CIRCUIT AFFIRMS SECURITIES ACT STANDING FOR DIRECT LISTING PURCHASERS

On September 20, 2021, in *Pirani v. Slack Technologies*, the Ninth Circuit held that a purchaser of unregistered securities in a direct listing has standing to sue under Sections 11 and 12(a)(2) of the 1933 Act.¹⁵⁰ Section 11 provides a cause of action against issuers and underwriters for alleged false statements in a registration statement to "any person acquiring *such security*."¹⁵¹ Section 12(a)(2) similarly provides that any person who offers or sells a security "by means of a prospectus or oral communication" shall be

¹⁴³ *Id.* at 59.

¹⁴⁴ *Id.* at 60.

¹⁴⁵ *Id.*

¹⁴⁶ *Parkcentral Global Hub Ltd. v. Porsche Auto. Holdings SE*, 763 F.3d 198, 216 (2d Cir. 2014).

¹⁴⁷ *Stoyas v. Toshiba Corp.*, 896 F.3d 933, 950 (9th Cir. 2018).

¹⁴⁸ *Morrone*, 997 F.3d at 60.

¹⁴⁹ *Id.*

¹⁵⁰ *Pirani v. Slack Techs., Inc.*, 13 F.4th 940 (9th Cir. 2021).

¹⁵¹ 15 U.S.C. § 77k(a) (emphasis added).

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liable “to the person purchasing *such security* from him” for false statements in the prospectus or communication.¹⁵²

In 2018, the SEC approved a proposed rule by the New York Stock Exchange permitting companies to go public through a “Selling Shareholder Direct Listing,” in which the company does not issue any new shares and files a registration statement solely to permit pre-existing shares to be sold on the exchange.¹⁵³ A company must register its pre-existing shares before they can be sold to the public, unless the shares are exempt. Thus, in a direct listing, both registered and unregistered shares may be made available to the public on the first day of the listing.¹⁵⁴

On June 7, 2019, Slack Technologies filed a registration statement and a Form S-8 registering shares sold as part of an employee compensation package, which incorporated the former by reference.¹⁵⁵ A few days later, on June 20, 2019, it completed a direct listing, in which it released 118 million registered and 165 million unregistered shares.¹⁵⁶ The plaintiff acquired 30,000 Slack shares from the direct listing and later purchased an additional 220,000 shares.¹⁵⁷ After Slack experienced service disruptions that allegedly caused the share price to fall, the plaintiff brought a putative class action against Slack and its officers, directors, and venture capital fund investors under Sections 11, 12(a)(2), and 15(a) of the 1933 Act, alleging misleading statements in Slack’s registration statement.¹⁵⁸ Although the plaintiff could not prove that the shares he purchased were sold pursuant to the allegedly misleading registration statement, the district court found that he had standing to bring Section 11 and 15 claims because the securities he purchased, even if unregistered, were “of the same nature” as those issued pursuant to the registration statement.¹⁵⁹ It also found that he had standing under Section 12(a)(2), interpreting the provision to cover all securities offered in the direct listing.¹⁶⁰

On appeal, the Ninth Circuit affirmed. With respect to Section 11, the Ninth Circuit panel majority held that “Slack’s unregistered shares sold in a direct listing are ‘such securities’ within the meaning of Section 11 because their public sale cannot occur without the only operative registration in existence.”¹⁶¹ According to the court, the legislative history of the 1933 Act indicated that liability should arise when the “connection between the statements made and the purchase of the security is clear,” and “both the registered and unregistered Slack shares sold in the direct listing were sold ‘upon a registration statement’ because they

¹⁵² *Id.* § 771(a)(2).

¹⁵³ See Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing of Amendment No. 3 and Order Granting Accelerated Approval of Proposed Rule Change, as Modified by Amendment No. 3, To Amend Section 102.01B of the NYSE Listed Company Manual To Provide for the Listing of Companies That List Without a Prior Exchange Act Registration and That Are Not Listing in Connection With an Underwritten Initial Public Offering and Related Changes to Rules 15, 104, and 123D, Exchange Act Release No. 34-82627, 83 Fed. Reg. 5650–01 (Feb. 8, 2018).

¹⁵⁴ See *Slack*, 13 F.4th at 944.

¹⁵⁵ *Id.* at 947 n.5.

¹⁵⁶ *Id.* at 944.

