

EVENT-DRIVEN SECURITIES LITIGATION

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INTRODUCTION

This Article examines a recent fundamental shift in the character of securities class action litigation. Whereas securities cases historically were anchored by financial or accounting fraud, increasingly such actions are premised on the alleged concealment of, or misrepresentation concerning,

the risk of adverse events that negatively impact stock performance. This new focus is the defining characteristic of event-driven securities litigation (EDSL), which has been controversial for multiple reasons. The Article examines the controversy in four parts. Part I examines the ascent of event-driven securities litigation. Part II examines seven recurring issues in the litigation, with an emphasis on these topics in EDSL involving the life sciences sector. Part III takes a deeper dive and analyzes six discrete categories of EDSL: (A) COVID-19, (B) cannabis, (C) corruption, (D) antitrust, (E) #MeToo, and (F) cybersecurity. Part IV discusses common proposed solutions to the perceived plague of event-driven securities litigation. The Article concludes that critiques of EDSL are mostly unjustified.

I. THE ASCENT OF EDSL

Securities class action litigation has experienced a major transformation in recent years.¹ Complaints filed in securities class actions asserting violations of section 10 of the Securities Exchange Act of 1934 (Exchange Act)² and companion Rule 10b-5,³ section 11 of the Securities Act of 1933 (Securities Act),⁴ and/or section 12 of the Securities Act⁵ are often referred to as core or standard filings. From 2009–2014, between 51% and 68% of

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1. See, e.g., Jeffrey Lubitz & Elisa Mendoza, *Event Driven Securities Litigation: The New Driver in Class Action Growth* 2, INSTITUTIONAL INVESTOR SERVICES (2020), <https://www.issgovernance.com/library/event-driven-securities-litigation-the-new-driver-in-class-action-growth/> [<https://perma.cc/5KU3-JQG4>] [hereinafter *New Driver*] (“[T]he trend of event-driven litigation is rising each year, while the more traditional accounting-based allegations are on the decline.”); Adam Hakki et al., *Civil Litigation Update: Major Civil Cases*, SIFMA COMPLIANCE & LEGAL SOCIETY 2020 ANNUAL SEMINAR 3 (2020), <https://www.sifma.org/wp-content/uploads/2020/03/TA1-Civil-Litigation-Update-Securities-Class-Actions-and-other-Major-Civil-Cases.pdf> [<https://perma.cc/6GJV-NU8D>] (“The biggest change in the realm of securities litigation has been the rise of the event-driven securities fraud lawsuit.”); PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP, *MITIGATING SECURITIES LITIGATION RISKS RELATED TO THE CORONAVIRUS 1* (2020), <https://www.paulweiss.com/practices/litigation/securities-litigation/publications/mitigating-securities-litigation-risks-related-to-the-coronavirus?id=30788> [<https://perma.cc/HK9B-A6SH>] (“The last few years have seen a dramatic increase in ‘event-driven’ litigation.”).

2. 15 U.S.C. § 78j(b).

3. 17 C.F.R. § 240.10b-5(b) (2021).

4. 15 U.S.C. § 77(k).

5. 15 U.S.C. § 77(l).

the core filings alleged (a) false statements in the defendant company's financial statements and/or (b) false projections of defendant's future earnings.⁶ Many of the filings during this period and earlier were made after defendants announced restatements of their financial statements.⁷ Major event-driven filings also occurred, and they date back at least to 2010,⁸ but they were uncommon.⁹

More recent years present a different picture. From 2015–2018 the share of core filings that alleged (a) false statements in the defendant company's financial statements and/or (b) false projections of defendant's future earnings never reached 50%.¹⁰ By 2016 only 10% of class action filings included allegations related to false projections of future earnings,¹¹ and the downward trend has continued.

Simultaneously, financial statement restatements and the share of core

6. See STEFAN BOETRICH & SVETLANA STARYKH, NERA ECONOMIC CONSULTING, RECENT TRENDS IN SECURITIES CLASS ACTION LITIGATION: 2018 FULL-YEAR REVIEW 17 (2019), https://www.nera.com/content/dam/nera/publications/2019/PUB_Year_End_Trends_012819_Final.pdf [<https://perma.cc/A7JU-P6NH>] [hereinafter 2018 FULL-YEAR REVIEW]; see also RENZO COMOLI & SVETLANA STARYKH, NERA ECONOMIC CONSULTING, RECENT TRENDS IN SECURITIES CLASS ACTION LITIGATION: 2013 FULL-YEAR REVIEW 14 (2014), https://www.nera.com/content/dam/nera/publications/2014/PUB_Year_End_Trends_1.2014.pdf [<https://perma.cc/3LSZ-YNJQ>] (setting forth statistics).

7. See Matthew C. Mochlman, *The Ascendancy of "Event-Driven" Securities Cases*, POMERANTZ MONITOR (May/June 2018), <http://pomerantzlawfirm.com/publications/2018/6/4/the-ascendancy-of-event-driven-securities-cases> [<https://perma.cc/2858-YMHW>] ("Fifteen years ago, securities fraud often came to light when a company restated its past financial results.").

8. An early example of EDSL is the suit commenced in 2010 against Massey Energy Co. following an explosion at its Upper Big Branch mine in West Virginia that killed 29 miners. See *In re Massey Energy Co. Sec. Litig.*, 883 F. Supp. 2d 597 (S.D. W. Va. 2012) (denying motions to dismiss consolidated amended class action complaint). This litigation produced a \$265 million all-cash settlement in 2014 that, as of December 31, 2020, ranked as the 69th largest securities class action settlement in the United States. See Institutional Investor Services, *The Top 100 U.S. Class Action Settlements of All-Time* 9 (2021), <https://www.issgovernance.com/file/publications/iss-scas-top-100-us-class-action-settlements-of-all-time-dec-2020.pdf> [<https://perma.cc/FT98-B9C6>] [hereinafter *Top 100 Settlements*].

9. See Reynolds Holding, *Investors Ignore Law of "Stuff Happens,"* REUTERS BREAKINGVIEWS (Apr. 11, 2019, 10:43 AM), <https://www.reuters.com/article/us-usa-fraud-breakingviews/breakingviews-holding-investors-ignore-law-of-stuff-happens-idUSKCN1RN210> [<https://perma.cc/L6G3-96HG>] [hereinafter *Stuff Happens*] (noting that EDSL was "relatively rare before 2017").

10. See 2018 FULL-YEAR REVIEW, *supra* note 6, at 17.

11. STEFAN BOETRICH & SVETLANA STARYKH, NERA ECONOMIC CONSULTING, RECENT TRENDS IN SECURITIES CLASS ACTION LITIGATION: 2016 FULL-YEAR REVIEW 15 (2017), https://www.nera.com/content/dam/nera/publications/2017/PUB_2016_Securities_Year-End_Trends_Report_0117.pdf [<https://perma.cc/BC4F-XNCP>].

filings alleging a restatement both sharply declined. The number of restatements peaked in the years immediately following the enactment of the Sarbanes-Oxley Act of 2002 (SOX)¹² and has plunged since then.¹³ In 2020 restatements reached a 20-year low.¹⁴ The number of reissuance restatements—those addressing a material error¹⁵ that called for the reissuance of a prior financial statement—decreased every year from 2006–2017, increased slightly in 2018, and reached a nadir in 2020.¹⁶ In 2020 only 80 companies issued restatements, compared with more than 300 companies in 2011.¹⁷ And in 2020 only 5% of core securities class action filings alleged a restatement,¹⁸ compared with 10% in 2016 and 19% in 2014.¹⁹

Notwithstanding the declining share of cases alleging financial fraud and the concurrent sharp reduction in the number of companies listed on Nasdaq and the New York Stock Exchange (NYSE),²⁰ the overall number of securities class action filings reached historically high levels from 2015–2020. New securities class action filings increased by approximately 80% from 2015–2017, stabilized between 420 and 430 annual filings from 2017–

12. Pub. L. No. 107-204, 116 Stat. 745 (2002).

13. Kevin LaCroix, *Number of Restatements Continues to Decline*, D&O DIARY (June 26, 2018), <https://www.dandodiary.com/2018/06/articles/financial-reporting/number-restatements-continues-decline/> [<https://perma.cc/66CT-AGDB>].

14. See AUDIT ANALYTICS, 2020 FINANCIAL RESTATEMENTS: A TWENTY-YEAR COMPARISON 4 (2021), https://www.auditanalytics.com/doc/2020_Financial_Restatements_A_Twenty-Year_Review.pdf [<https://perma.cc/3ZP7-76X2>] [hereinafter 2020 FINANCIAL RESTATEMENTS] (“Since their peak in 2006, the number of annual financial restatements has declined by over 80%.”).

15. While there are no bright-line rules in this context, an error that results in a misstatement of 5–10% of pre-tax income is sometimes used as a parameter that defines a material error. *Financial Restatements: Understanding Differences and Significance*, EY CENTER FOR BOARD MATTERS (May 2015).

16. 2020 FINANCIAL RESTATEMENTS, *supra* note 14, at 5.

17. Nicola M. White, *Pervasive SPAC Accounting Error Prompts Mass Restatements*, BLOOMBERG TAX (July 26, 2021, 4:46 AM), <https://news.bloombergtax.com/financial-accounting/pervasive-spac-accounting-error-prompts-mass-restatements> [<https://perma.cc/RX68-WBK9>].

18. CORNERSTONE RESEARCH, SECURITIES CLASS ACTION FILINGS: 2020 YEAR IN REVIEW 11 (2021), <https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2020-Year-in-Review> [<https://perma.cc/BQV4-7LEK>] [hereinafter 2020 YEAR IN REVIEW].

19. CORNERSTONE RESEARCH, SECURITIES CLASS ACTION FILINGS: 2018 YEAR IN REVIEW 10 (2019), <https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2018-Year-in-Review> [<https://perma.cc/BH5K-GDKJ>].

20. From 1996–2020 the number of U.S.-listed companies dipped by 35%, from 8,783 to 5,720. JANEEN MCINTOSH & SVETLANA STARYKH, NERA ECONOMIC CONSULTING, RECENT TRENDS IN SECURITIES CLASS ACTION LITIGATION: 2020 FULL-YEAR REVIEW 2 (2021), https://www.nera.com/content/dam/nera/publications/2021/PUB_2020_Full-Year_Trends_012221.pdf [<https://perma.cc/M37C-9VRU>] [hereinafter 2020 FULL-YEAR REVIEW].

2019, and then declined to 326 new filings in 2020, possibly as a short-term repercussion of the COVID-19 pandemic.²¹ In 2020 the ratio of new filings to listed companies declined to 5.7%, but this measure was still higher than the annual ratios during the first twenty years following the enactment of the Private Securities Litigation Reform Act (PSLRA)²² in 1995.²³

Two major factors explain the recent explosive growth in the overall number of securities class action filings during a span in which financial fraud cases have declined and there are significantly fewer publicly listed companies. First, beginning in 2016 cases objecting to mergers and acquisitions (M&A) migrated from the Delaware Court of Chancery to federal district court in Delaware or elsewhere. The federal filings typically allege a violation of § 14(a) of the Exchange Act, which prohibits material misrepresentations and omissions in proxy solicitations associated with registered securities.²⁴ In 2020 M&A objection filings accounted for 33% of the aggregate 326 federal securities class action filings.²⁵ In 2019 the share was 39% and in 2016 it was 31%.²⁶ By comparison, from 2009–2015 M&A objection suits accounted for a significantly lower mean 22% of the annual number of securities class action filings.²⁷ This migration to federal court is attributable to a 2016 decision by the Court of Chancery which clarified that so-called M&A disclosure settlements, which merely seek enhanced proxy disclosures, are strongly disfavored and generally will not be approved.²⁸

Second, complaints alleging securities fraud linked to specific negative events or occurrences have proliferated.²⁹ In a typical event-driven case the

21. *Id.*

22. Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified as amended in scattered sections of 15 and 18 U.S.C.).

23. See 2020 FULL-YEAR REVIEW, *supra* note 20, at 2 (setting forth statistics).

24. See 17 C.F.R. § 240.14a-9(a) (2021) (prohibiting proxy solicitations that violate rules promulgated by the SEC) and SEC Rule 14a-9 (prohibiting false or misleading statements made in any proxy statement, form of proxy, notice of meeting, or other communication). Liability is generally subject to a negligence standard. *Beck v. Dobrowski*, 559 F.3d 680, 682 (7th Cir. 2009).

25. 2020 FULL-YEAR REVIEW, *supra* note 20, at 3.

26. *Id.*

27. 2018 FULL-YEAR REVIEW, *supra* note 6, at 6.

28. *In re Trulia S'holder Sec. Litig.*, 129 A.3d 884, 898 (Del. Ch. 2016).

29. See Roger A. Cooper & Noelle M. Reed, *Defending Event-Driven Securities Litigation*, CORPORATE DISPUTES, Jan.-Mar. 2021, at 49, 51, 56 (“The event-driven securities litigation trend has continued over the last 12 months. . . . [EDSL] in some form is here to stay.”); John C. Coffee, Jr., *Securities Litigation in 2019: Predictions and Speculations*, N.Y. L.J., Jan. 2019, at 5 [hereinafter Coffee, *Predictions*]:

[T]he character of securities litigation has recently changed. Once, securities class actions were largely about financial disclosures. . . . In this world, the biggest disaster was an accounting restatement. Now the biggest disaster may be

defendant company's stock price drops following the disclosure or occurrence of a negative event which plaintiffs link to prior soft statements by the issuer that it was in regulatory compliance, its internal controls were effective, or it adhered to its corporate code of conduct or ethics. The underlying theory in most of these actions is that the occurrence or event upon which the case is based was the materialization of an undisclosed or an under-disclosed risk that caused a stock price drop.³⁰ This differs from traditional accounting fraud cases which are usually initiated following a corrective disclosure—in which a company corrects a false or misleading statement or omission—that is alleged to have caused a price drop.³¹

Complaints in event-driven cases are often filed in the immediate aftermath of a stock's price decline, whereas complaints in traditional accounting cases are generally filed only after months of investigation by plaintiffs' counsel.³² However, an inference that EDSL pleadings therefore must be considerably flimsier is undercut by at least three factors. First, EDSL complaints commonly free-ride on both government investigations into defendant firms' misconduct³³ and the associated press coverage. Indeed, government investigations and enforcement proceedings are a major catalyst for event-driven litigation.³⁴ Second, other EDSL follows consumer cases in which discovery has already occurred.³⁵ Third, plaintiffs in the

a literal disaster. . . . The best characterization for this new type of securities litigation is that it is 'event-driven' litigation.

30. *New Driver, supra* note 1, at 4 (“The main theory in the event-driven cases is that the occurrence or event upon which the case is based was the materialization of an under-disclosed or downplayed risk.”).

31. *See* *Arkansas Teachers Ret. Sys. v. Goldman Sachs Grp., Inc.*, 879 F.3d 474, 480 n.3 (2d Cir. 2018) (“A ‘corrective disclosure’ is an announcement or series of announcements that reveals to the market the falsity of a prior statement.”).

32. John C. Coffee, Jr., *The Changing Character of Securities Litigation in 2019: Why It's Time to Draw Some Distinctions*, CLS BLUE SKY BLOG (Jan. 22, 2019), <http://clsbluesky.law.columbia.edu/2019/01/22/the-changing-character-of-securities-litigation-in-2019-why-its-time-to-draw-some-distinctions/> [<https://perma.cc/X49U-VUKJ>] [hereinafter Coffee, *Distinctions*].

33. *See* Emily Strauss, *Is Everything Securities Fraud?*, CLS BLUE SKY BLOG (May 19, 2021), <https://clsbluesky.law.columbia.edu/2021/05/19/is-everything-securities-fraud/> [<https://perma.cc/8HNK-NMGM>] (observing that in EDSL, “shareholder plaintiffs almost universally benefit from government investigations”).

34. *See* Nancy J. Laben et al., *Initial Litigation Phase—Coordinating Parallel Proceedings Involving the Government*, in 5 SUCCESSFUL PARTNERING BETWEEN INSIDE AND OUTSIDE COUNSEL § 67B:8 (Apr. 2021 Update).

35. JEFFREY A. DAILEY & NEAL ROSS MARDER, *THE RISE IN EVENT-DRIVEN SECURITIES LITIGATION—WHY IT MATTERS TO DIRECTORS AND OFFICERS 2* (2018), <https://www.akingump.com/a/web/99361/aokuj/the-rise-in-event-driven-securities-litigation-why-it-matters-to-pdf> [<https://perma.cc/A6BJ-G4ZK>].

derivative actions that often proceed in tandem with event-driven class actions increasingly sue only after inspecting corporate books and records obtained pursuant to section 220 of the Delaware General Corporation Law.³⁶ This statute often operates as a tool for shareholders to obtain pre-complaint discovery to construct their derivative cases based on adverse events³⁷ or as a device to bolster existing complaints.³⁸ Delaware courts have liberalized their interpretation of section 220 in recent years,³⁹ thereby enabling shareholders to pursue claims for breach of director oversight duties that more frequently survive motions to dismiss.⁴⁰

EDSL historically had been uncommon, but by 2018 such suits accounted for more than one-quarter of all securities class actions filings⁴¹ and an expanding portion of aggregate Investor Losses⁴² in core cases.⁴³ The

36. See Cooper & Reed, *supra* note 29, at 53 (noting inspection trend); Ed Micheletti, Bonnie David & Alexis Wiseley, *Trends in Books and Records Litigation*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Feb. 11, 2020), <https://corpgov.law.harvard.edu/2020/02/11/trends-in-books-and-records-litigation/> [<https://perma.cc/HJ2C-NVWB>] (same).

37. See Paul Ferrillo & Gregory A. Markel, *Guest Post: Section 220 Books and Records Demands: Can You Obtain Privileged Documents Too?*, D&O DIARY (May 17, 2021), <https://www.dandodiary.com/2021/05/articles/corporate-litigation/guest-post-section-220-books-and-records-demands-can-you-obtain-privileged-documents-too/#> [<https://perma.cc/3QKG-T4TU>] (“There has been an explosive growth in Section 220 demand litigation in recent years with many shareholders using Section 220 as a tool for obtaining pre-complaint discovery to build cases against corporations and their officers and directors.”); William Savitt, Sarah K. Eddy & Cynthia Fernandez Lumermann, *Section 220 as Pre-Complaint Discovery—Recent Developments*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 15, 2020), <https://corpgov.law.harvard.edu/2020/12/15/section-220-as-pre-complaint-discovery-recent-developments/> [<https://perma.cc/2ZM8-LX4S>].

38. See, e.g., J. Edward Moreno, *New McDonald’s Suit Widens Stockholder Sex Scandal Probe*, LAW360 (Aug. 6, 2021, 7:14 PM), <https://www.law360.com/delaware/articles/1410576/new-mcdonald-s-suit-widens-stockholder-sex-scandal-probe> [<https://perma.cc/VC5E-3C22>] (observing that information requested in § 220 litigation could play vital role in parallel #MeToo derivative litigation against McDonald’s Corporation).

39. Caremark *Claims on the Rise Fueled by Section 220 Demands*, CLEARY GOTTlieb (Jan. 11, 2021), <https://www.clearygottlieb.com/news-and-insights/publication-listing/caremark-claims-on-the-rise-fueled-by-section-220-demands> [<https://perma.cc/YX6Q-K62B>].

40. See Robert C. Bird, *Caremark Compliance for the Next Twenty-Five Years*, 58 AM. BUS. L.J. 63 (2021) (examining recent phenomenon of such claims surviving motions to dismiss); Roy Shapira, *A New Caremark Era: Causes and Consequences*, 98 WASH. U. L. REV. 1857 (2021) (same).

41. *Stuff Happens*, *supra* note 9.

42. NERA Economic Consulting uses the term “Investor Losses” as a proxy for the aggregate amount that investors lost from buying defendant’s stock, rather than investing in the broader market during the alleged class period. Historically, Investor Losses “have been a powerful predictor of settlement size.” 2018 FULL-YEAR REVIEW, *supra* note 6, at 11.

43. See *id.* at 12 (“Over the past couple of years, growth in aggregate Investor Losses was concentrated in filings alleging regulatory violations, a substantial number of which were also *event-driven* securities cases. . . .”).

rise of EDSL has continued since then. One report concluded that the number of new event-driven filings increased from 34 in 2018 to 47 in 2020,⁴⁴ and even this is a significant under-count insofar as it excludes, *inter alia*, most filings in the life sciences sector and antitrust-driven securities litigation. Suits against foreign companies whose securities are traded on U.S.-based exchanges have been a major component of EDSL,⁴⁵ consistent with the recent overall increase in suits involving such companies. The share of securities fraud class actions filed against non-U.S. issuers spiked from 15% in 2019 to 27% (88 cases) in 2020.⁴⁶

This Article does not examine M&A objection litigation, which has been widely chronicled elsewhere.⁴⁷ Instead, the Article is concerned with EDSL, which has received scant scholarly attention despite its undeniable importance. It has been suggested that such litigation has multiple salient characteristics. First, critics assert that law firms filing most of these cases represent a new breed of plaintiffs' firms not previously associated with traditional securities class action litigation and lacking connections to institutional investors.⁴⁸ This description is flawed. The so-called new breed primarily includes three plaintiffs' firms—The Rosen Law Firm, Pomerantz LLP (which was founded in 1936),⁴⁹ and Glancy Prongay & Murray LLP (collectively, the RPG Firms). The RPG Firms were responsible for more than 50% of first filed securities class action complaints each year from

44. See *New Driver*, *supra* note 1 (setting forth statistics).

45. Colby Hamilton, *Skadden Securities Team Sees 'Event-Driven' Class Actions as Continuing Trend for 2019*, N.Y. L.J., Jan. 7, 2019, <https://www.law.com/newyorklawjournal/2019/01/04/skadden-securities-team-sees-event-driven-class-actions-as-continuing-trend-for-2019/> [<https://perma.cc/4SSM-66N8>].

46. DECHERT LLP, 2020 DEVELOPMENTS IN U.S. SECURITIES FRAUD CLASS ACTIONS AGAINST NON-U.S. ISSUERS 6 (2021), <https://www.dechert.com/knowledge/publication/2021/3/developments-in-u-s--securities-fraud-class-action-lawsuits-agai.html> [<https://perma.cc/6NQE-5JQL>].

47. See, e.g., Jill E. Fisch, Sean J. Griffith & Steven Davidoff Solomon, *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform*, 93 TEX. L. REV. 557 (2015) (examining merger litigation); Gideon Mark, *Multijurisdictional M&A Litigation*, 40 J. CORP. L. 291 (2015) (same).

48. See Kevin LaCroix, *Scrutinizing Event-Driven Securities Litigation*, D&O DIARY (Mar. 27, 2018), <https://www.dandodiary.com/2018/03/articles/securities-litigation/scrutinizing-event-driven-securities-litigation/> [<https://perma.cc/877G-WWL4>] (noting emergence of two-tier plaintiffs' bar in securities class action litigation, in which older, more established firms focus on financial fraud cases while new entrants focus on event-driven cases "because that is what is left to them").

49. See POMERANTZ LLP, *The Firm*, <https://pomlaw.com/the-firm> [<https://perma.cc/QE63-TGCA>] (describing Pomerantz as "the oldest law firm in the world dedicated to representing defrauded investors") (last visited Oct. 12, 2021).

2015–2020.⁵⁰ But their filings did not ignore traditional accounting fraud and, conversely, non-RPG traditional plaintiffs’ firms make numerous EDSL filings. In 2018 the RPG Firms served as lead or co-lead counsel in more settlements of traditional securities class actions with accounting allegations than any other plaintiffs’ firm,⁵¹ and a 2021 analysis of filings concluded that “[t]he cream of the shareholder bar . . . is betting on event-driven securities class actions.”⁵²

The second commonly attributed characteristic is that in cases in which the RPG Firms do serve as lead counsel, lead plaintiffs are less likely to be institutional investors and settlement amounts are lower compared with cases involving other plaintiffs’ firms.⁵³ The PSLRA created a rebuttable presumption that the lead plaintiff in a securities class action will be the shareholder seeking appointment with the largest financial stake in the litigation,⁵⁴ rather than the first class member to sue. In the years following the statute’s enactment institutional investors were increasingly appointed as lead plaintiff in core filings, and from 2004–2012 they were as likely or more likely to be appointed lead plaintiff than were individuals.⁵⁵ Subsequently, this pattern changed. From 2013–2018 individuals were appointed as lead plaintiff more often than were institutional investors⁵⁶ and in 2019 the proportion of securities class action settlements with a public pension plan as lead plaintiff declined to its lowest level during the decade 2010–2019.⁵⁷ The RPG Firms are largely responsible for the increasing frequency of the

50. See CORNERSTONE RESEARCH, SECURITIES CLASS ACTION FILINGS: 2020 MIDYEAR ASSESSMENT 24 (2020), <https://www.cornerstone.com/Publications/Reports/2020-Securities-Class-Action-Filings-2020-Midyear-Assessment> [<https://perma.cc/M793-65HS>].

51. Rachel Graf, *Filing-Happy Law Firms Not Limited to Event-Driven Claims*, LAW360 (Apr. 17, 2019, 8:06 PM), <https://www.law360.com/articles/1150820/filing-happy-law-firm-not-limited-to-event-driven-claims> [<https://perma.cc/5SZV-PRNH>].

52. Alison Frankel, *Competing Shareholder Class Actions Against Peloton Show ‘Everything Is Securities Fraud’ Trend*, REUTERS (May 25, 2021, 4:02 PM), <https://www.reuters.com/business/legal/competing-shareholder-class-actions-against-peloton-show-everything-is-2021-05-25/> [<https://perma.cc/74EM-F6H2>].

53. See CORNERSTONE RESEARCH, SECURITIES CLASS ACTION SETTLEMENTS: 2018 REVIEW AND ANALYSIS 2 (2019), <https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Settlements-2018-Review-and-Analysis> [<https://perma.cc/N82F-4SXM>].

54. 15 U.S.C. § 77z-1(a)(3)(B).

55. CORNERSTONE RESEARCH, ACCOUNTING CLASS ACTION FILINGS AND SETTLEMENTS: 2018 REVIEW AND ANALYSIS 18 (2019), <https://www.cornerstone.com/Publications/Report/s/2018-Accounting-Class-Action-Filings-and-Settlements> [<https://perma.cc/6LMA-BAW9>].

56. *Id.*

57. CORNERSTONE RESEARCH, SECURITIES CLASS ACTION SETTLEMENTS: 2019 REVIEW AND ANALYSIS 12 (2020), <https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Settlements-2019-Review-and-Analysis> [<https://perma.cc/V94Y-U2GE>] [hereinafter 2019 SETTLEMENTS].

appointment of individuals, rather than institutional investors, as lead plaintiff in securities class actions.⁵⁸

Institutional investors serving as lead plaintiffs may play a role in ensuring greater recovery for the class of investors in strong cases⁵⁹ and such plaintiffs are associated with a lower level of attorneys' fees in relation to damages.⁶⁰ Institutional investors do tend to be involved in cases with significantly larger potential damages and which involve much larger defendant companies, and these factors correlate with settlement size. Of the top 100 securities class action settlements of all-time, as of December 31, 2020, 92% had an institutional lead plaintiff.⁶¹

The foregoing outcomes, desirable from investors' perspective, likely occur for multiple reasons.⁶² But these benefits may be offset by political factors. The largest institutional investors serving as lead plaintiffs have been state or municipal pension funds, which are managed directly by elected politicians (such as state comptrollers) or by political appointees.⁶³ This suggests that some plaintiffs' firms pay to play via campaign contributions,⁶⁴

58. *Id.* at 12.

59. See Adam C. Pritchard & Stephen J. Choi, *Lead Plaintiffs and Their Lawyers: Mission Accomplished, or More to be Done?*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 25, 2017), <https://corpgov.law.harvard.edu/2017/05/25/lead-plaintiffs-and-their-lawyers-mission-accomplished-or-more-to-be-done/> [<https://perma.cc/26J7-Y83S>].

60. 2019 SETTLEMENTS, *supra* note 57, at 12.

61. *Top 100 Settlements*, *supra* note 8, at 11.

62. See, e.g., Serena Hallowell, Alec Coquin & Jake Bissell-Linsk, *Mutual Funds Should Consider Shareholder Litigation*, LAW360 (Oct. 8, 2019, 12:43 PM), <https://www.law360.com/classaction/articles/1206257/mutual-funds-should-consider-shareholder-litigation> [<https://perma.cc/Z6BV-BBZ6>] (observing that institutional investors

make good lead plaintiffs because they are likely to have a substantial interest in the outcome of the litigation, typically have adequate record-keeping regarding their investments, are not susceptible to the disruptions caused by changing life circumstances that can affect individuals, and are experienced fiduciaries and sophisticated consumers of legal services).

63. Adam C. Pritchard, Stephen J. Choi & Drew T. Johnson-Skinner, *The Price of Pay to Play in Securities Class Actions*, 8 J. EMPIR. LEG. STUD. 650, 651 (2011).

64. See Adam C. Pritchard & Stephen J. Choi, *Lead Plaintiffs and Their Lawyers: Mission Accomplished, or More to Be Done?*, HARV. L. SCH. F. ON CORP. GOV. & FIN. REG. (May 25, 2017), <https://corpgov.law.harvard.edu/2017/05/25/lead-plaintiffs-and-their-lawyer-s-mission-accomplished-or-more-to-be-done/> [<https://perma.cc/NYW6-BR4T>] (suggesting that "some class action law firms are buying lead counsel status with campaign contributions"); Drew T. Johnson-Skinner, Note, *Paying-to-Play in Securities Class Actions: A Look at Lawyers' Campaign Contributions*, 84 N.Y.U. L. REV. 1725, 1750 (2009) ("[P]laintiffs' law firms are contributing to the pension funds that select them as counsel. . . . [I]t is clear that the campaign contributions that could be the basis of paying-to-play are present across a broad range of cases. The amount of money contributed by firms is also significant.").

and a prime reason newer plaintiffs' firms are unable to form relationships with major institutional investors is they cannot afford to ante up.⁶⁵ Accordingly, a reduced role for pension funds as lead plaintiffs in securities class actions may be advantageous.

Moreover, depending on the metric used, it is arguable whether the RPG Firms recover less for their investor clients. None of the RPG Firms ranked among the top ten most frequent lead counsel in the top 100 U.S. securities class action settlements, as of December 31, 2020.⁶⁶ Collectively, the three firms accounted for only four of the top 100 settlements.⁶⁷ But conversely, in 2020 Glancy Prongay, The Rosen Law Firm (the plaintiffs' firm probably most closely associated with EDSL),⁶⁸ and Pomerantz placed eighth, tenth, and thirteenth, respectively, among fifty law firms ranked according to total investor recovery, expressed as an aggregate dollar amount.⁶⁹

Third, it has been asserted that the dismissal rate for EDSL is higher than it is for other categories of securities class actions.⁷⁰ This assertion also is dubious. According to litigation consulting firm Cornerstone Research, from 2014–2019 the RPG Firms had 53% of their class actions dismissed, compared to 41% for all other plaintiffs' law firms.⁷¹ However, Cornerstone did not conclude that this difference is statistically significant⁷² and the comparative dismissal rates were not segregated into event and non-event securities filings. Moreover, a separate review of approximately 500 securities class actions filed against public firms from 2000–2015 concluded that EDSL has a significantly *lower* dismissal rate than traditional securities fraud cases.⁷³

Justified or not, there is common attribution of the foregoing three primary characteristics to EDSL. The attribution has provided substantial fuel for the argument that such litigation is meritless and should be curtailed, either legislatively or judicially.⁷⁴

65. See John C. Coffee, Jr., *What's Really Happening in Securities Litigation? A Tale of Two Bars*, N.Y. L.J., Mar. 15, 2018 (raising this argument).

66. See *Top 100 Settlements*, *supra* note 8, at 13 (listing top 100 settlements).

67. *Id.* at 13–19.

68. Coffee, *Predictions*, *supra* note 29, at 2.

69. INSTITUTIONAL SHAREHOLDER SERVICES, *THE TOP 50 OF 2020*, at 5 (2021), <https://www.issgovernance.com/file/publications/iss-scas-the-top-50-of-2020.pdf> [<https://perma.cc/PA/G3-RWF4>].

70. See, e.g., Andrew J. Pincus, *Back to the Future: Jump in Securities Class Actions Shows Need for Reform*, 24 (No. 25) WESTLAW J. SEC. LITIG. & REG. (Apr. 11, 2019) (noting higher dismissal rates for cases filed by RPG Firms).

71. 2020 YEAR IN REVIEW, *supra* note 18, at 34.

72. *Id.*

73. See Strauss, *supra* note 33 (reporting dismissal rates).

74. See U.S. CHAMBER INST. FOR LEGAL REFORM, *CONTAINING THE CONTAGION*:

II. RECURRING EDSL ISSUES

This next part analyzes a spectrum of recurring issues in event-driven securities litigation, which is not restricted to private actions.⁷⁵ Six major issues are discussed: (A) the proposition that corporate mismanagement does not constitute securities fraud; (B) the effect of the Supreme Court's decision in *Matrixx Initiatives v. Siracusano*,⁷⁶ with a spotlight on EDSL in the life sciences sector; (C) the effect of the Supreme Court's decision in *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund (Omnicare)*⁷⁷ and the related problem of determining which statements are non-actionable puffery; (D) disclosure obligations under Items 103 and 303 of Regulation S-K; (E) the safe harbor for forward-looking statements; (F) confidential witnesses; and (G) loss causation and class certification. Some combination of the foregoing issues arises in virtually every event-driven case. The part begins with the most common argument advanced by critics—that the events generating EDSL constitute non-actionable corporate mismanagement.

A. Corporate Mismanagement as Securities Fraud

Critiques of EDSL often commence with the proposition that whereas many of the events that drive the litigation merely constitute corporate mismanagement, the law is settled that neither the Exchange Act nor the Securities Act is designed to regulate such conduct.⁷⁸ A related and perhaps subsidiary argument is that EDSL often constitutes an impermissible attempt to establish fraud by hindsight, by blurring the distinction between fraud and

PROPOSALS TO REFORM THE BROKEN SECURITIES CLASS ACTION SYSTEM 14 (2019), <https://www.instituteforlegalreform.com/uploads/sites/1/Securities-Class-Action-System-Reform-Proposals.pdf> [<https://perma.cc/ZUJ3-F23U>] [hereinafter CONTAINING THE CONTAGION].

75. See Michael S. Flynn, James P. Rouhandeh & Michael Kaplan, *Regulators Join in Event-Driven Securities Litigation*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 13, 2019), <https://corpgov.law.harvard.edu/2019/04/13/regulators-join-in-event-driven-securities-litigation/> [<https://perma.cc/W668-NPEF>] (discussing EDSL by SEC against Volkswagen AG stemming from the company's use of software "defeat devices" to evade emissions tests of diesel vehicles).

76. 563 U.S. 27 (2011).

77. 575 U.S. 175 (2015).