¹⁵⁷ *Id.*

¹⁵⁸ *Id.*

¹⁵⁹ *Pirani v. Slack Techs., Inc.*, 445 F. Supp. 3d 367, 381, 393 (N.D. Cal. 2020).

¹⁶⁰ *Id.* at 383.

¹⁶¹ *Slack*, 13 F.4th at 947.

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could only be sold to the public at the time of effectiveness of the statement.”¹⁶² Moreover, since there was only one registration statement, the case did “not present the traceability problem identified by this court in cases with successive registrations.”¹⁶³ From a policy perspective, the court added, a contrary interpretation “would essentially eliminate Section 11 liability for misleading or false statements made in a registration statement in a direct listing for both registered and unregistered shares.”¹⁶⁴

The Ninth Circuit further held that “Section 12 liability (resulting from a false prospectus) is consistent with Section 11 liability (resulting from a false registration statement).”¹⁶⁵ It reasoned that “the shares at issue in Slack’s direct listing, registered and unregistered, were sold ‘by means of a prospectus’ because the prospectus was a part of the offering materials (*i.e.*, the registration statement and prospectus) that permitted the shares to be sold to the public.”¹⁶⁶

Judge Miller dissented, stating that “such security” in Section 11 “requires the plaintiff to ‘have purchased a security issued under that, rather than some other, registration statement.’”¹⁶⁷ Because the plaintiff could not show that his shares “were issued under the allegedly false or misleading registration statement,” he lacked standing under Section 11.¹⁶⁸ Judge Miller expressed that “[w]hat appears to be driving today’s decision [is] not the text or history of [S]ection 11 but instead the court’s concern that it would be bad policy for a [S]ection 11 action to be unavailable when a company goes public through a direct listing.”¹⁶⁹ In his view, based on “the text that Congress enacted” rather than “the rules of the New York Stock Exchange,” Section 12 also has “[t]he unambiguous meaning [that] a security offered or sold ‘by means of a prospectus’ is . . . a registered security sold in a public offering.”¹⁷⁰

The Ninth Circuit majority noted that this was “a case of first impression,”¹⁷¹ arising as the result of a new regulatory development.¹⁷² On November 3, 2021, defendants petitioned the Ninth Circuit for rehearing and rehearing en banc.¹⁷³ As the dissenting opinion suggests, the decision raises questions about whether the Ninth Circuit’s policy-driven approach will be adopted in other circuits.

F. SHAREHOLDER SUITS RELATED TO ESG DISCLOSURES

The second half of 2020 saw an uptick in shareholder derivative actions and securities fraud suits stemming from ESG-related commitments and disclosures against a range of companies. Those actions included a series of derivative suits, filed in California federal courts, alleging misrepresentations about corporate

¹⁶² *Id.* at 948 (quoting H.R. Rep. No. 73-85, at 9 (1933) (Conf. Rep.)).

¹⁶³ *Id.* at 947.

¹⁶⁴ *Id.* at 948.

¹⁶⁵ *Id.* at 949.

¹⁶⁶ *Id.*

¹⁶⁷ *Id.* at 952 (Miller, J., dissenting) (quoting *Hertzberg v. Dignity Partners, Inc.*, 191 F.3d 1076, 1080 (9th Cir. 1999)).

¹⁶⁸ *Id.* (quoting *In re Century Aluminum Co. Sec. Litig.*, 729 F.3d 1104, 1106 (9th Cir. 2013)).

¹⁶⁹ *Id.* at 953.

¹⁷⁰ *Id.* at 954.

¹⁷¹ *Id.* at 946.

¹⁷² See *Slack*, 445 F. Supp. 3d at 378.

¹⁷³ Petition for Rehearing and Rehearing En Banc, *Pirani v. Slack Techs., Inc.*, No. 20-16419 (9th Cir. Nov. 3, 2021).

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commitments to workforce and leadership diversity by companies in industries ranging from software to consumer retail.¹⁷⁴ Several courts have now held that such diversity-related derivative litigation was barred by the plaintiffs' failure to adequately allege demand futility—*i.e.*, plead with particularity that a majority of directors were conflicted from deciding whether to pursue the claims. For example, in April 2021, a Central District of California court dismissed without leave to amend derivative breach of fiduciary duty, abuse of control, and Section 14(a) claims against directors and officers of Monster, a Delaware beverage corporation.¹⁷⁵ The complaint alleged that the defendants failed to “to ensure diversity on the Board and in senior management,” “failed to ensure compliance with federal and state anti-discrimination laws,” misrepresented the company’s “policy of being committed to diversity and inclusion,” and “received unjust compensation.”¹⁷⁶ The court held that the plaintiff failed to plead sufficient facts showing that the independent directors faced a substantial risk of personal liability.¹⁷⁷ Among other things, the district court noted that “[w]ith respect to [the plaintiff’s] claims about racial diversity, Delaware imposes no duty to maintain diversity on a Board of Directors,” undercutting the plaintiff’s arguments on director liability.¹⁷⁸