78. See, e.g., Richard Zelichov, *Guest Post: Corporate Mismanagement Becomes Event-Driven Securities Litigation*, D&O DIARY (Oct. 21, 2018), <https://www.dandodiary.com/2018/10/articles/securities-litigation/guest-post-corporate-mismanagement-becomes-event-driven-securities-litigation/> [<https://perma.cc/ESZP-5AZS>] (arguing that event-driven cases undermine established law that "Section 10(b) [of the Exchange Act] does not create a federal private right of action for corporate mismanagement").

mistake. In short, the argument goes, mere misplaced optimism has been transformed by plaintiffs into fraud.

There is no doubt that mismanagement is not the subject of federal securities laws. In 1977 the Supreme Court stated in *Santa Fe Industries, Inc. v. Green*⁷⁹ that “[w]e thus adhere to the position that ‘Congress by [§] 10(b) did not seek to regulate transactions which constitute no more than internal corporate mismanagement.’”⁸⁰ Similarly, in 2019, when the Second Circuit affirmed the dismissal of a putative class action complaint in *Singh v. Cigna Corp.*, it highlighted plaintiffs’ “creative attempt to recast corporate mismanagement as securities fraud.”⁸¹ Numerous other federal courts are in accord.⁸² Because the federal securities laws do not regulate this category of conduct, a corporation has no affirmative duty to disclose mismanagement.⁸³

No doubt some—perhaps many—complaints filed in event-driven cases merely allege non-actionable corporate mismanagement and are properly dismissed. However, as will be demonstrated in subsequent parts of this Article, a sizeable fraction of EDSL does not concern internal corporate mismanagement and thus is not subject to the *Santa Fe* limitation. The expansive critique of EDSL also falters because numerous other complaints that might encompass mismanagement fit within recognized fraud categories.

To state a claim for securities fraud under section 10(b) a plaintiff must plead, *inter alia*, that defendant acted with scienter.⁸⁴ Under the PSLRA, plaintiff is required to plead with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.⁸⁵ In the context of section 10(b), scienter “refers to a mental state embracing intent

79. 430 U.S. 462 (1977).

80. *Id.* at 479 (citing *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 12 (1971)).

81. 918 F.3d 57, 59–60 (2d Cir. 2019). The Second Circuit added: “The attempt relies on a simple equation: first, point to banal and vague corporate statements affirming the importance of regulatory compliance; next, point to significant regulatory violations; and *voilà*, you have alleged a prima facie case of securities fraud!” *Id.*

82. See, e.g., *In re Hertz Global Holdings, Inc.*, 905 F.3d 106, 117 (3d Cir. 2018) (“[W]e have long held ‘that an allegation of mismanagement on the part of a defendant will not alone support’ a securities fraud claim.”); *City of Dearborn Heights Act 345 Police & Fire Ret. Sys. v. Waters Corp.*, 632 F.3d 751, 760 (1st Cir. 2011) (“Allegations of corporate mismanagement are not actionable under Rule 10b-5.”); *Acito v. IMCERA Grp., Inc.*, 47 F.3d 47, 55 (2d Cir. 1995) (“It is well settled that section 10(b) was not designed to regulate corporate mismanagement.”).

83. *Ulbricht v. Ternium S.A.*, No. 18-CV-6801, 2020 WL 5517313, at *10 (E.D.N.Y. Sept. 14, 2020).

84. *Lehmann v. Ohr Pharm.*, No. 19-3486, 2020 WL 5988517, at *1 (2d Cir. Oct. 9, 2020).

85. *Id.*

to deceive, manipulate, or defraud.”⁸⁶ Scierter is the most frequently litigated issue in section 10(b) cases, particularly at the pleading stage.⁸⁷ Pursuant to the Supreme Court’s decision in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*,⁸⁸ a complaint adequately pleads scierter “only if a reasonable person would deem the inference of scierter cogent and at least as compelling as any opposing inference one could draw from the facts alleged.”⁸⁹ Corporations are defendants in virtually all section 10(b) cases.⁹⁰ Where a defendant is a corporation, *Tellabs* requires pleading facts that give rise to a strong inference that an individual whose intent could be imputed to the corporation acted with the requisite scierter.⁹¹

One caveat to the general proposition that corporate mismanagement does not equate to fraud is that lying to investors about the mismanagement is actionable. The Ninth Circuit observed in 2019 that “*Santa Fe* does not protect defendants who mismanage their company and lie to investors about that mismanagement.”⁹² Similarly, the Third Circuit explained in 2018 that allegations of mismanagement can support the requisite inference of scierter in a section 10(b) action if facts are alleged that defendant was aware that mismanagement had occurred “and lied about the existence of that mismanagement.”⁹³

But lying is not essential. Both materially misleading statements about mismanagement⁹⁴ and material omissions about mismanagement⁹⁵ also may be actionable. Rule 10b-5 has always specified that it is unlawful to “omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not

86. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). *Accord* *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 313 (2007).

87. Daniel A. McLaughlin & Mark Taticchi, *Corporate Scierter Under Section 10(b) and Rule 10b-5*, 46 BLOOMBERG BNA SEC. REG. & LAW REP. 875 (2014).

88. 551 U.S. 308 (2007).

89. *Id.* at 323.

90. McLaughlin & Taticchi, *supra* note 87.

91. *Jackson v. Abernathy*, 960 F.3d 94, 98 (2d Cir. 2020) (per curiam).

92. *Oklahoma Police Pension and Ret. Sys. v. LifeLock, Inc.*, No. 17-16895, 2019 WL 3020946, at *2 n.4 (9th Cir. July 10, 2019).

93. *In re Hertz Global Holdings, Inc.*, 905 F.3d 106, 117–18 (3d Cir. 2018). *See also* Richard A. Booth, *Loss Causation and the Materialization of Risk Doctrine in Securities Fraud Class Actions*, 75 BUS. LAW. 1791, 1800 (2020) (noting that claims of mismanagement may be actionable “if covered up by an affirmative misrepresentation”).

94. *See, e.g., In re Meridian Sec. Litig.*, 772 F. Supp. 223, 227 (E.D. Pa. 1991) (“The plaintiffs here do not allege mere mismanagement; they allege fraud disguised by materially misleading public statements.”).

95. *In re Ebix Sec. Litig.*, 898 F. Supp. 2d 1325, 1340 (N.D. Ga. 2012) (noting that false or misleading statements concerning material facts about mismanagement may be actionable).

misleading.”⁹⁶ Thus, if a non-disclosure about corporate mismanagement renders misleading other statements by defendants, a viable securities fraud claim may be stated.⁹⁷

In short, because corporate mismanagement violates section 10(b) if the conduct at issue is fraudulent,⁹⁸ the most common critique of EDSL is flawed. Numerous event-driven securities cases involve conduct proscribed by Rule 10b-5, as will be shown below. At this juncture it suffices to note that, of the top 100 U.S. securities class action settlements, as of December 31, 2020, 61 did not involve an accounting restatement.⁹⁹ Of the top 50 settlements, 25 did not involve a restatement.¹⁰⁰ The import is that “the argument that securities fraud cases should be limited to instances of accounting fraud would leave defrauded investors in a majority of cases without any recourse.”¹⁰¹ Indeed, such a limitation would substantially undermine both of the commonly recognized goals of private securities litigation—compensation and deterrence,¹⁰² which are mutually reinforcing.

The corollary argument that event-driven complaints also impermissibly plead fraud by hindsight has been well-received as doctrine by federal courts.¹⁰³ But the doctrine, which lacks both nuance and clear parameters, has primarily functioned as a case management device.¹⁰⁴ The device facilitates case screening, based on judicial intuition, at the motion to

96. See 17 C.F.R. § 240.10b-5(b) (2021).

97. *Menora Mivtachim Ins. Ltd. v. Int'l Flavors & Fragrances Inc.*, No. 19 Civ. 7536 (NRB), 2021 WL 1199035, at *15 (S.D.N.Y. Mar. 30, 2021); *Fries v. N. Oil & Gas, Inc.*, 285 F. Supp. 3d 706, 718–19 (S.D.N.Y. 2018).

98. See THOMAS LEE HAZEN, 4 TREATISE ON THE LAW OF SECURITIES REGULATION § 12.191 (May 2021 Update) (“[T]he fact that mismanagement is involved does not preclude a Rule 10b-5 claim for material misrepresentation.”).

99. *Top 100 Settlements*, *supra* note 8, at 24–25.

100. *Id.*

101. Julie G. Reiser & Steven J. Toll, *Event-Driven Litigation Defense*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 23, 2019), <https://corpgov.law.harvard.edu/2019/05/23/event-driven-litigation-defense/> [<https://perma.cc/QD9D-ZWTS>].

102. See, e.g., Jill E. Fisch, *Confronting the Circularity Problem in Private Securities litigation*, 2009 WIS. L. REV. 333, 336 (identifying dual goals).

103. See, e.g., *Karth v. Keryx Biopharm.*, 6 F.4th 123, 135 (1st Cir. 2021) (stating that plaintiff may not plead fraud by hindsight); *In re Triangle Cap. Corp. Sec. Litig.*, 988 F.3d 743, 754–55 (4th Cir. 2021) (stating that plaintiff is not permitted to “use the benefit of 20-20 hindsight to turn management’s business judgment into securities fraud”) (citing *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1419 (9th Cir. 1994)); *In re 3M Co. Sec. Litig.*, No. 20-CV-2488, 2021 WL 4482987, at *10 (D. Minn. Sept. 30, 2021) (dismissing action against 3M in large part because plaintiffs were pleading fraud by hindsight). See also Mitu Gulati, Jeffrey J. Rachlinski & Donald C. Langevoort, *Fraud by Hindsight*, 98 NW. U. L. REV. 773, 775 (2004) (“Courts cite concerns with hindsight in nearly one-third of all published opinions in securities class action cases.”).

104. Gulati, Rachlinski & Langevoort, *supra* note 103, at 776-77.

dismiss stage of securities litigation.¹⁰⁵ But it does not permit an obvious or even principled demarcation between fraud and mistake.

B. The Matrixx Effect

A plaintiff asserting a section 10(b) claim generally must plead and prove that defendant made a material misrepresentation or omission.¹⁰⁶ In 2011 the Supreme Court unanimously held in *Matrixx* that plaintiffs adequately pleaded materiality when the defendant drug manufacturer failed to disclose warnings from doctors and hospitals that a statistically insignificant number of people claimed they suffered from anosmia after using *Matrixx*'s nasal spray Zicam.¹⁰⁷ Prior to *Matrixx* numerous courts had ruled that pharmaceutical companies had no duty to disclose reports of adverse events associated with a drug if the reports did not provide statistically significant evidence that the adverse events may have been caused by, and were not simply randomly associated with, the drug's use.¹⁰⁸

The Supreme Court declined in *Matrixx* to adopt a bright-line rule that adverse event reports relating to a company's products are immaterial absent a statistically significant risk that the product is the cause of the adverse event. Instead, the Court affirmed the continued application of the materiality standard it previously established in 1988 in *Basic v. Levinson*¹⁰⁹—whether a reasonable investor would have viewed the undisclosed information as having significantly altered the total mix of information made available.¹¹⁰ While *Matrixx* concluded that the mere existence of an adverse event report does not automatically satisfy the materiality standard, and something more is needed,¹¹¹ it failed to illuminate what that means.¹¹² *Matrixx* also rejected a bright-line rule requiring an

105. *Id.* at 825 (“Instead of developing the doctrine into a clear rule about what constitutes fraud by hindsight, judges rely on their own intuition to sort out facts that suggest real problems and facts that suggest nothing more than fraud by hindsight.”).

106. *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 341 (2005).

107. *Matrixx Initiatives, Inc.*, 563 U.S. at 44–49.

108. Robert Giuffra, *Materiality of Misrepresentations in U.S. Securities Litigation*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 5, 2011), <https://corpgov.law.harvard.edu/2011/04/05/materiality-of-misrepresentations-in-u-s-securities-litigation/> [<https://perma.cc/SZ2C-PUFA>].

109. 485 U.S. 224 (1988).

110. *Id.* at 231–32.

111. 563 U.S. at 44.

112. See Stephen M. Goodman, *If You Smell Smoke, When Do You Report the Fire? The Impact of the Matrixx Case on Disclosure of Adverse Event Reports*, 9 PHARM. L. & INDUS. REP. 652 (May 27, 2011) (“[A]s a result of *Matrixx*, the first whiff of smoke may force a drugmaker to make a public disclosure of the possibility that its drug is causing a fire, even

allegation of statistical significance to establish the requisite strong inference of scienter under section 10(b) and Rule 10b-5.¹¹³

Matrixx reaffirmed *Basic*, but some scholars contend that *Matrixx* simultaneously relaxed and expanded the definition of a material risk and simplified the requisite pleading of scienter.¹¹⁴ The result, according to other critics, is that *Matrixx* opened the floodgates of EDSL.¹¹⁵ Indeed, the Supreme Court decided in *Matrixx*—an event-driven case—that an adverse event can be the basis for a securities fraud class action.¹¹⁶

Drug companies might have obtained a significant litigation advantage if the Supreme Court had adopted a bright-line materiality standard, given that adverse event reports are pervasive. In 2020, for example, the Food & Drug Administration (FDA) received more than 2.2 million such reports.¹¹⁷ The over-the-counter homeopathic drug at issue in *Matrixx* was not subject to the FDA's adverse event reporting requirements and the Court did not decide whether the public availability of an adverse event report suffices to defeat a securities claim based on a company's alleged failure to disclose the information. This created some ambiguity.

Ten years later the impact of the Court's refusal to adopt a bright-line standard in *Matrixx* has been most evident in two respects. First, companies continue to lack direction about their disclosure obligations, especially regarding the clinical trial data that underlie much of the disclosures in the life sciences sector.¹¹⁸ The uncertainty concerning such data—which, combined with evaluations, often totals thousands of pages¹¹⁹—has been compounded by other factors. The PSLRA's statutory safe harbor—which protects forward-looking soft information accompanied by adequate cautionary language—does not protect such hard data as the information derived from clinical trials¹²⁰ or forward-looking statements made in initial

though it may ultimately be shown that the smoke came from some unrelated source.”).

113. 563 U.S. at 48–49.

114. See Coffee, *Distinctions*, *supra* note 32 (advancing this argument).

115. *Stuff Happens*, *supra* note 9.

116. 563 U.S. at 43–47.

117. FOOD & DRUG ADMIN., *FDA Adverse Events Reporting System (FAERS) Public Dashboard*, <https://fis.fda.gov/sense/app/d10be6bb-494e-4cd2-82e4-0135608ddc13/sheet/7a47a261-d58b-4203-a8aa-6d3021737452/state/analysis> [<https://perma.cc/UMT2-EDHG>] (last visited Oct. 12, 2021).

118. Joseph G. Milner, *Sunlight and Other Disinfectants: Disclosure Obligations under the Federal Securities and Drug Regulatory Regimes*, 72 FOOD & DRUG L.J. 141, 168 (2017).

119. Stuart R. Cohn & Erin M. Swick, *The Sitting Ducks of Securities Class Action Litigation: Bio-Pharmas and the Need for Improved Evaluation of Scientific Data*, 35 DEL. J. CORP. L. 911, 927 (2010).

120. Eric Schmid, Note, *Fraud or Confusion: A Pill for Chronic Securities Litigation in the Life Sciences Sector*, 61 B.C. L. REV. 1899, 1916 (2020).

public offering (IPO) registration statements.¹²¹ Life sciences companies also are handicapped by a general absence of guidance from the SEC concerning disclosure requirements.¹²²

Second, while *Matrixx* initially seemed to favor plaintiffs, the odds that life science defendants can prevail on motions to dismiss appear to have shortened since the decision was issued, whether in connection with scienter or materiality. Both elements can be raised at this stage of the litigation, but courts often deferred ruling on materiality prior to *Matrixx* because it is inherently fact-based. Since then, dismissal motions in EDSL have frequently asserted materiality arguments, especially as to whether defendants' alleged misrepresentations are mere puffery or vague expressions of corporate optimism. Both are generally non-actionable because they are immaterial as a matter of law.¹²³ Defendant *Matrixx* did not raise a puffery defense,¹²⁴ but the issue has acquired importance generally in EDSL and specifically in life sciences cases.¹²⁵

Because biotechnology and pharmaceutical companies are disproportionately impacted by event-driven litigation it is useful to consider how defendants in this sector have fared on motions to dismiss in the post-*Matrixx* era. A 2017 survey examined all 61 district court decisions on motions to dismiss federal securities claims from 2005–2016 where the defendant biotechnology company did not already have a drug or device on the market and its alleged false or misleading statements concerned clinical trials or the FDA approval process for its primary drug or device candidate. During the post-*Matrixx* period 2012–2016, 78% of the decisions resulted in complete dismissals, compared with only 56% of the decisions during the pre-*Matrixx* period of 2005–2011.¹²⁶

More recent results are similar. In 2020, eighty securities fraud class actions were filed against life sciences companies, accounting for almost

121. See 15 U.S.C. § 78u-5(b)(2)(D) (setting forth IPO exclusion).

122. Katherine Cohen, Joseph W. Cormier & Mahnu V. Davar, *Predictable Materiality: A Need for Common Criteria Governing the Disclosure of Clinical Trial Results by Publicly-Traded Pharmaceutical Companies*, 29 J. CONTEMP. HEALTH & POL'Y 201, 215 (2013).

123. *Singh v. Cigna Corp.*, 918 F.3d 57, 630–64 (2d Cir. 2019).

124. 563 U.S. at 33 n.2.

125. See, e.g., *Schaeffer v. Nabriva Therapeutics PLC*, 19 Civ. 4183 (VM), 2020 WL 7701463, at *9 (S.D.N.Y. Apr. 28, 2020) (granting motion to dismiss in large part because alleged misrepresentations were puffery).

126. Doug Greene, Genevieve York-Erwin & Michael Tomasulo, *Myths and Misconceptions of Biotech Securities Claims: An Analysis of Motion to Dismiss Results from 2005-2016*, D&O DISCOURSE (Mar. 14, 2017), <https://www.dandodiscourse.com/2017/03/14/myths-misconceptions-of-biotech-securities-claims-an-analysis-of-motion-to-dismiss-result-s-from-2005-2016/> [<https://perma.cc/3PYV-X3MQ>].

25% of all securities fraud lawsuits, and this share was similar in 2019.¹²⁷ Two of the three RPG Firms were two of the top four leaders in the 2020 sector filings.¹²⁸ Life sciences companies present an attractive EDSL target for multiple reasons. Clinical stage ventures often must tap capital markets to fund expensive drug trials, exposing them to potential liability under the more lenient standards applicable to securities claims involving IPOs.¹²⁹ In addition, the prospects of drug companies are highly dependent on the unpredictable regulatory approval process. A setback at any stage can present disclosure issues. An unexpected adverse approval decision by the FDA typically results in an immediate precipitous stock price decline,¹³⁰ which may be especially severe for a newly public clinical stage company with a single product candidate. Market volatility caused by the COVID-19 pandemic exacerbated this concern for numerous small-cap newly public life sciences companies whose stock prices dipped below their IPO prices in 2020.¹³¹

Motions to dismiss are filed in nearly all life sciences EDSL. In 2020 courts issued 43 opinions in class actions in the life sciences sector, 24 of which concerned allegations of misrepresentations during product development. Of the 24 cases, courts dismissed 15 in whole and five in part, including appellate decisions affirming lower courts' dismissal orders.¹³² Winning arguments for defendants encompassed both materiality and scienter.¹³³ In 2020 courts also issued six opinions addressing fraud claims that arose after a drug or medical device's development process. Of the six cases, five were dismissed in whole and one was dismissed in part.¹³⁴ *Matrixx* was not particularly helpful to plaintiffs in the foregoing litigation¹³⁵

127. DECHERT LLP, *Dechert Survey: Developments in Securities Fraud Class Actions Against Life Sciences Companies* 4 n.7 (Jan. 28, 2021), <https://www.dechert.com/knowledge/publication/2021/1/dechert-survey--developments-in-securities-fraud-class-actions-a.html> [<https://perma.cc/YSP6-WPZG>] [hereinafter *Dechert 2021 Survey*].

128. *Id.* at 6.

129. WILSON SONSINI GOODRICH & ROSATI, *2019 Life Sciences Securities Litigation Roundup* (Apr. 28, 2020), <https://www.wsgr.com/en/insights/2019-life-sciences-securities-litigation-roundup.html> [<https://perma.cc/4Z8X-ZPSB>] [hereinafter *2019 Roundup*].

130. Lisa Dwyer, Michael Biles & Rebecca Matsumura, *Avoiding Shareholder Class Actions after FDA Drug Denials*, LAW360 (Oct. 26, 2020, 6:03 PM EDT), <https://www.law360.com/articles/1319457/avoiding-shareholder-class-actions-after-fda-drug-denials> [<https://perma.cc/MMA7-AWSE>].

131. *2019 Roundup*, *supra* note 129.

132. *Dechert 2021 Survey*, *supra* note 127, at 11–12.

133. *Id.* at 12–14.

134. *Id.* at 14.

135. *See, e.g.*, *Nguyen v. Endologix, Inc.*, 962 F.3d 405 418 (9th Cir. 2020) (affirming dismissal of class action and rejecting plaintiff's reliance on *Matrixx*).

and overall, the developing body of case law in life sciences EDSL has been generally defense-friendly.

C. *Omnicare's Impact, the Puffery Problem, and Codes of Conduct*

The next section considers the impact of the Supreme Court's *Omnicare* decision and the related problem of addressing statements that may constitute puffery. The decision addresses opinion statements, which are ubiquitous in corporate communications, are frequently crucial to investors, and often underlie EDSL.

1. *Omnicare*

In 2015 the Supreme Court resolved a circuit split and unanimously held in *Omnicare* that pure statements of opinion are not untrue statements of material fact actionable as securities fraud, regardless whether an investor can ultimately prove the belief wrong.¹³⁶ Pursuant to that holding, opinion statements give rise to liability in only three circumstances: (1) when the speaker does not actually hold the stated belief, (2) when the statement incorporates an underlying untrue statement of fact; and (3) when the statement omits a material fact and thus is misleading to a reasonable investor.¹³⁷

Omnicare set a high bar for pleading the falsity of opinion statements but in some respects the case favors plaintiffs. *Omnicare* removed from plaintiffs the burden of alleging knowing noncompliance with applicable laws. Now they can allege that defendants' claim of compliance is baseless given pervasive violations.¹³⁸ Another clear implication of the case is that opinion statements can create omission-based liability for securities fraud. *Omnicare*, like *Matrixx*, thus may have served to encourage plaintiffs to pursue EDSL,¹³⁹ especially in the third circumstance noted above. *Omnicare* is informative in all cases that involve opinion statements,¹⁴⁰ but the case

136. 575 U.S. at 185.

137. *Id.* at 183–87, 189.

138. James D. Cox, “*We’re Cool*” *Statements after Omnicare: Securities Fraud Suits for Failure to Comply with the Law*, 68 SMU L. REV. 715, 724 (2015).

139. See John C. Coffee, Jr., *Event-Driven Securities Litigation: Its Rise and Partial Fall*, N.Y. L.J., Mar. 20, 2019, <https://www.law.com/newyorklawjournal/2019/03/20/event-driven-securities-litigation-its-rise-and-partial-fall/?slreturn=20190803000217> [<https://perma.cc/37BB-7UNB>] (suggesting that plaintiffs’ firms may have overread the two cases “and concluded that all disasters would be material”).

140. Donald C. Langevoort, *Disasters and Disclosures: Securities Fraud Liability in the Shadow of a Corporate Catastrophe*, 107 GEO. L.J. 967, 976 (2019).

“provided a hook on which plaintiffs tie event-driven suits.”¹⁴¹

Omnicare was a section 11 action and in the aftermath of the decision some counsel hoped to confine it to that statute,¹⁴² which imposes strict liability for untrue statements and misleading omissions made in registration statements and prospectuses. However, lower federal courts have disagreed as to whether and how the holding should be cabined. By late-2021 the Ninth Circuit had extended *Omnicare* to section 10(b) claims¹⁴³ and section 14 claims;¹⁴⁴ the Fourth Circuit had applied *Omnicare* to dismiss a section 14 claim;¹⁴⁵ the Third Circuit had twice declined to decide whether *Omnicare* applies to Exchange Act claims,¹⁴⁶ and four additional Circuits had expressly extended *Omnicare* to section 10(b) claims.¹⁴⁷ According to one federal district court decision, issued in 2021, “[o]utside the Third Circuit, the majority view appears to be that *Omnicare* applies to 10(b) and 10b-5 cases.”¹⁴⁸ *Omnicare* has been extended by numerous courts, and applied in SEC enforcement actions,¹⁴⁹ despite the considerable differences between section 11 and section 10(b) claims.

Omnicare, like *Matrixx*, is especially relevant for EDSL involving life sciences companies. *Omnicare* is germane because much event-driven litigation in this sector is underpinned by allegations that defendants’ opinion statements during or after product development were misleading, and the decision likely applies broadly to any statement related to medical or scientific matters in which interpretive judgment is required. This includes pandemic EDSL targeting vaccine development and efficacy, where “*Omnicare* will likely play a significant role.”¹⁵⁰

141. Michelle Reed & Matthew Lloyd, *Stemming the Tide of Meritless Securities Class Actions*, 24 WESTLAW J. DERIVATIVES (2020).

142. Coffee, *supra* note 139.

143. *City of Dearborn Heights Act 345 Police & Fire Ret. Sys. v. Align Tech., Inc.*, 856 F.3d 605, 616 (9th Cir. 2017).

144. *Golub v. Gigamon Inc.*, 994 F.3d 1102, 1107 (9th Cir. 2021).

145. *Paradise Wire & Cable Defined Benefit Pension Plan v. Weil*, 918 F.3d 312, 322–23 (4th Cir. 2019).

146. *Jaroslawicz v. M&T Bank Corp.*, 912 F.3d 96 (3d Cir. 2018); *In re Amarin Corp. PLC Sec. Litig.*, 689 F. App’x 124, 132 n.12 (3d Cir. 2017).

147. *Tongue v. Sanofi*, 816 F.3d 199 (2d Cir. 2016); *Police & Ret. Sys. of City of Detroit v. Plains All Am. Pipeline, L.P.*, 777 F. App’x 726, 730 (5th Cir. 2019); *Nakkhumpun v. Taylor*, 782 F.3d 1142, 1159 (10th Cir. 2015); *Carvelli v. Ocwen Fin. Corp.*, 934 F.3d 1307, 1322 (11th Cir. 2019).

148. *Ortiz v. Canopy Growth Corp.*, No. 2:19-cv-20543-KM-ESK, 2021 WL 1967714, at *33 (D.N.J. May 17, 2021) (amended op.).

149. *See, e.g., SEC v. Thompson*, 238 F. Supp. 3d 575, 601 & n.13 (S.D.N.Y. 2017) (suggesting that *Omnicare* applies to all antifraud provisions of the federal securities laws).

150. GIBSON, DUNN & CRUTCHER LLP, *2021 Mid-Year Securities Litigation Update* 18 (Aug. 30, 2021), <https://www.gibsondunn.com/wp-content/uploads/2021/08/2021-mid-year->

Prior to *Omnicare* courts tended to find opinion statements non-actionable in life sciences cases for multiple reasons, including defendants' common argument that the statements were immaterial puffery. Now, motions to dismiss in life sciences EDSL often turn on *Omnicare*'s application.¹⁵¹ While some attorneys believe the decision has provided a firmer foundation for dismissal,¹⁵² federal courts appear to disagree as to whether *Omnicare* expanded or restricted liability for opinion statements. For example, in a pair of contrasting 2020 decisions the Second Circuit stated that *Omnicare* increased plaintiffs' ability to plead an actionable opinion,¹⁵³ whereas the Third Circuit observed that *Omnicare* imposed a rigorous benchmark.¹⁵⁴ The judicial disagreement appears intertwined with the courts' somewhat inconsistent articulation of *Omnicare*'s requirements.¹⁵⁵ Nevertheless, the judicial application of *Omnicare* to biotechnology claims has resulted in a higher dismissal rate than the overall rate for securities class actions.¹⁵⁶

The higher dismissal rate in post-*Omnicare* life sciences EDSL may be explained by *Omnicare*'s acknowledgement that when evaluating opinion statements investors take into account "the customs and practices of the relevant industry."¹⁵⁷ This might be especially important in the pharmaceutical industry, where manufacturers and the FDA engage in an ongoing dialogue about clinical trials during the drug approval process.¹⁵⁸ The

securities-litigation-update.pdf [https://perma.cc/XE4Y-DZDM].

151. DAVIS POLK & WARDWELL LLP, Client Memorandum, *Addressing the Growing Threat of Securities Class Actions in the Life Sciences Sector 2* (Dec. 6, 2016), <https://www.davispolk.com/publications/addressing-growing-threat-securities-class-actions-life-sciences-sector> [https://perma.cc/EJC5-C9K8].

152. See GIBSON, DUNN & CRUTCHER LLP, *2021 Mid-Year Securities Litigation Update 17* (Aug. 30, 2021), <https://www.gibsondunn.com/wp-content/uploads/2021/08/2021-mid-year-securities-litigation-update.pdf> [https://perma.cc/A3JF-BA98] ("*Omnicare* has remained a significant pleading barrier in the first half of 2021."); Doug Greene et al., *Omnicare, Five Years Later: Strategies for Securities Defense Lawyers' More Effective Use of the Decision*, 35 LEGAL BACKGROUNDER, Apr. 3, 2020, <https://www.wlf.org/2020/04/02/publishing/omnicare-five-years-later-strategies-for-securities-defense-lawyers/> [https://perma.cc/K4Q3-AC8L] (setting forth this argument).

153. *Abramson v. Newlink Genetics Corp.*, 965 F.3d 165, 174–76 (2d Cir. 2020).

154. *Jaroslawicz v. M&T Bank Corp.*, 962 F.3d 701, 717 (3d Cir. 2020).

155. See SIDLEY AUSTIN LLP, *Securities Class Actions in the Life Sciences Sector: 2019 Annual Survey 6* (2020), <https://www.sidley.com/en/insights/newsupdates/2020/05/securities-class-actions-in-the-life-sciences-sector-2019> [https://perma.cc/3QFN-QK8A] (noting inconsistency).

156. Greene et al., *supra* note 152.

157. *Omnicare*, 575 U.S. at 190.

158. See *Tongue v. Sanofi*, 816 F.3d 199, 211 (2d Cir. 2016) (observing that sophisticated investors would fully expect FDA and defendants to engage in such a dialogue).

importance of the factor is magnified in the case of sophisticated investors, who should understand that optimistic statements by issuers about the likelihood of drug approval do not constitute assurances of success.¹⁵⁹

2. The Puffery Problem and Codes of Conduct

As noted *supra*, a successful section 10(b) claim generally requires proof of a material misrepresentation or omission. An alleged misrepresentation or omission is material if there is a substantial likelihood that a reasonable investor would consider it important in deciding whether to buy or sell stock shares, and a statement is not material unless, in view of such an investor, it has “significantly altered the ‘total mix’ of information made available.”¹⁶⁰ A fundamental unresolved problem with this framework is that “there are conflicting visions of the reasonable investor.”¹⁶¹

Some assertions are immaterial as a matter of law. Puffery is one major category of immaterial statements. Courts have set forth disparate definitions, but in the Second Circuit—which hears more federal securities cases than any other Circuit—puffery is defined as statements that are “too general to cause a reasonable investor to rely upon them.”¹⁶² Archetypal examples include statements that are explicitly aspirational, general statements about reputation, integrity, and compliance with ethical norms, and mere generalizations regarding a company’s business practices.¹⁶³ At least in the Second Circuit, consistent with the general standard regarding materiality, determining whether a specific statement constitutes puffery requires a court to look at context, including the specificity of the statement and whether it is clearly designed to distinguish the company to the investing public in some meaningful way.¹⁶⁴ This approach likewise is consistent with *Omnicare*. The issue of whether a statement is mere puffery is not encompassed by the *Omnicare* framework, but puffery issues often arise in securities litigation that involves opinion statements and the case underscored that “whether an omission makes an expression of opinion

159. *Id.* at 211–12.

160. *Basic v. Levinson*, 485 U.S. 224, 231–32 (1988).

161. Hillary A. Sale & Donald C. Langevoort, “*We Believe*”: *Omnicare*, *Legal Risk Disclosure and Corporate Governance*, 66 *DUKE L.J.* 763, 776 (2016).

162. *City of Pontiac Policemen’s & Firemen’s Ret. Sys. v. UBS AG*, 752 F.3d 175, 183 (2d Cir. 2014).

163. *In re Signet Jewelers Ltd. Sec. Litig.*, 389 F. Supp. 3d 221, 229 (S.D.N.Y. 2019).

164. *Indiana Pub. Ret. Sys. v. SAIC, Inc.*, 818 F.3d 85, 98 (2d Cir. 2016); *In re Petrobras Sec. Litig.*, 116 F. Supp. 3d 368, 381 (S.D.N.Y. 2015) (“Whether a representation is ‘mere puffery’ depends, in part, on the context in which it is made.”).

misleading always depends on context.”¹⁶⁵

Puffery issues often arise in EDSL when plaintiffs allege that defendant corporation’s code of ethics or code of conduct includes material misrepresentations.¹⁶⁶ Multiple definitions of an ethics code have been expressed, and one functional rendering is “a formal document that states an organization’s primary values and the ethical rules it expects its employees to follow.”¹⁶⁷ Codes of ethics are often referred to interchangeably as codes of conduct, but many companies have created discrete documents¹⁶⁸ which are subject to different requirements.

SOX section 406 and its implementing regulations require each public company to: (1) disclose whether or not it has adopted a code of ethics, (2) publish the code if it has been adopted, and (3) disclose why a code has not been adopted, if none has been.¹⁶⁹ SOX, enacted in 2002, did not mandate code adoption, but it clearly provided a strong incentive to do so.¹⁷⁰ Subsequently, in 2003 the SEC approved NYSE and Nasdaq rules that require listed companies to adopt. The NYSE specifies that “[l]isted companies must adopt and disclose a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive officers.”¹⁷¹ Nasdaq Rule 5610 is similar, but it specifically refers to a code of conduct.¹⁷² The exchange requirements are much broader than the relevant SOX provisions, which apply only to the registrant’s principal executive officer and principal financial and

165. *Omnicare*, 575 U.S. at 190.

166. DAVIS POLK & WARDWELL LLP, Client Memorandum, *Codes of Ethics and Securities Litigation* (Apr. 30, 2020), https://www.davispolk.com/sites/default/files/codes_of_ethics_and_securities_litigation.pdf [<https://perma.cc/GQ8T-B8PM>] (“[F]ederal securities lawsuits targeting statements about corporate codes of ethics are now common in so-called ‘event-driven’ cases. . .”).

167. Margaret Anne Cleek & Sherry Lynn Leonard, *Can Corporate Codes of Ethics Influence Behavior?*, 17 J. BUS. ETHICS 619, 622 (1998).