Similarly, in two cases against technology companies AMD and NortonLifeLock, Northern District of California courts dismissed derivative suits alleging misleading statements about workforce diversity.¹⁷⁹ In these cases, plaintiffs challenged corporate statements, such as “AMD is growing a diverse, inclusive workforce that embraces different perspectives and experiences”¹⁸⁰ and “the composition of the [NortonLifeLock] Board should reflect the benefits of diversity as to gender, race, ethnic cultural and geographic backgrounds,”¹⁸¹ as materially misleading under Section 14(a), among other claims. In dismissing the complaints for failure to plead demand futility, the courts in both cases stressed that it is insufficient for plaintiffs to “lump[] the Directors together and [rely on] their ‘mere[] [] proximity to the’ alleged violation”¹⁸² or that a “director is counted as interested merely because he or she is a member of the board.”¹⁸³ Rather than “group the Directors together as all ‘similarly situated,’” plaintiffs must show that “the relevant facts apply to each of the board members (up to the requisite number for a majority).”¹⁸⁴ Together, these and other decisions highlight demand futility as a significant obstacle for plaintiffs in ESG-related derivative litigation.¹⁸⁵

¹⁷⁴ See, e.g., *Klein v. Ellison*, No. 20-cv-04439, Dkt. No. 1 (N.D. Cal. July 2, 2020); *Esa v. NortonLifeLock Inc.*, No. 20-cv-05410, Dkt. No. 1 (N.D. Cal. Aug. 5, 2020); *Lee v. Fisher*, No. 20-cv-06163, Dkt. No. 1 (N.D. Cal. Sept. 1, 2020); *Falat v. Sacks*, No. 20-cv-01782, Dkt. No. 1 (C.D. Cal. Sept. 18, 2020).

¹⁷⁵ *Falat v. Sacks*, 2021 WL 1558940, at *1–3 (C.D. Cal. Apr. 8, 2021).

¹⁷⁶ *Id.*

¹⁷⁷ *Id.* at *5.

¹⁷⁸ *Id.*

¹⁷⁹ See *City of Pontiac Police & Fire Ret. Sys. v. Caldwell*, 2021 WL 2711750, at *9 (N.D. Cal. July 1, 2021); *Esa v. NortonLifeLock, Inc.*, 2021 WL 3861434, at *6 (N.D. Cal. Aug. 30, 2021).

¹⁸⁰ *Caldwell*, 2021 WL 2711750, at *2.

¹⁸¹ *Esa*, 2021 WL 3861434, at *1.

¹⁸² *Caldwell*, 2021 WL 2711750, at *8 (quoting *Towers v. Iger*, 912 F.3d 523, 531 (9th Cir. 2018)).

¹⁸³ *Esa*, 2021 WL 3861434, at *4.

¹⁸⁴ *Id.*

¹⁸⁵ See also, e.g., *Ocegueda*, 526 F. Supp. 3d at 648; *In re Danaher Corp. S’holder Derivative Litig.*, 2021 WL 2652367, at *6 (D.D.C. June 28, 2021).

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Courts have also recently dismissed ESG-related derivative actions for failure to state a claim. As these decisions emphasize, plaintiffs bear the burden of establishing that allegedly false ESG statements are material, as opposed to mere puffery. For instance, in *Ocegueda*, the plaintiff brought derivative breach of fiduciary duty and Section 14(a) claims, alleging misrepresentations in Facebook’s 2019 and 2020 proxy statements. The statements related to Facebook’s commitments to diversity and inclusion, including “building a workforce that is as diverse as the communities [it] serves” and “including individuals from diverse backgrounds at the board level.”¹⁸⁶ In addition to holding that the plaintiff failed to adequately plead demand futility, the Northern District of California court held that the challenged statements were “non-actionable puffery or aspirational (and hence immaterial).”¹⁸⁷ Further, although the plaintiff cited newspaper reports of slow progress at workforce diversity, the court found that this was “not inconsistent with a commitment to diversity” and did not render the statements false.¹⁸⁸ Another Northern District of California court reached the same conclusions in a derivative action alleging misstatements about Oracle’s commitment to “actively seek[ing] women and minority candidates from the pool in which director candidates are chosen.”¹⁸⁹