168. *See, e.g.*, *Constr. Laborers Pension Tr. for So. Cal. v. CBS Corp.*, 433 F. Supp. 3d 515, 532–34 (S.D.N.Y. 2020) (discussing CBS’s separate Business Conduct Statement and Code of Ethics).

169. 17 C.F.R. § 229.406(a), (c) (2021).

170. THOMAS LEE HAZEN, 2 LAW SEC. REG. § 9:97 (Dec. 2020 Update) (noting shaming effect of § 406).

171. NEW YORK STOCK EXCHANGE, *Listed Company Manual* § 303A.10 (amended Nov. 25, 2009). <https://nyseguide.srorules.com/listed-company-manual> [<https://perma.cc/XUP6-P6BT>].

172. *See* NASDAQ STOCK MARKET, Rulebook, Rule 5610, <https://listingcenter.nasdaq.com/rulebook/nasdaq/rules/nasdaq-5600-series> [<https://perma.cc/MB37-3DXU>] (last visited Nov. 28, 2021) (“Each Company shall adopt a code of conduct applicable to all directors, officers and employees, which shall be publicly available.”).

accounting officers and do not require code adoption.¹⁷³

Most of the largest public companies doing business in the United States had adopted an ethics code prior to SOX, often in response to negative publicity surrounding major bribery scandals.¹⁷⁴ SOX and the SEC's approval of the new NYSE and Nasdaq rules accelerated this trend because companies that fail to comply with the foregoing requirements may lose their listing status. More than 95% of both Fortune U.S. 100 and Fortune Global 100 companies have adopted a code of ethics.¹⁷⁵ Many U.S. companies have chosen to adopt a single code that satisfies the requirements of both the SEC and the relevant exchange and is applicable to all employees, officers, and directors.

EDSL complaints frequently allege that defendant company's code of conduct or ethics falsely represented reporting or compliance standards, or the company used its code misleadingly to trumpet the existence of an ethical corporate culture while omitting to disclose allegedly prevalent misconduct.¹⁷⁶ Historically, code-based claims rarely survived the pleading stage¹⁷⁷ and courts continue to be highly skeptical in the EDSL era. For example, in *Singh*, decided in 2019, the Second Circuit explained that general statements about reputation, integrity, and ethical norms are non-actionable puffery—because they are too general to cause a reasonable investor to rely upon them—and then held that statements in defendant Cigna's code of conduct fell squarely within this category.¹⁷⁸ Numerous other decisions, issued both before and after *Singh*, are in accord.¹⁷⁹

173. PILLSBURY WINTHROP LLP, Client Alert, *SEC Rule Changes Require New York Stock Exchange and Nasdaq-Listed Companies to Adopt Codes of Conduct or Ethics Policies for All Directors, Officers and Employees* (Jan. 28, 2004), <https://www.pillsburylaw.com/image/s/content/2/6/v2/2601/3B440EB3356461C853C814386738BAEA.pdf> [<https://perma.cc/U5KR-WYVC>].

174. Joshua A. Newberg, *Corporate Codes of Ethics, Mandatory Disclosure, and the Market for Ethical Conduct*, 29 VT. L. REV. 253, 255–56 (2005).

175. See Maira Babri, Bruce Davidson & Sven Helin, *An Updated Inquiry into the Study of Corporate Codes of Ethics: 2005–2016*, J. BUS. ETHICS (2019), <https://link.springer.com/article/10.1007/s10551-019-04192-x> [<https://perma.cc/TDG7-4ZY9>] (setting forth statistics); Alexander Cohen & Joel Trotter, *Codes of Ethics: SEC Requirements* (Nov. 14, 2013), <https://www.jdsupra.com/legalnews/codes-of-ethics-sec-requirements-26240/> [<https://perma.cc/2TA8-FPYW>] (“Unsurprisingly, almost all public companies have adopted a code of ethics. . .”).

176. See DAVIS POLK & WARDWELL LLP, *supra* note 166.

177. *Id.*

178. 918 F.3d at 63. See also Adam Hakki & Agnès Dunogué, *2d Circ. 's Logical Take on 'Event-Driven' Securities Claims*, LAW360 (May 13, 2019, 3:29 PM), <https://www.law360.com/articles/1151124/print?section=appellate> [<https://perma.cc/JH5F-5PNM>] (predicting that *Singh* will increase dismissal rate for EDSL).

179. See David A. Hoffman, *The Best Puffery Article Ever*, 91 IOWA L. REV. 1395, 1405–

The foregoing outcomes are driven in large part by a concern about creating a rule that would “turn all corporate wrongdoing into securities fraud.”¹⁸⁰ The judicial solution to that concern has been to usually deem statements in codes of conduct and ethics immaterial as a matter of law. This solution directly counters Congress (as expressed in SOX), the SEC, the NYSE, and Nasdaq, which collectively determined that codes of conduct and ethics are of such high importance to investors that they must be adopted and disclosed.¹⁸¹

Courts are more inclined to permit code-based claims in at least three situations. First, the code includes highly specific, affirmative factual statements—as opposed to broad declarations describing a company’s ethical goals—that directly conflict with conduct alleged by plaintiffs.¹⁸² In multiple Circuits the test is whether the code contains objectively verifiable factual misrepresentations.¹⁸³ Second, the subject statements concern the company’s adherence to its code.¹⁸⁴ Companies seeking to minimize exposure in the second scenario likely would confine statements about their codes to merely aspirational goals of compliance.¹⁸⁵ Third, the code

06 (2006) (observing that “despite hostility from scholars, defendants [in securities cases] have been increasingly successful in obtaining dismissals based on puffery arguments”).

180. Retail Wholesale & Dep’t Store Union Local 338 Ret. Fund v. Hewlett-Packard Co., 845 F.3d 1268, 1276 (9th Cir. 2017).

181. See Ann Lipton, *The Puffery Problem*, BUS. L. PROF. BLOG (Jan. 25, 2020), https://lawprofessors.typepad.com/business_law/2020/01/the-puffery-problem.html [<https://perma.cc/T3AH-5MRJ>] (suggesting that it is “perverse” to deem immaterial as a matter of law statements in mandated codes of ethics).

182. See, e.g., *In re Grupo Televisa Sec. Litig.*, 368 F. Supp. 3d 711, 721 (S.D.N.Y. 2019) (“[S]tatements contained in a code of conduct are actionable where they are directly at odds with the conduct alleged in a complaint.”); *In re Moody’s Corp. Sec. Litig.*, 599 F. Supp. 2d 493, 508 (S.D.N.Y. 2009) (“Moody’s repeatedly asserts its independence in its Code of Conduct. . .”).

183. See, e.g., *In re Stratasys Ltd. S’holder Sec. Litig.*, 864 F.3d 879, 882 (8th Cir. 2017) (“Optimistic statements are not actionable if they cannot be supported by objective data or otherwise subject to verification by proof.”); Retail Wholesale & Dep’t Store Union Local 338 Ret. Fund v. Hewlett-Packard Co., 845 F.3d 1268, 1275–76 (9th Cir. 2017) (stating that codes of conduct are inherently aspirational and not objectively verifiable).

184. See, e.g., *Holwell v. AbbVie, Inc.*, No. 1:18-cv-06790, 2020 WL 5235005, at *4 (N.D. Ill. Sept. 1, 2020) (concluding that statements in defendant’s Code of Business Conduct were not inherently aspirational and instead were unqualified statements regarding defendant’s conduct); *In re Grupo Televisa Sec. Litig.*, 368 F. Supp. 3d 711, 721–22 (S.D.N.Y. 2019) (noting that corporate statements about code of ethics proclaimed the concrete steps that Televisa was taking to ensure that its executives and employees did not violate bribery prohibition).

185. See William F. Sullivan, Scott Carlton & Ryan A. Walsh, *Decoding the Import of a Company’s Code of Ethics*, LAW360 (Feb. 6, 2017, 10:26 AM), <https://www.law360.com/articles/887959/decoding-the-import-of-a-company-s-code-of-ethics> [<https://perma.cc/P8D5->

delineates mandatory rules for employee behavior, rather than standards or guidelines.¹⁸⁶ A 2020 decision involving defendant Tenaris, S.A. is instructive. In that event-driven case, the district court distinguished between statements set forth in the company's Code of Ethics and Code of Conduct. The former was non-actionable, because the statement was generalized and aspirational about how Tenaris expected its employees to comport themselves. The latter was actionable, because it stated that Tenaris will not condone bribery, whereas the complaint alleged involvement by the company in bribery schemes in both Argentina and Uzbekistan.¹⁸⁷

D. Items 103 and 303

Disclosure requirements are the cornerstone of federal securities regulation. The requirements seek to level the playing field for investors, issuers, and the public, by reducing asymmetries and the space for fraud.¹⁸⁸ However, as the Supreme Court emphasized in *Matrixx*, disclosure is mandatory only if there is a specific legal duty to disclose.¹⁸⁹ Such a duty may arise in two situations. The first is where a statement would otherwise be inaccurate, incomplete, or misleading without the omitted fact.¹⁹⁰ The second is where a statute or regulation requires disclosure.¹⁹¹ Disclosure complications multiply because the case law concerning a duty to update is jumbled,¹⁹² and the Supreme Court has declined to provide clarity.¹⁹³

VY97] (recommending such an approach).

186. See *Plymouth Cty. Ret. Sys. v. Patterson Cos., Inc.*, No. 18-cv-871 (MJD/SER), 2019 WL 3336119, at *16 (D. Minn. July 25, 2019), *report and recommendation adopted as modified*, 2019 WL 4277302 (D. Minn. Sept. 10, 2019) (“[T]his is a code of ethics that outlines specific guidance for compliance with a specific subset of [antitrust] law.”); Sarah Lightdale, Jan Shapiro & Linh Nguyen, *Puffery or Not? Courts Examine Corporate Codes of Conduct*, N.Y. L.J., July 16, 2020, <https://www.cooley.com/-/media/cooley/pdf/reprints/2020/nylj07162020454413cooley.ashx> [<https://perma.cc/4DW5-4X56>].

187. *In re Tenaris S.A. Sec. Litig.*, No. 18-cv-7059, 2020 WL 6108919, at *7–8 (E.D.N.Y. Oct. 9, 2020).

188. Hillary A. Sale, *Disclosure's Purpose*, 107 GEO. L.J. 1045, 1045 (2019).

189. 563 U.S. at 45.

190. *Stratte-McClure v. Morgan Stanley*, 776 F.3d 94, 101 (2d Cir. 2015).

191. *Id.*

192. See Bruce Mendelsohn & Jesse Brush, *The Duties to Correct and Update: A Web of Conflicting Case Law and Principles*, 43 SEC. REG. L.J. 67 (2015).

193. See Jason Halper, Kyle De Young & Adam Magid, *2019 Year in Review: Securities Litigation and Enforcement*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Feb. 20, 2020), <https://corpgov.law.harvard.edu/2020/02/20/2019-year-in-review-securities-litigation-and-enforcement/> [<https://perma.cc/K9FL-DZAZ>] (observing that Supreme Court declined to hear appeal of Ninth Circuit decision concerning duty to update which “appears to be in tension with six other circuits”).

For U.S. reporting companies the principal disclosure requirements are set forth in Regulation S-K (Reg S-K), which governs required disclosures in a company's periodic Form 10-K and 10-Q filings. EDSL complaints often allege violations of S-K Items 103 and 303.¹⁹⁴ The former requires a brief description of any material and pending non-routine legal proceedings against the issuer or one of its subsidiaries.¹⁹⁵ The instructions for Item 103 add that issuers must disclose "any such proceedings known to be contemplated by governmental authorities."¹⁹⁶ Courts have interpreted this language to require disclosure only of actions "substantially certain to occur."¹⁹⁷ As noted by Professor Langevoort, "this standard truncates the duty considerably."¹⁹⁸

Plaintiffs in EDSL often rely on the defendant's failure to disclose the details of uncharged criminal violations and unpublicized government investigations to plead a claim stemming from an Item 103 violation.¹⁹⁹ Such reliance is usually, but not always, misplaced. The controlling principle concerning uncharged violations is that "disclosure is not a rite of confession, and companies do not have a duty to disclose uncharged, unadjudicated wrongdoing."²⁰⁰ However, a company may be required to disclose

194. See, e.g., Gregg L. Weiner & Israel David, *Next 'Trend' in Securities Litigation: Fraud Cases Brought Under Item 303*, N.Y. L.J., May 28, 2015, <https://www.friedfrank.com/siteFiles/Publications/NYLJ%2006022015.pdf> [<https://perma.cc/57FX-75WH>]. Item 105 of Reg S-K also provides a basis for EDSL. Item 105, most recently amended in 2020, requires that, where appropriate, companies must: (1) provide under the caption "Risk Factors" a discussion of the material factors that make an investment in the registrant or offering speculative or risky, and (2) concisely explain how each risk affects the registrant or the securities being offered. 17 C.F.R. § 229.105 (2021). The 2020 amendment changed the Item 105 disclosure standard from "the most significant factors" to "material" factors that make an investment risky. See COOLEY, *SEC Adopts Amendments to Regulation S-K to Modernize Descriptions of Business, Legal Proceedings and Risk Factors* (Oct. 2020), <https://www.cooley.com/news/insight/2020/2020-10-05-sec-amendments-regulation-s-k-modernize-descriptions> [<https://perma.cc/2RRK-TGVG>] (explaining 2020 amendment to Item 105). This change may further encourage EDSL. In 2021 the Supreme Court denied a petition for writ of certiorari seeking clarity with respect to the scope of disclosures required under Item 105. See *M&T Bank Corp. v. Jaroslawicz*, 141 S. Ct. 1284 (2021).

195. 17 C.F.R. § 229.103 (2021).

196. *Id.*

197. *In re Lions Gate Ent. Corp. Sec. Litig.*, 165 F. Supp. 3d 1, 12 (S.D.N.Y. 2016); *Richman v. Goldman Sachs Grp., Inc.*, 868 F. Supp. 2d 261, 274–75 (S.D.N.Y. 2012).

198. Langevoort, *supra* note 140, at 998.

199. See, e.g., *Emps. Ret. Sys. of Providence v. Embraer S.A.*, No. 16 Civ. 6277, 2018 WL 1725574, at *4–6 (S.D.N.Y. Mar. 30, 2018) (discussing DOJ and SEC investigations concerning potential FCPA violations).

200. *City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG*, 752 F.3d 173, 184 (2d Cir. 2014); *In re Banco Bradesco S.A. Sec. Litig.*, 277 F. Supp. 3d 600, 649–50 n.14 (S.D.N.Y. 2017).

uncharged wrongdoing if its statements are or become materially misleading in the absence of disclosure.²⁰¹

The law regarding regulatory investigations—which are generally confidential—is somewhat more nuanced. There is no automatic duty to disclose even those investigations deemed material,²⁰² because an investigation on its own is not a pending legal proceeding.²⁰³ At least in the Southern District of New York, a company has no disclosure obligation unless and until it determines that an on-going investigation is “substantially certain” to lead to a formal enforcement action—so long as the company’s other disclosures are not rendered misleading by the omission of information about the investigation.²⁰⁴

The same is true with regard to issuance of a Wells Notice, in which SEC Enforcement Division staff inform a potential defendant that they are considering recommending that the Commission begin an enforcement proceeding and the company is allowed a final opportunity to counter such a recommendation.²⁰⁵ Several courts have held that nothing in Item 103 mandates disclosure of a Wells Notice.²⁰⁶ This is sensible because SEC staff have no power to authorize an enforcement action, and if disclosure occurs but no action follows, then the defendant will have prematurely and disadvantageously disclosed a securities fraud investigation that has gone nowhere. Similarly, no disclosure obligation is triggered merely because a

201. *Singer v. Reali*, 883 F.3d 425, 441 (4th Cir. 2018); *Menaldi v. Och-Ziff Capital Mgt. Grp. LLC*, 164 F. Supp. 3d 568, 581 (S.D.N.Y. 2016).

202. *Langevoort*, *supra* note 140, at 997.

203. *Plymouth Cnty. Ret. Sys. v. Patterson Cos., Inc.*, No. 18-cv-871, 2019 WL 3336119, at *14 (D. Minn. July 25, 2019), *report and recommendation adopted as modified*, 2019 WL 4277302 (D. Minn. Sept. 10, 2019).

204. *In re Lions Gate Ent. Corp. Sec. Litig.*, 165 F. Supp. 3d 1, 12, 21–22 (S.D.N.Y. 2016); *Richman v. Goldman Sachs Grp., Inc.*, 868 F. Supp. 2d 261, 273–75 (S.D.N.Y. 2012); *see also* James J. Beha II, Jordan Eth & Craig D. Martin, *Corporate Disclosure of Government Investigations Under Securities Law*, N.Y. L.J., Apr. 27, 2016, <https://media2.mofo.com/documents/160427corporatedisclosuregovtinvestigations.pdf> [<https://perma.cc/2GS8-LN9G>] (discussing *Lions Gate* decision).

205. *In re Lions Gate*, 165 F. Supp. 3d at 9 (“A Wells Notice informs the recipient that the SEC Enforcement Division staff has decided to recommend that the Commission bring an enforcement proceeding, identifies alleged violations of securities law, and provides potential defendants the opportunity to make a responsive submission.”); *see also* David M.J. Rein & Jacob E. Cohen, *Further Clarity on Duty to Disclose Wells Notices*, LAW360 (Feb. 3, 2016, 10:06 AM), <https://www.law360.com/articles/754295> [<https://perma.cc/8G2N-CG8W>] (discussing duty to disclose Wells Notices).

206. *See, e.g.*, *Richman*, 868 F. Supp. 2d at 274 (“At best, a Wells Notice indicates not litigation, but only the desire of the Enforcement staff to move forward, which it has no power to effectuate.”).

regulator requests documents,²⁰⁷ requests a tolling agreement, or decides not to close an investigation.²⁰⁸ Both the Department of Justice (DOJ) and SEC routinely request and receive tolling agreements,²⁰⁹ but such requests typically occur during investigative fact-finding, before an enforcement decision has been made.

Consistent with the foregoing principles, multiple courts have rejected securities fraud claims stemming from undisclosed or minimally disclosed investigations.²¹⁰ But this is not a uniform result. Some courts have deemed disclosures to be actionable half-truths when they take the form of statements that the company is unaware of any pending government investigations that would have a material impact on the company or its operations. Half-truths are distinguishable from pure omissions, which entail a complete failure to make a statement.²¹¹ If an undisclosed investigation presented a serious threat, this may constitute an actionable half-truth, even if the extent of the threat was indeterminate.²¹²

In 2020 the SEC adopted amendments to Item 103 and certain other provisions of Reg S-K, which became effective in late 2020 and early 2021.²¹³ Those amendments, while significant, failed to provide further

207. See *In re PolarityTE, Inc. Sec. Litig.*, No. 2:18-cv-00510, 2020 WL 6873798, at *13 (D. Utah Nov. 22, 2020) (rejecting argument that SEC document request constitutes an investigation).

208. Robin Bergen, Matthew Solomon, Adam Fleisher, Rahul Mukhi & Alexander Janghorbani, Mylan *Case Shows SEC Stance on Disclosing Investigations*, LAW360 (Oct. 17, 2019, 4:56 PM), <https://www.law360.com/articles/1208570> [<https://perma.cc/9RJ3-6TNT>].

209. See, e.g., Russell Ryan, *What if SEC Tolling Agreements are Unenforceable in Court?*, LAW360 (July 24, 2020, 6:11 PM), <https://www.law360.com/articles/1291961> [<https://perma.cc/59NT-PLJA>] (noting that the SEC is increasingly reliant on tolling agreements and investigative subjects usually accede to SEC demands for them).

210. *In re Inv. Tech. Grp., Inc. Sec. Litig.*, 251 F. Supp. 3d 596, 617 (S.D.N.Y. 2017); *In re Lions Gate*, 165 F. Supp. 3d at 21–22; *Lubbers v. Flagstar Bancorp. Inc.*, 162 F. Supp. 3d 571, 580 (E.D. Mich. 2016).

211. *In re Vivendi, S.A. Sec. Litig.*, 838 F.3d 223, 239–40 (2d Cir. 2016) (distinguishing between pure omissions and half-truths); *Ong v. Chipotle Mexican Grill, Inc.*, No. 16 Civ. 141, 2017 WL 933108, at *8 (S.D.N.Y. Mar. 8, 2017).

212. *Menaldi v. Och-Ziff Capital Mgmt. Grp. LLC*, 164 F. Supp. 3d 568, 584 (S.D.N.Y. 2016); *In re BioScrip, Inc. Sec. Litig.*, 95 F. Supp. 3d 711, 727 (S.D.N.Y. 2015); *In re FBR Inc. Sec. Litig.*, 544 F. Supp. 2d 346, 359 (S.D.N.Y. 2008).

213. Nicolas Grabar, Jeffrey D. Karpf & David Lopez, *Major Changes to MD&A and Related Requirements*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 11, 2021), <https://corpgov.law.harvard.edu/2021/01/11/major-changes-to-md-a-and-related-requirements/> [<https://perma.cc/EB6E-FVQA>]; Mark S. Bergman & Raphael M. Russo, *SEC Amends Disclosure Requirements for Business Sections, Legal Proceedings and Risk Factors*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 3, 2020), <https://corpgov.law.harvard.edu/2020/10/03/sec-amends-disclosure-requirements-for-business-sections-legal-proceedings-and-risk-factors/> [<https://perma.cc/RBT6-YJXA>].

clarity concerning required disclosures of investigations. Many of the rule changes opt for a principles-based approach in lieu of a prescriptive approach, allowing companies to choose how to disclose material information to investors.²¹⁴ In the absence of a robust body of case law and SEC interpretative guidance, disclosure practices concerning investigations vary. Some companies choose to disclose regulatory investigations for multiple practical reasons, including a desire to preemptively manage the narrative.²¹⁵ Many of the same considerations applicable to voluntary disclosure of regulatory investigations also can shape the decision to disclose significant internal investigations, and both situations brim with risk for the company.²¹⁶

EDSL plaintiffs similarly rely on Item 303, which requires companies to include in certain public filings management's discussion and analysis of their financial conditions and results of operations (MD&A).²¹⁷ It applies to registration statements, tender offer statements, annual and quarterly reports, and any other documents required to be filed under the Exchange Act.²¹⁸ Item 303, as amended in 2020, requires disclosure when a company knows of (1) any trends or uncertainties that have had or are reasonably likely to have a material impact on revenues or income and (2) events that are reasonably likely to cause a material change in the relationship between costs and revenues.²¹⁹ Prior to amendment the standard was whether the events "will cause" a material change, and this modification may further encourage EDSL.²²⁰ Whereas Item 103 requires principally descriptive disclosure, Item 303 mandates some analysis of the probability of an adverse outcome, its potential amount, and the potential effect on the company's financial

214. Valerie Jacob, Pamela Marcogliese & Sarah Solum, *New Wave of Regulation S-K Amendments*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 22, 2020), <https://corpgov.law.harvard.edu/2020/12/22/new-wave-of-regulation-s-k-amendments/> [<https://perma.cc/JU4M-897F>].

215. Deborah S. Birnbach, *Do You Have to Disclose a Government Investigation?*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 9, 2016), <https://corpgov.law.harvard.edu/2016/04/09/do-you-have-to-disclose-a-government-investigation/> [<https://perma.cc/EU5K-F6QJ>].

216. Robin M. Bergen, Matthew Solomon, Adam Fleisher, Rahul Mukhi & Alexander Janghorbani, *Cleary Gottlieb Discusses SEC Action for Non-Disclosure of DOJ Investigation*, CLS BLUE SKY BLOG (Oct. 15, 2019), <https://clsbluesky.law.columbia.edu/2019/10/15/cleary-gottlieb-discusses-sec-action-for-non-disclosure-of-doj-investigation/> [<https://perma.cc/PC7H-BB48>].

217. 17 C.F.R. § 229.10(a) (2021).

218. *See* 17 C.F.R. § 229.10(a) (2021).

219. *Id.* § 229.303(a).

220. PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP, Client Memorandum, *Mitigating Securities Litigation Risks Related to the Coronavirus* (Mar. 5, 2020), <https://www.paulweiss.com/practices/litigation/securities-litigation/publications/mitigating-securities-litigation-risks-related-to-the-coronavirus?id=30788> [<https://perma.cc/4Z44-FUPV>].

statements.

Both section 10(b) and Item 303 impose materiality requirements, but the standard is lower for the latter. As noted *supra*, materiality of an omission for purposes of liability under section 10(b) is subject to a “substantial likelihood” standard adopted by the Supreme Court in *Basic*—there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by a reasonable investor as having significantly altered the total mix of information made available.²²¹

By contrast, Item 303 materiality is subject to a more relaxed “reasonable likelihood” standard adopted by the SEC. The Commission considers an analysis of whether a trend, uncertainty, or event is “reasonably likely” to require an objective assessment of the likelihood that an event will occur balanced with a materiality analysis concerning the need for disclosure.²²² Pursuant to this framework, where a trend, demand, commitment, event, or uncertainty is known, corporate management must make dual assessments. First, management must determine whether the foregoing is likely to come to fruition. If management determines that it is not reasonably likely to occur, then no disclosure is required.²²³ Second, if management cannot make that determination, then it must objectively evaluate the consequences of the known trend, demand, commitment, event, or uncertainty, on the assumption that it will come to fruition. Disclosure is then required unless management determines that a material effect on the registrant’s financial condition or results of operations is not reasonably likely to occur.²²⁴ The SEC has unequivocally distinguished the Item 303 standard from the *Basic* standard.²²⁵ However, at least in the Second Circuit, both materiality tests must be satisfied in order for a plaintiff to state a section 10(b) claim stemming from an Item 303 violation.²²⁶

EDSL plaintiffs often allege that the defendant omitted the requisite description of known trends and uncertainties under Item 303,²²⁷ even though the provision provides no express private right of action for non-

221. *Basic Inc., v. Levinson*, 485 U.S. 224, 231–32 (1988).

222. *Stratte-McClure v. Morgan Stanley*, 776 F.3d 94, 103 (2d Cir. 2015).

223. *Id.*

224. *Id.*

225. Aaron J. Benjamin, *Stuck with Steckman: Why Item 303 Cannot Be a Surrogate for Section 11*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 17, 2017), <https://corpgov.law.harvard.edu/2017/05/17/stuck-with-steckman-why-item-303-cannot-be-a-surrogate-for-section-11/> [<https://perma.cc/WV9K-2CHH>].

226. *Stratte-McClure*, 776 F.3d at 103.

227. *See, e.g., Das v. Rio Tinto PLC*, 332 F. Supp. 3d 786 (S.D.N.Y. 2018) (alleging failure to make requisite Item 303 disclosure in case involving FCPA violations).

compliance.²²⁸ Specifically, while regulatory investigations do not often trigger MD&A disclosure, plaintiffs frequently claim that Item 303 requires such disclosure if the company reasonably expects the investigation will have a material adverse effect.²²⁹ Plaintiffs likely assert the claim to circumvent the fundamental securities rule that silence, absent a duty to disclose, is not misleading.²³⁰

Notwithstanding a perception by some scholars and practitioners of a circuit split on this issue,²³¹ and the Supreme Court's initial grant of certiorari to resolve the purported split,²³² there is agreement among those circuits that have considered the issue that a failure to comply with Item 303 may constitute a violation of Rule 10b-5 but it does not automatically do so.²³³ Instead, a determination of whether an Item 303 violation should give rise to section 10(b) liability requires a case-specific inquiry and is greatly dependent on the unique qualities of defendant corporation's business and markets. As will be seen in multiple parts *supra*, this inquiry has proven difficult for courts. Non-compliance with Item 303 by omitting known trends and uncertainties from a registration statement or prospectus also may be actionable under Securities Act sections 11 and 12(a)(2).²³⁴ The latter statute imposes liability for material misstatements and material misleading omissions on persons who offer or sell securities by a prospectus or oral communication.²³⁵

E. The PSLRA's Safe Harbor

The PSLRA introduced into both the Exchange Act and the Securities Act safe harbors for certain forward-looking statements that protect issuers and those acting on their behalf, subject to some exclusions. The PSLRA broadly defines "forward-looking statement" to encompass projections of

228. Benjamin, *supra* note 225.

229. Birnbach, *supra* note 215.

230. Douglas W. Greene, *Why Item 303 Just Doesn't Matter in Securities Litigation*, LAW360 (Oct. 13, 2015, 12:49 PM), <https://www.law360.com/articles/711040> [<https://perma.cc/N4NE-EU5Y>].

231. See, e.g., Daniel Hemel & Dorothy S. Lund, *Sexual Harassment and Corporate Law*, 118 COLUM. L. REV. 1583, 1637–38 (2018) (noting "an important circuit split").

232. *Leidos, Inc. v. Ind. Pub. Ret. Sys.*, 137 S. Ct. 1395 (2017). The Supreme Court dismissed the case after being advised of a settlement by the parties. *Leidos, Inc. v. Ind. Pub. Ret. Sys.*, 138 S. Ct. 2670 (2017) (mem.).

233. See Matthew C. Turk & Karen E. Woody, *The Leidos Mixup and the Misunderstood Duty to Disclose in Securities Law*, 75 WASH. & LEE L. REV. 957, 1033 (2018) (rejecting view that actual circuit split exists).

234. *Stratte-McClure v. Morgan Stanley*, 776 F.3d 94, 101 (2d Cir. 2015).

235. 15 U.S.C. § 77l(a)(2).

future performance, plans and objectives for future operations, and assumptions underlying these statements.²³⁶ The statute immunizes from liability any forward-looking statement provided that: (1) the statement is identified as such and is accompanied by meaningful cautionary language identifying important factors that could cause actual results to differ materially from those in the statement, or (2) the statement is immaterial, or (3) a plaintiff fails to show that defendant had actual knowledge that the statements were false or misleading when made.²³⁷ The immunizing language is disjunctive, so there is no liability with respect to statements covered by any of the three categories.²³⁸ Because the safe harbor incorporates an actual knowledge standard, a complaint may allege scienter as to a forward-looking statement only by alleging “knowing falsity.”²³⁹ Plaintiffs often seek to establish actual knowledge using information provided by confidential witnesses,²⁴⁰ who typically are defendants’ former employees.²⁴¹

The PSLRA safe harbor can be characterized as a trade-off between encouraging honest voluntary disclosures and effectively shielding forward-looking information from liability.²⁴² More than twenty-five years after the PSLRA’s enactment, safe harbor warnings have become ubiquitous in issuers’ periodic reports and other communications containing such soft information as earnings estimates,²⁴³ but the success of the tradeoff remains unclear.²⁴⁴ The statutory harbor continues to complement the similar and sometimes overlapping common law “bespeaks caution” doctrine. Under the doctrine alleged misrepresentations are deemed immaterial as a matter of law if no reasonable investor could consider them important in light of adequate cautionary language,²⁴⁵ and thus if a statement is puffery the

236. *Id.* §§ 77z-2(i)(1), 78u-5(i)(1).

237. *Id.* §§ 77z-2(c)(1), 78u-5(c)(1).

238. *Wochos v. Tesla, Inc.*, 985 F.3d 1180, 1190 (9th Cir. 2021).

239. *Slayton v. Am. Express Co.*, 604 F.3d 758, 773 (2d Cir. 2010).

240. Richard A. Rosen & Jessica S. Carey, *The Safe Harbor for Forward-Looking Statements After Twenty Years*, INSIGHTS, May 2016, https://www.paulweiss.com/media/3592238/insights_0516_rosen.pdf [<https://perma.cc/7JVQ-2PCB>].

241. *See* Gideon Mark, *Confidential Witness Interviews in Securities Litigation*, 96 N.C. L. REV. 789, 790 (2018) (noting that CWs are defendant company’s current or former employees or, less frequently, customers or suppliers).

242. *See* Langevoort, *supra* note 140, at 995.

243. Ann Morales Olazábal, *False Forward-Looking Statements and the PSLRA’s Safe Harbor*, 86 IND. L.J. 595, 597–98 (2011).

244. *See, e.g.*, Marilyn F. Johnson et al., *The Impact of Securities Litigation Reform on the Disclosure of Forward-Looking Information by High Technology Firms*, 39 J. ACCT. RES. 297 (2001) (summarizing costs and benefits of PSLRA safe harbor).

245. *See, e.g., In re Bemis Co. Sec. Litig.*, 512 F. Supp. 3d 518, 537 n.6 (S.D.N.Y. 2021)

doctrine likely applies. Forward-looking statements often are aspirational²⁴⁶ and if they are deemed to be puffery they will be regarded as immaterial and likewise will be protected under the statutory harbor.

The PSLRA safe harbor and bespeaks caution doctrine have particular importance in EDSL because in such litigation “what is being challenged is often a forward-looking risk assessment.”²⁴⁷ For example, in life sciences EDSL, issuers’ remarks about their expectations concerning FDA approval and the timeline for commercial release of a drug have often been framed as forward-looking statements.²⁴⁸

Separately or in combination, the harbor and doctrine often block EDSL plaintiffs, who primarily pursue two lines of attack. First, plaintiffs argue that the subject statements are not forward-looking, because certain elements or aspects relate to unprotected present or historical facts. Resolution of this argument can be difficult. The ultimate test is whether the truth or falsity of the statement depends on subsequent events,²⁴⁹ and this framework gives plaintiffs some ground on which to scrimmage. If a statement is linked to a future event, and its veracity cannot be determined until after this future event occurs, it generally finds a harbor.²⁵⁰ Six circuits have held that if a statement is mixed, the elements unrelated to the future receive no protection.²⁵¹ The Ninth Circuit has taken an additional step and held that a materially false, non-forward-looking portion of a mixed statement generally precludes application of the safe harbor to the forward-looking portion.²⁵² Other courts have agreed with the Ninth Circuit²⁵³ and the Supreme Court has declined to address the issue.²⁵⁴

(explaining the doctrine).

246. See, e.g., *SEC v. Revolutions Med. Corp.*, No. 12-cv-3298, 2015 WL 11190068, at *4 (N.D. Ga. Apr. 3, 2015) (observing that statements classified as puffery frequently are forward-looking).

247. *Langevoort*, *supra* note 140, at 995.

248. See, e.g., *In re Aratana Therapeutics Sec. Litig.*, 315 F. Supp. 3d 737, 758 (S.D.N.Y. 2018) (“Nearly all of defendants’ statements as to their expectations regarding FDA approval and the timeline for ENTYCE’s commercial release were framed as opinions, forward-looking statements, or both.”).

249. *Rosen & Carey*, *supra* note 240, at 2.

250. *Julianello v. K-V Pharm. Co.*, 791 F.3d 915, 921 (8th Cir. 2015).

251. SCHULTE ROTH & ZABEL LLP, *SPAC Litigation Alert: SEC Cautions SPAC Participants that Claims of Reduced Liability Exposure Are Overstated* 3 n.13 (Apr. 13, 2021), <https://www.srz.com/resources/spac-litigation-alert-sec-cautions-spac-participants-that-claims.html> [<https://perma.cc/732L-TRVK>].