Another recent opinion by a District of Columbia court considered the meaning of diversity. In *Danaher*, the plaintiffs filed a derivative action against directors of Danaher, “argu[ing] that [d]efendants falsely represented Danaher as a diverse corporation even though no African American serves on the Board.”¹⁹⁰ Specifically, the plaintiffs challenged company statements including “[w]e’re passionate about recruiting, developing and retaining the most talented and diverse team possible” and “we have made good efforts [around diversity and inclusion].”¹⁹¹ Although the court dismissed the complaint for failure to plead demand futility, it also noted that the challenged statements “d[id] not apply to the Board or imply that the Board is diverse,” but rather referred to Danaher’s “associates” and “workforce.”¹⁹² The court noted that most of the challenged statements “are also of the type that—at least in other contexts—courts consider not actionable” because they are not “capable of objective verification.”¹⁹³

Further, the *Danaher* court expressed doubt as to plaintiffs’ theory of “diversity,” explaining that the fact that “there are no African Americans on Danaher’s Board does not inherently mean that the Board is not diverse,” as “[t]he Board could be racially diverse in other ways” and “there are other types of diversity besides racial diversity.”¹⁹⁴ In dismissing the complaint, the court added that it “reject[ed] [plaintiffs’] cramped and archaic understanding of diversity.”¹⁹⁵ As this decision portends, courts adjudicating ESG-

¹⁸⁶ *Ocegueda*, 526 F. Supp. 3d at 643.

¹⁸⁷ *Id.* at 651.

¹⁸⁸ *Id.*

¹⁸⁹ *Ellison*, 2021 WL 2075591, at *4.

¹⁹⁰ *In re Danaher*, 2021 WL 2652367, at *1.

¹⁹¹ *Id.* at *5.

¹⁹² *Id.* at *6.

¹⁹³ *Id.* at *7 n.7.

¹⁹⁴ *Id.* at *7.

¹⁹⁵ *Id.*

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related suits will likely be required to parse and interpret value-laden claims, and it remains to be seen how other courts will approach corporate statements about diversity and inclusion and other ESG matters.

Despite these decisions, the risk of ESG-related securities and derivative litigation, along with regulatory action and shareholder proxy battles continues to grow. Thus, companies should comprehensively review their ESG-related strategy and disclosures, including in both public and non-public filings, documents, and statements.

G. SUITS RELATED TO SPECIAL PURPOSE ACQUISITION COMPANIES

Litigation involving SPACs has significantly increased in 2021, led by a surge in claims under Section 10(b) of the 1934 Act. From the beginning of 2019 through midyear 2021, 27 federal securities class actions involving SPACs have been filed, with 14 of those filings—more than half—in the first half of 2021 alone.¹⁹⁶ Over the same period, there were 166 SPAC merger transactions and 23 core federal securities class action filings involving SPACs, yielding a litigation rate of 14%, which is equal to the litigation risk faced by new public issuers in the first three years after their IPOs.¹⁹⁷ The landscape of securities litigation in the SPAC context is still developing and will likely remain uncertain for some time. Indeed, in response to recent derivative lawsuits claiming that SPACs are “investment companies” subject to registration under the Investment Company Act of 1940,¹⁹⁸ over 50 major U.S. law firms, including S&C, issued a statement on August 27, 2021 rejecting “the assertion that SPACs are investment companies as without factual or legal basis.”¹⁹⁹

A common allegation in SPAC-related litigation is a claim that the defendant misrepresented the product viability or business prospects of the SPAC target prior to the merger. Of the 14 SPAC-related federal class action filings between January and the end of June 2021, eight filings contained such allegations.²⁰⁰ For instance, in a May 2021 putative class action filed in the Eastern District of New York, the plaintiffs alleged that Danimer Scientific, a plastics company, and certain of its officers and directors had violated Sections 10(b) and 20(a) of the 1934 Act by making misrepresentations about the biodegradability of its signature polymer product after it had merged with a SPAC.²⁰¹ The industry sectors subject to such allegations have been diverse and span the consumer,²⁰² financial,²⁰³ health care,²⁰⁴ and basic materials sectors.²⁰⁵

¹⁹⁶ Cornerstone Research, *Securities Class Action Filings: 2021 Midyear Assessment*, at 8.