252. *In re Quality Sys., Inc. Sec. Litig.*, 865 F.3d 1130, 1146–48 (9th Cir. 2017).

253. See, e.g., *In re 3M Co. Sec. Litig.*, No. 20-CV-2488, 2021 WL 4482987, at *16 (D. Minn. Sept. 30, 2021) (noting that safe harbor does not protect a combination of (a) false or misleading statements about past or present facts and (b) forward-looking statements).

254. *Quality Sys., Inc. v. Miami Fire Fighters*, 139 S. Ct. 589 (2018).

Second, EDSL plaintiffs argue that the cautionary language is insufficiently meaningful. Cautionary statements identify important factors that could cause actual results to differ materially from those in the forward-looking statement, and a determination as to whether the accompanying caution is meaningful is inherently case specific.²⁵⁵ The issue is frequently litigated and courts are especially hostile to defendants if the cautionary language implies that a predicted risk is merely possible when management knows that it is certain or has already materialized.²⁵⁶

F. The Role of Confidential Witnesses

Confidential witnesses (CWs) play an outsized role in EDSL. One of the major unintended consequences of the PSLRA has been the widespread use of such witnesses in securities cases. CWs are usually current or former employees of the defendant company who provide information to plaintiffs for use in their complaints,²⁵⁷ typically in an effort to buttress falsity or scienter allegations, or both.²⁵⁸ This information is furnished anonymously, in the sense that the CWs—commonly located by private investigators hired by plaintiffs' counsel—are not identified by name in the pleadings. Anonymity is provided because the witnesses fear retaliation by the defendant companies against which they provide information.²⁵⁹ Federal courts have accepted this pleading practice, in recognition of the risk of retaliation.²⁶⁰ There is some inconsistency between courts, but at least in the Second, Third, and Ninth Circuits the use of CWs is allowed if they have certain indicia of reliability and personal knowledge. At a minimum, the CW must be described with sufficient particularity to support the probability that a person in a position occupied by the witness would possess the

255. Rosen & Carey, *supra* note 240, at 6.

256. See, e.g., *In re Harman Int'l Indus. Inc. Sec. Litig.*, 791 F.3d 90, 102–03 (D.C. Cir. 2015) (explaining that cautionary language cannot be meaningful if it is misleading in light of historical facts).

257. *In re Bofl Holding, Inc., Sec. Litig.*, No. 15-CV-02324, 2016 WL 5390533, at *16 (S.D. Cal. Sept. 27, 2016); Gideon Mark, *Confidential Witnesses in Securities Litigation*, 36 J. CORP. L. 551, 554–55 (2011).

258. See, e.g., *Kendall v. Odonate Therapeutics, Inc.*, No. 30-cv-01828, 2021 WL 3406271, at *7–8 (S.D. Cal. Aug. 4, 2021) (denying motion to dismiss in life sciences EDSL after crediting information from five CWs in scienter analysis).

259. See Gideon Mark, *Recanting Confidential Witnesses in Securities Litigation*, 45 LOY. U. CHI. L.J. 575, 596–97 (2014) (discussing multiple forms of retaliation).

260. See, e.g., *In re Cabletron Sys., Inc.*, 311 F.3d 11, 30 (1st Cir. 2002) (observing that requiring plaintiffs to name their confidential internal corporate sources would have a chilling effect on employees who provide information about corporate malfeasance).

information alleged.²⁶¹ Courts generally expect to see job descriptions and responsibilities, and often dates of employment and reporting lines.²⁶²

Two specific aspects of the PSLRA have sparked the ubiquitous use of CWs in securities litigation. The first is the statute's elevated bar for pleading securities fraud. The PSLRA amended the Exchange Act to impose two strict pleading requirements, both of which must be satisfied for a complaint to survive a dismissal motion. A private securities complaint involving an allegedly false or misleading statement must specify each statement alleged to be misleading, the reason(s) why the statement is misleading, and, if an allegation is made on information and belief, all facts on which that belief is formed.²⁶³ In addition, the complaint must, with respect to each act or omission alleged to violate the securities laws, state with particularity facts giving rise to a strong inference that the particular defendant acted with the requisite scienter.²⁶⁴

The second major change mandated by the PSLRA is the imposition of an automatic stay of all discovery and other proceedings during the pendency of a motion to dismiss,²⁶⁵ absent application of one of two exceptions—when particularized discovery is necessary to preserve evidence or to prevent undue prejudice to the party seeking relief.²⁶⁶ Congress created the stay to prevent fishing-expedition and extortive discovery.²⁶⁷ Federal courts have an expansive view of the scope of the provision,²⁶⁸ and most of them have

261. *Davoli v. Costco Wholesale Corp.*, 854 F. App'x 116, 117 (9th Cir. 2021) (affirming dismissal of second consolidated amended complaint after rejecting allegations by CWs); *Novak v. Kasaks*, 216 F.3d 300, 314 (2d Cir. 2000).

262. *See, e.g., Brendon v. Allegiant Travel Co.*, 412 F. Supp. 3d 1244, 1260 (D. Nev. 2019) (noting that first amended complaint specified job titles, locations, responsibilities, dates of employment, and supervisors for each CW).

263. *See* 15 U.S.C. § 78u-4(b)(1).

264. *Id.* § 78u-4(b)(2).

265. Pre-PSLRA, defendants in federal securities litigation were required to participate in discovery while motions to dismiss were pending. Defendants could avoid discovery only by moving for a protective order, requesting a stay, and showing good cause under Rule 26(c) of the Federal Rules of Civil Procedure. Such motions were usually denied. Gideon Mark, *Federal Discovery Stays*, 45 U. MICH. J.L. REFORM 405, 434 (2012).

266. 15 U.S.C. § 78u-4(b)(3)(B).

267. Wendy Gerwick Couture, *The PSLRA Discovery Stay in Complex Litigation*, CLS BLUE SKY BLOG (July 7, 2014), <https://clsbluesky.law.columbia.edu/2014/07/07/the-pslra-discovery-stay-in-complex-litigation/> [<https://perma.cc/5FXR-J4MH>].

268. In July 2021 the Supreme Court granted certiorari to decide whether the PSLRA's discovery stay also applies in state court securities class actions based on federal law. State trial courts have sharply divided on this issue, even within such jurisdictions as California and New York, where most sections 11 and 12 claims are filed. *See Pivotal Software, Inc. v. Superior Ct. of Cal.*, 141 S. Ct. 2884 (2021) (granting petition for certiorari); Andrew Clubok, Melissa Sherry & Gavin Masuda, *Supreme Court's Impending Decision Concerning Whether PSLRA Discovery Stay Applies in State Court*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July

rejected attempts to lift the stay on the ground that a defendant has already produced the documents in a government investigation, an internal investigation, a bankruptcy proceeding, or another action not governed by the PSLRA.²⁶⁹

The PSLRA stay has major practical significance. The parties in securities class actions rarely file motions for summary judgment²⁷⁰ and from 1997 to 2020 only 0.4% of core federal securities filings (nineteen cases) advanced to trial.²⁷¹ Accordingly, the ultimate outcome of the litigation is primarily dependent on the resolution of motions to dismiss. If plaintiffs survive the motion, the likelihood of a substantial settlement—following almost inevitable class certification and not infrequent mediation—exponentially increases.²⁷² Not surprisingly, then, motions to dismiss were filed in ninety-five percent of all securities class actions filed and resolved from 2000 to 2018.²⁷³ These motions are almost always resolved absent discovery, because plaintiffs generally fail to have the automatic stay lifted under either of the two statutory exceptions.²⁷⁴ Approximately half of securities fraud class action complaints do survive motions to dismiss,²⁷⁵ and almost all of them rely on confidential witnesses.

The combination of the PSLRA's strict pleading requirements and

28, 2021), <https://corpgov.law.harvard.edu/2021/07/28/supreme-courts-impending-decision-concerning-whether-pslra-discovery-stay-applies-in-state-court/> [<https://perma.cc/82JV-P2PZ>] (stating that state trial courts, including New York and California, where most security claims are filed, are divided on the issue). In September 2021 the case was removed from the Supreme Court's November argument calendar, pending a settlement. Dean Seal, *Justices Shelve Securities Discovery Case as Sides Near Deal*, LAW360 (Sept. 2, 2021, 9:45 PM), <https://www.law360.com/articles/1418647> [<https://perma.cc/HP9X-BWRL>] (reporting that the Court had suspended review of the case as the parties closed in on a settlement).

269. DAVID M.J. REIN, MATTHEW A. SCHWARTZ & JOHN P. COLLINS, JR., *SECURITIES LITIGATION INVOLVING THE PRIVATE SECURITIES LITIGATION REFORM ACT (PSLRA)* (2021), Thomas Reuters Practical Law W-010-6738.

270. See 2018 FULL-YEAR REVIEW, *supra* note 6, at 19 (“Motions for summary judgment were filed by defendants in 7.1%, and by plaintiffs in only 1.9%, of the securities class actions filed and resolved over the 2000–2018 period, among those we tracked.”).

271. 2020 YEAR IN REVIEW, *supra* note 18, at 18.

272. William S. Freeman & Catherine T. Zeng, *The Trouble with ‘Confidential Witness’ Allegations*, LAW360 (Feb. 3, 2012, 2:12 PM), <https://www.law360.com/articles/303826> [<https://perma.cc/387H-FDPD>]; *accord* CONTAINING THE CONTAGION, *supra* note 74, at 19 (“The district court’s decision on the motion to dismiss is the critical event in securities class actions: if the motion to dismiss is denied, class certification and settlement virtually always follow. . . .”).

273. 2018 FULL-YEAR REVIEW, *supra* note 6, at 20.

274. Mark, *supra* note 241, at 795.

275. GREGORY A. MARKEL, GIOVANNA A. FERRARI & HEATHER E. MURRAY, *DEFENDING AGAINST CONFIDENTIAL WITNESS ALLEGATIONS* (2021), Thomson Reuters Practical Law W-000-6239.

discovery stay explains the prevalence of CWs.²⁷⁶ Plaintiffs must plead their cases with particularity, but they are generally barred from obtaining discovery to bolster their complaints until after all motions to dismiss have been resolved. The repercussion has been almost universal reliance by plaintiffs in securities class action pleadings on information furnished by confidential witnesses.²⁷⁷ Absent publicly available information generated by regulatory investigations, allegations based on information from CWs often are the only specific allegations in a complaint supporting a securities fraud claim.²⁷⁸

Confidential witnesses are even more critical in EDSL than in traditional accounting-based securities fraud litigation. In virtually all securities fraud suits pleading and proving scienter is the major challenge confronting plaintiffs, because a showing of scienter almost always requires some form of non-public information that was actually known to defendants when they made false or misleading statements to the public.²⁷⁹ In this respect scienter differs from pleading and proving falsity and loss causation.

In the standard accounting case that until recently dominated securities litigation, the pool of CWs potentially useful to plaintiffs was finite and generally restricted to non-executive level accounting staff.²⁸⁰ But with EDSL's ascent the pool of potential CWs has ballooned. In a typical event-driven case there are likely to be numerous current or former employees with knowledge of non-public negative developments in the defendant company's core operations. The list extends beyond accounting staff to encompass sales, marketing, administrative, and supply-chain personnel, among others.²⁸¹

276. See *Union Asset Mgt. Holding AG v. SanDisk LLC*, 227 F. Supp. 3d 1098, 1100 (N.D. Cal. 2017) (“The combined effect of the high scienter standard in securities fraud litigation and the strict PSLRA discovery stay is to place great weight at the pleading stage on the statements of confidential witnesses.”).

277. See, e.g., *In re BofI Holding, Inc., Sec. Litig.*, No. 15-CV-02324, 2016 WL 5390533, at *16 (S.D. Cal. Sept. 27, 2016) (“The Court is aware that confidential witnesses have become a staple of securities litigation.”).

278. ASS'N OF THE BAR OF THE CITY OF N.Y. SEC. LITIG. COMM., SUBCOMM. ON USE OF CONFIDENTIAL SOURCES, DIALOGUE ON THE CURRENT LAW AND PROPOSALS FOR REFORM ON THE USE OF INFORMATION FROM AND THE DISCLOSURE OF THE IDENTITY OF INFORMANTS 3 (2009), <http://www.nycbar.org/pdf/report/uploads/20071798-UseofConfidentialSources.pdf> [<https://perma.cc/U32G-X36M>].

279. Steve Berman & Mike Stocker, *The Rise in Event-Driven Securities Class Actions*, LAW360 (Mar. 26, 2018, 12:35 PM), <https://www.law360.com/articles/1025863> [<https://perma.cc/5FQC-N8QL>].

280. *Id.*

281. See, e.g., *Okla. Police Pension & Ret. Sys. V. Lifelock, Inc.*, 780 Fed. App'x 480, 484 n.5 (9th Cir. 2019) (noting that in securities class action based on defendants' defective identity theft alerts, plaintiffs rely on CW who was Identity Alert Specialist); *Schiro v. Cemex*,

Massive job cuts stemming from the COVID-19 pandemic in 2020 are also likely to accelerate the use of CWs in EDSL. As noted above, the typical CW is a former employee. At the peak of the pandemic in 2020 more than 22 million jobs vanished in the United States and by February 2021 barely half of those jobs had been recovered.²⁸² The large-scale layoffs by numerous companies greatly expanded the universe of former employees who might become CWs, and this expansion is likely to further catalyze plaintiffs' use of such witnesses.²⁸³

The common use of CWs raises some difficult issues. First, federal courts disagree about how to evaluate information provided by such witnesses. Some circuits, including the Fifth²⁸⁴ and Seventh,²⁸⁵ automatically steeply discount allegations based on information furnished by CWs. This reflexive steep discounting is indefensible²⁸⁶ but common. Other courts that do not automatically discount still are skeptical. In one case the First Circuit rejected plaintiffs' reliance on statements from at least a dozen different CWs.²⁸⁷

Second, the use of CWs raises thorny issues concerning both the discovery of the witnesses²⁸⁸ and the discovery and filing (sealed or not) by defendants of witness interview notes and memoranda prepared by plaintiffs' private investigators, particularly when one or more of the confidential witnesses recant after being contacted and sometimes pressured by defense

S.A.B. de C.V., 396 F. Supp. 3d 283, 304–06 (S.D.N.Y. 2019) (noting that in EDSL based on bribery of Colombian government officials, plaintiffs rely on statements from CWs who include security guard and community relations representative).

282. Anneken Tappe & Tal Yellin, *These Five Charts Show the Pandemic's Brutal Impact on American Workers*, CNN.COM (Mar. 11, 2021, 7:21 AM), <https://www.cnn.com/2021/03/11/economy/pandemic-job-market/index.html> [<https://perma.cc/R96Y-NNVV>].

283. See Joni Jacobsen, Nicolle Jacoby & Angela Liu, *Mitigating Risk Amid Layoff-Driven Confidential Witness Boom*, LAW360 (Mar. 10, 2021, 4:13 PM EST), <https://www.law360.com/articles/1362556> [<https://perma.cc/9PQA-GXVP>] (predicting expanded use of CWs in light of pandemic layoffs).

284. *Ind. Elec. Workers' Pension Tr. Fund v. Shaw Grp., Inc.*, 537 F.3d 527, 535 (5th Cir. 2008).

285. *City of Livonia Emp. Ret. Sys. v. Boeing Co.*, 711 F.3d 754, 759 (7th Cir. 2013); *Higginbotham v. Baxter Int'l Inc.*, 495 F.3d 753, 756–57 (7th Cir. 2007).

286. See Mark, *supra* note 257, at 569–73 (explaining why automatic steep discounting is unjustified).

287. *In re Biogen Inc. Sec. Litig.*, 857 F.3d 34, 41–44 (1st Cir. 2017).

288. See Jeff G. Hammel & Elizabeth R. Marks, *Confidential Witnesses: Reliable Source or Imaginary Friend?*, 45 SEC. REG. & LAW REP., July 15, 2013 (discussing discovery issues).

counsel.²⁸⁹ Third, CW recantation, which is not rare,²⁹⁰ often requires the court to decide how to treat recanting statements in connection with a motion to dismiss and whether to reconsider the denial of such a motion if the recantation occurs after the initial ruling. Reconsideration is procedurally improper because it introduces extrinsic material at the pleading stage, but numerous courts have glossed over this point.²⁹¹ Alleged recantation also requires courts to decide whether and when to impose sanctions under Rule 11 of the Federal Rules of Civil Procedure,²⁹² which “should be reserved for egregious cases.”²⁹³ The foregoing issues are likely to arise even more often as EDSL becomes the norm.²⁹⁴

Finally, two appellate decisions from 2020 may impact the continued use of CWs in EDSL. In the first case the Second Circuit held that a plaintiff cannot establish corporate scienter by relying on the statements of employees who never shared their knowledge with specific senior executives who made alleged misstatements.²⁹⁵ This holding may provide a robust defense to companies confronting complaints based on information provided by CWs.²⁹⁶

In the second case, the Ninth Circuit held that a former employee’s allegations in a whistleblower lawsuit may qualify as a corrective disclosure and thus may be used to plead loss causation in a subsequent securities class action, even absent additional disclosures or corroborating evidence.²⁹⁷ The

289. See, e.g., *Mosell v. Sasol Ltd.*, No. 20-cv-01008, 2021 WL 67107 (S.D.N.Y. Jan. 4, 2021) (resolving issues concerning proposed redactions and sealing of exhibits); Heather Speers, *Confidential Witness Allegations in Securities Fraud Litigation*, 31 CORP. COUNSEL, No. 2, Mar. 15, 2017, at 9–10 (noting that defense counsel often attempt to contact CWs).