¹⁹⁷ *Id.*

¹⁹⁸ 15 U.S.C. § 80a-1 *et seq.*

¹⁹⁹ See *Over 55 of the Nation's Leading Law Firms Respond to Investment Company Act Lawsuits Targeting the SPAC Industry*, PR Newswire (Aug. 30, 2021), <https://www.prnewswire.com/news-releases/over-55-of-the-nations-leading-law-firms-respond-to-investment-company-act-lawsuits-targeting-the-spac-industry-301365180.html>.

²⁰⁰ Cornerstone Research, *Securities Class Action Filings: 2021 Midyear Assessment*, at 5.

²⁰¹ *Rosencrants v. Danimer Scientific, Inc.*, No. 21-cv-02708, Dkt. No. 1 (E.D.N.Y. May 14, 2021).

²⁰² See, e.g., *Malriat v. QuantumScape Corp.*, No. 21-cv-00058, Dkt. No. 1 (N.D. Cal. Jan. 5, 2021).

²⁰³ See, e.g., *Bond v. Clover Health Invs., Corp.*, No. 21-cv-00096, Dkt. No. 1 (M.D. Tenn. Feb. 5, 2021).

²⁰⁴ See, e.g., *Pitman v. Immunovant, Inc.*, No. 21-cv-00918, Dkt. No. 1 (E.D.N.Y. Feb. 19, 2021).

²⁰⁵ See, e.g., *Theodore v. PureCycle Tech., Inc.*, No. 21-cv-00809, Dkt. No. 1 (M.D. Fla. May 11, 2021).

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Plaintiffs have also targeted post-SPAC merger companies for allegedly inadequate financial disclosures, as, for example, in a recent putative class action against Virgin Galactic and its officers. Virgin Galactic is an aerospace company formed via a merger between its predecessor and a SPAC, Social Capital Hedosophia Holdings, in October 2019.²⁰⁶ Following the SEC's April 12, 2021 statement that SPACs should classify certain warrants as liabilities rather than equity,²⁰⁷ Virgin Galactic announced on April 30, 2021 that it would postpone the reporting of its Q1 2021 financial results due to the accounting treatment for warrants of Social Capital Hedosophia that were outstanding at the time of the SPAC merger.²⁰⁸ The plaintiffs alleged that Virgin Galactic's share price dropped by 9% per share and that the defendants violated Sections 10(b) and 20(a) of the 1934 Act by failing to disclose that the outstanding warrants were to be treated as liabilities rather than equities, that Virgin Galactic had deficient disclosure controls and procedures for financial reporting, and that it improperly accounted for the outstanding warrants.²⁰⁹

Given the rapidly developing regulatory environment for SPACs, such claims may be a source of unexpected litigation risk, even for officers and directors who no longer have a role with the post-merger company. Notably, although the accounting treatment of the outstanding warrants predated the SPAC merger, the class action complaint named certain officers of Virgin Galactic as defendants, rather than directors and officers of the SPAC.

H. EFFECTS OF COVID-19 ON SECURITIES LITIGATION

In 2021, filings of COVID-related securities suits have remained relatively modest. Notably, COVID-related suits against three large cruise operators, filed last year, were all dismissed. In February 2021, the lead plaintiff voluntarily dismissed a securities class action against Royal Caribbean Cruises, which had alleged misstatements about booking slowdowns and safety protocols onboard its ships.²¹⁰

In April 2021, a Florida district court granted a motion to dismiss a securities class action against Norwegian Cruise Lines, which alleged that Norwegian made unduly positive statements in its SEC filings including that "despite the current known impact [from COVID-19], the Company's booked position remained ahead of [the] prior year and at higher prices on a comparable basis" and purportedly engaged in deceptive sales practices to attract customers despite its knowledge of the severity of the pandemic.²¹¹ The court ruled that the statements were puffery because "they are vague and so broad that no reasonable investor would have relied on them."²¹² The lead plaintiff did not seek leave to amend the complaint.²¹³

²⁰⁶ *Lavin v. Virgin Galactic Holdings, Inc.*, No. 21-cv-03070, Dkt. No. 1 (E.D.N.Y. May 28, 2021).

²⁰⁷ See discussion above, at p. 10.

²⁰⁸ See *Lavin*, Dkt. No. 1, at 3.

²⁰⁹ *Id.* at 13.

²¹⁰ *City of Riviera Beach Gen. Emps. Ret. Sys. v. Royal Caribbean Cruises Ltd.*, No. 20-cv-24111, Dkt. No. 44 (S.D. Fla. Feb. 25, 2021).

²¹¹ *Douglas v. Norwegian Cruise Lines*, 2021 WL 1378296, at *1–2 (S.D. Fla. Apr. 12, 2021).

²¹² *Id.* at *4.

²¹³ *Id.* at *10.

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Shortly thereafter, in May 2021, another Florida district court dismissed a securities class action against Carnival Cruise Lines, alleging that Carnival made misleading disclosures regarding its compliance with health and safety protocols despite being aware of increasing incidents of COVID-19 aboard its ships and continued violations of port-of-call regulations and health-and-safety protocols.²¹⁴ The court held that the plaintiffs had failed to plead that statements made by Carnival in January, February, and March 2020 were materially false or misleading.²¹⁵ For instance, it noted “the COVID-19 specific warnings provided in Carnival’s 2019 10-K” and also rejected as “hindsight knowledge” plaintiffs’ allegations that Carnival did not implement effective safety measures contrary to its statements.²¹⁶

While these decisions do not foreclose further litigation based on COVID-related statements, they suggest that courts will not readily find false or misleading statements in the context of corporate responses to a fluid and fast-changing pandemic, particularly if it appears that plaintiffs are pleading fraud by hindsight.

Similar to last year, several new securities cases focus on biomedical companies seeking to develop or supply COVID-19 vaccines or treatments. Besides a filing against drug-maker AstraZeneca in January 2021,²¹⁷ three actions were brought against pharmaceutical companies. In March, a putative securities fraud class action was filed against CytoDyn Inc. and certain of its officers, alleging that the defendants misleadingly and “aggressively tout[ed] Leronlimab,” a potential HIV therapy developed by CytoDyn, “as a treatment for COVID-19” in order “to pump up the stock price of CytoDyn.”²¹⁸ In April, investors filed a putative securities class action against Emergent BioSolutions Inc., which had signed vaccine production deals with Johnson & Johnson and AstraZeneca worth \$875 million and received \$628 million from the federal government’s Operation Warp Speed program. After allegations emerged of contamination issues at Emergent’s facilities, the plaintiffs claimed that Emergent and certain of its officers defrauded shareholders by making false statements about the company’s manufacturing capabilities.²¹⁹ Finally, in June, a plaintiff filed a putative securities class action against Ocugen, Inc. and its CEO and CFO, alleging that the biopharmaceutical company misled investors about its plans to advance a COVID-19 vaccine candidate for Emergency Use Authorization with the Food and Drugs Administration.²²⁰ Subsequently, a plaintiff separately initiated a derivative suit against Ocugen’s board for breaches of fiduciary duty and violations of Sections 10(b) and 21D of the 1934 Act, citing the events alleged in the securities action.²²¹

As companies adapt to the pandemic, the familiar types of COVID-related securities suits, against companies either directly involved in the response to the pandemic or whose operations are uniquely

²¹⁴ *In re Carnival Corp. Sec. Litig.*, 2021 WL 2583113, at *1–4 (S.D. Fla. May 28, 2021).

²¹⁵ *Id.* at *11–16.

²¹⁶ *Id.* at *11, *13.

²¹⁷ *Monroe Cnty. Emps.’ Ret. Sys. v. AstraZeneca plc*, No. 21-cv-00722, Dkt. No. 1 (S.D.N.Y. Jan. 26, 2021).

²¹⁸ *Lewis v. CytoDyn Inc.*, No. 21-cv-05190, Dkt. No. 1, at 2–3 (W.D. Wash. Mar. 17, 2021).

²¹⁹ *Palm Tran, Inc. – Amalgamated Transit Union Local 1577 Pension Plan v. Emergent BioSolutions Inc.*, No. 21-cv-00955, Dkt. No. 1, at 1–3 (D. Md. Apr. 19, 2021).

²²⁰ *Nicanor v. Ocugen, Inc.*, No. 21-cv-02725, Dkt. No. 1, at 6–8 (E.D. Pa. June 17, 2021).

²²¹ *Musso v. Musunuri*, No. 21-cv-03876, Dkt. No. 1 (E.D. Pa. Aug. 30, 2021).

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vulnerable to disruption caused by COVID-19, will likely become less prominent. Whether plaintiffs develop novel theories of liability in future COVID-related suits remains to be seen.

MEET THE EDITORS



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