290. See Mark, *supra* note 241, at 804–16 (discussing recantation by CWs).

291. See Michael B. Eisenkraft, *Dealing with Confidential Witness Recantation Statements*, LAW360 (Jan. 23, 2017, 12:33 PM), <https://www.law360.com/articles/883453> [<https://perma.cc/RC7B-ZA9E>] (discussing failure by multiple courts to follow clear rule that extrinsic evidence should not be considered during reconsideration of motion to dismiss).

292. FED. R. CIV. P. 11.

293. John C. Coffee, Jr., *Confidential Distortion: Dealing with Confidential Witnesses in Securities Litigation*, CLS BLUE SKY BLOG (Sept. 25, 2017), <https://clsbluesky.law.columbia.edu/2017/09/25/confidential-distortion-dealing-with-confidential-witnesses-in-securities-litigation/> [<https://perma.cc/GA76-HKKC>].

294. See, e.g., WINSTON & STRAWN LLP, *Plaintiffs Increasingly Pursuing Class Action Securities Fraud Claims Following Data Breaches* (Jan. 30, 2018), <https://www.winston.com/en/thought-leadership/plaintiffs-increasingly-pursuing-class-action-securities-fraud.html> [<https://perma.cc/E6TZ-977F>] (noting potential importance of CWs in data breach EDSL).

295. *Jackson v. Abernathy*, 960 F.3d 94, 99 (2d Cir. 2020) (per curiam).

296. Susanna M. Buergel et al., *Paul Weiss Discusses Increased Burden of Pleading Corporate Scienter*, CLS BLUE SKY BLOG (June 5, 2020), <https://clsbluesky.law.columbia.edu/2020/06/05/paul-weiss-discusses-increased-burden-of-pleading-corporate-scienter/> [<https://perma.cc/L8FL-Q8U6>].

297. *In re BofI Holding, Inc. Sec. Litig.*, 977 F.3d 781, 791–92 (9th Cir. 2020).

Ninth Circuit credited the whistleblower in light of his detailed and specific descriptions and firsthand knowledge²⁹⁸—a test similar to that commonly used to evaluate information sourced from CWs. In so holding, the Ninth Circuit joined the Sixth Circuit in rejecting the categorical rule that allegations in another civil lawsuit, standing alone, can never qualify as a corrective disclosure.²⁹⁹ Rejection of such a rule may create a new path for EDSL plaintiffs to plead and prove scienter if information attributed to CWs is discounted, even though the Ninth Circuit's discussion was confined to loss causation. The new avenue is to allege scienter based on prior whistleblower claims.³⁰⁰

G. Loss Causation and Class Certification

To state a claim for securities fraud under section 10(b) a plaintiff must plead both that (1) she relied upon defendant's allegedly fraudulent conduct in purchasing or selling securities and (2) defendant's conduct caused, at least in part, plaintiff's subsequent economic loss.³⁰¹ These two elements are generally known, respectively, as transaction causation (or reliance) and loss causation. The latter is codified in the PSLRA, which specifies that the plaintiff bears the burden of proof on this issue.³⁰² Pleading and proving the two elements have raised multiple difficult issues that have featured prominently in EDSL.

1. Rebutting the *Basic* Presumption

In *Basic* the Supreme Court held that if plaintiff-investors prove that a company's alleged material misrepresentations were publicly known, the company's stock traded in an efficient market, and plaintiffs purchased their stock after the misrepresentations were made but before the truth was revealed, they can invoke a presumption that the misrepresentations affected the stock price and they purchased the stock in reliance on the integrity of that price.³⁰³ Thus, under *Basic* plaintiffs may satisfy Rule 10b-5's reliance

298. *Id.* at 792.

299. *Norfolk Cnty. Ret. Sys. v. Cmty. Health Sys., Inc.*, 877 F.3d 687, 696 (6th Cir. 2017). The Eleventh Circuit has taken a contrary view. *Sapssov v. Health Mgmt. Assocs., Inc.* 608 F. App'x 855, 863 (11th Cir. 2015).

300. See Glenn Vanzura & Kevin Kelly, *Bofi Ruling May Erode Cos.' Securities Class Action Defenses*, LAW360 (Oct. 28, 2020, 5:48 PM), <https://www.law360.com/articles/1323672> [<https://perma.cc/C8KW-WARR>] (discussing such an approach).

301. *Erica P. John Fund, Inc. v. Halliburton Co.*, 563 U.S. 804, 812 (2011).

302. 15 U.S.C. § 78u-4(b)(4).

303. 485 U.S. at 247, 248 n.27.

requirement by invoking a presumption that the price of stock traded in an efficient market fully reflects all public material information. The fundamental premise underlying the fraud-on-the-market (FOTM) theory is that an investor presumptively relies on a misrepresentation that was reflected in the market price at the time of her transaction,³⁰⁴ even if the investor was unaware of the fraudulent conduct at the time of her purchase or sale.

The FOTM theory can establish the requisite transaction causation, but it does not establish the requisite loss causation, which is conceptually different. In order to establish loss causation plaintiff must show that after purchasing her shares and before selling, the following occurred: (1) the truth became known, and (2) the revelation caused the fraud-induced inflation in the stock's price to be reduced or eliminated.³⁰⁵ The most direct way for plaintiffs to satisfy the requirement is to identify one or more corrective disclosures,³⁰⁶ which reveal the falsity of a previous representation to the market.³⁰⁷ In a FOTM case the plaintiff must show that the corrective disclosure was a substantial factor in causing a decline in the security's price, thus creating an actual economic loss for the plaintiff.³⁰⁸ The disclosure need not precisely mirror the prior misrepresentation³⁰⁹ and it can be established by a series of cumulative, partial disclosures.³¹⁰ What exactly constitutes a corrective disclosure for purposes of loss causation is an unresolved question. In general, however, a disclosure is not corrective if it contains information derived entirely from public sources of which the market was presumed to be aware.³¹¹ Corrective disclosures in EDSL often arise externally—for example, when a regulatory action is announced.³¹²

Corrective disclosures are not essential for plaintiffs to prevail but proving causation in their absence can be daunting. Plaintiffs have an alternative—albeit not entirely distinct—theory at their disposal, which is that the occurrence or event upon which the case is based was the

304. Erica P. John Fund, Inc. v. Halliburton Co., 563 U.S. 804, 813 (2011).

305. Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 347 (2005).

306. *In re Bofl Holding, Inc. Sec. Litig.*, 977 F.3d 781, 790 (9th Cir. 2020).

307. *Id.*

308. McCabe v. Ernst & Young, LLP, 494 F.3d 418, 425–26 (3d Cir. 2007).

309. Howard v. Liquidity Servs., 177 F. Supp. 3d 289, 315 (D.D.C. 2016).

310. Sapssov v. Health Mgmt. Assocs., Inc., 608 F. App'x 855, 862 (11th Cir. 2015).

311. Grigsby v. Bofl Holding, Inc., 979 F.3d 1198, 1205 (9th Cir. 2020).

312. Lyle Roberts, *Justices Should Clarify Securities Fraud Loss Causation*, LAW360 (Apr. 29, 2021, 6:02 PM), <https://www.law360.com/articles/1380152> [<https://perma.cc/YA46-SDZC>]. See also Richard A. Booth, *What's A Nice Company Like Goldman Sachs Doing in the Supreme Court? How Securities Fraud Class Actions Rip Off Ordinary Investors—And What to Do About It*, 66 VILL. L. REV. TOLLE LEGE 71, 75 (2021) (observing that events can serve as corrective disclosures, even though the Supreme Court has never expressly so held).

materialization of an undisclosed or an under-disclosed risk that caused a stock price drop. The Circuits remain divided, but a majority of them to consider the issue have held that some form of risk materialization can suffice to show loss causation.³¹³ Some courts have treated this as the equivalent of a corrective disclosure.³¹⁴ The use of the risk materialization theory is especially common in EDSL,³¹⁵ and plaintiffs in event-driven cases have pursued both approaches simultaneously.³¹⁶

Defendants often challenge the pleading of loss causation at the motion to dismiss stage, whether plaintiffs' complaint has alleged corrective disclosures or a risk materialization theory. However, loss causation issues can be highly factual, thus often precluding a successful motion to dismiss based on this issue. If defendants' motion is entirely or partially denied, their next best chance to escape the case is to defeat plaintiffs' motion for class certification. In recent years this next stage has become a critical battleground in securities litigation. To obtain certification plaintiffs must show, *inter alia*, that questions of law or fact common to the class predominate over individual questions.³¹⁷ Historically, predominance has been the primary issue contested at the certification stage in securities fraud cases. *Basic*'s creation of a presumption of reliance in cases where the security at issue trades in an efficient market considerably eases plaintiffs' burden in this regard, and thus most purported securities classes seek certification based on the FOTM theory.³¹⁸

To determine whether a security traded in an efficient market courts generally analyze a set of structural features commonly known as the *Cammer*³¹⁹ and *Krogman*³²⁰ factors, which include both indirect indicia of

313. Dorothy Spenner, James Heyworth, Daniel McLaughlin & Ariel Atlas, 'Materialization of Risk' in *Securities Class Actions: Part 1*, LAW360 (June 6, 2017, 2:04 PM), <https://www.law360.com/articles/927937> [<https://perma.cc/9FBX-QEPA>].

314. *Id.*

315. Elissa Mendoza & Jeff Lubin, *Event Driven Securities Litigation*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 18, 2020), <https://corpgov.law.harvard.edu/2020/12/18/event-driven-securities-litigation/> [<https://perma.cc/ZGW4-U4HH>] ("The main theory in the event-driven cases is that the occurrence or event upon which the case is based was the materialization of an under-disclosed or downplayed risk.")

316. *See, e.g., In re Aurora Cannabis, Inc. Sec. Litig.*, No. 19-20588, 2021 WL 2821167, at *15 (D.N.J. July 6, 2021) (asserting both theories in cannabis EDSL).

317. FED. R. CIV. P. 23(b)(1)–(3).

318. David Tabak, *Testing Securities Market Efficiency with Cammer Factors*, LAW360 (Feb. 5, 2019, 2:54 PM), <https://www.law360.com/articles/1125546/testing-securities-market-efficiency-with-cammer-factors> [<https://perma.cc/UFH4-Y4PK>].

319. *Cammer v. Bloom*, 711 F. Supp. 1264, 1279–87 (D.N.J. 1989).

320. *Krogman v. Sterritt*, 202 F.R.D. 467, 474 (N.D. Tex. 2001). The three *Krogman* factors are the market capitalization of the company, the bid-ask spread of the stock, and the percentage of stock not held by insiders. *Id.*

efficiency such as high average weekly trading volume and direct empirical evidence demonstrating a cause and effect relationship between unexpected corporate events or financial releases and an immediate response in the stock price.³²¹ The existence of a causal relationship is the fifth *Cammer* factor, and it may be the most important one. However, if the remaining factors strongly support a presumption of market efficiency, courts can dispose of causation.³²²

The Supreme Court held in 2011 that plaintiffs need not prove (and defendants cannot rebut) loss causation in order to enjoy the *Basic* presumption of class-wide reliance at the class certification stage, because loss causation has no logical connection to the facts necessary to establish the efficient market predicate to the FOTM theory.³²³ But loss causation remains relevant at the certification stage, for multiple reasons. First, loss causation may be relevant to the typicality of the class representatives' claims and the adequacy of the representation under Rule 23 of the Federal Rules of Civil Procedure.³²⁴ Class representatives who sold prior to any corrective disclosure or risk materialization, or otherwise early in the class period, could be subject to distinctive loss causation defenses.³²⁵

Second, the Supreme Court held in 2013 in *Comcast Corp. v. Behrend* that because plaintiffs must satisfy Rule 23(b)(3)'s predominance requirement through evidentiary proof, plaintiffs seeking class certification must proffer a model establishing that damages are capable of measurement on a class-wide basis.³²⁶ That model must be applicable to the proposed class in a manner consistent with plaintiffs' overall theory of liability. While plaintiffs need not prove damages (or materiality or loss causation) when seeking certification, and a plurality of courts has held that inadmissible fact evidence may be considered at this stage,³²⁷ the requisite damages model necessarily implicates loss causation issues. *Comcast* involved federal

321. *In re Petrobras Sec. Litig.*, 862 F.3d 250, 276 (2d Cir. 2017).

322. *In re Allergan PLC Sec. Litig.*, No. 18 Civ. 12089, 2021 WL 4077942, at *10 (S.D.N.Y. Sept. 8, 2021).

323. *Erica P. John Fund, Inc. v. Halliburton Co.*, 563 U.S. 804, 813 (2011).

324. FED. R. CIV. P. 23.

325. Dorothy Spenner, James Heyworth, Daniel McLaughlin & Ariel Atlas, 'Materialization of Risk' in *Securities Class Actions: Part 2*, LAW360 (June 7, 2017, 11:24 AM), <https://www.law360.com/articles/927977> [<https://perma.cc/HL68-Y5X3>].

326. 569 U.S. 27, 34 (2013).

327. See Alexander Madrid, Allison Ebeck & Chelsey Dawson, *Courts' Clashing Standards for Evidence at Class Cert.: Part 1*, LAW360 (July 15, 2021, 7:14 PM), <https://www.law360.com/employment-authority/articles/1402801> [<https://perma.cc/66VX-C5YJ>] (discussing conflicting standards adopted by federal courts). Conversely, the plurality position (adopted by five Circuits) is that courts may only consider admissible expert evidence at the certification stage. *Id.*

antitrust law, but the holding applies to class certification generally and in securities litigation specifically. Still, the case has sowed much confusion among the lower courts.³²⁸ The Fifth Circuit rejected a proposed class in EDSL arising from the 2010 Deepwater Horizon oil spill and premised on a risk materialization theory, because plaintiffs' proposed damages model failed the *Comcast* test.³²⁹ In other EDSL, plaintiffs' models satisfied *Comcast*,³³⁰ or the court certified a class after deciding that *Comcast* was inapposite.³³¹

Third, the Supreme Court held in 2014 in *Halliburton Co. v. Eric P. John Fund, Inc. (Halliburton II)* that defendants are entitled to rebut the *Basic* presumption before a class is certified.³³² This can be done by (1) showing a lack of reliance, (2) disproving the indirect indicia of efficiency, or (3) showing that the alleged misrepresentation did not actually impact the price of the security, and the same substantive evidence that is relevant to loss causation also may be relevant to reliance.³³³

Efforts to rebut the *Basic* presumption spell trouble for courts because the *Cammer* factors do not create bright lines. There are no clear benchmarks for how securities should perform with respect to each of them,³³⁴ and while in theory a test could *disprove* that a security traded in an efficient market, no single test—nor any combination of tests—can prove that a security *did* trade in an efficient market.³³⁵ Still, it is defendants rather than plaintiffs who confront a steep uphill battle in this environment. The fraction of stocks deemed inefficient in class certification proceedings is less than 2% of all stocks for which a class certification has been decided by the courts.³³⁶ A

328. See, e.g., Alex Parkinson, Comment, *Comcast Corp. v. Behrend and Chaos on the Ground*, 81 U. CHI. L. REV. 1213, 1225–38 (2014) (describing chaos among lower federal court concerning *Comcast*'s implications).

329. *Ludlow v. BP, P.L.C.*, 800 F.3d 674, 689–91 (5th Cir. 2015).

330. See, e.g., *Waggoner v. Barclays PLC*, 875 F.3d 79 (2d Cir. 2017) (affirming certification in § 10(b) action against investment bank for allegedly providing secret advantages to high-frequency traders); *In re Allergan PLC Sec. Litig.*, No. 18 Civ. 12089, 2021 WL 4077942, at *14–15 (S.D.N.Y. Sept. 8, 2021) (certifying class in pharmaceutical EDSL after rejecting argument premised on *Comcast* that plaintiffs' damages model was inconsistent with liability theory).

331. See, e.g., *Utesch v. Lannett Co.*, No. 16-5932, 2021 WL 35609949, at *13, 19 (E.D. Pa. Aug. 12, 2021) (certifying class in antitrust EDSL stemming from generic drug price-fixing).

332. 573 U.S. 258, 269 (2014).

333. *In re Allstate Corp. Sec. Litig.*, 966 F.3d 595, 605–08 (7th Cir. 2020).

334. David Tabak, *Testing Securities Market Efficiency with Cammer Factors*, LAW360 (Feb. 5, 2019, 2:54 PM), <https://www.law360.com/articles/1125546> [<https://perma.cc/7PKY-VPKE>].

335. *Id.*

336. Assen Koev & Tiago Duarte-Silva, *The Cammer Turnover Factor in Securities Class*

separate analysis reported that certification motions were denied in only 1% of securities fraud class actions resolved from 2011–2020, and denials often involved unique facts “rather than reflecting consistently viable strategies for opposing class certification.”³³⁷

Both plaintiffs and defendants often present event studies—the basic function of which is to determine whether a highly unusual price movement has occurred—to seek to prove the presence or absence of price impact. Such studies often play a prominent role in impact analysis,³³⁸ but it is not exactly clear what defendants must do to prevent class certification with respect to this factor. In order to mount a successful *Halliburton II* challenge, defendants must prove an absence of front-end impact, which is price impact at the time of the misrepresentation.³³⁹ However, there is disagreement as to whether defendants also must prove an absence of back-end impact, which occurs at the time of the corrective disclosure.³⁴⁰

2. *Goldman Sachs* and the Inflation Maintenance Theory

The lack of clarity concerning price impact is perhaps most acute when plaintiffs rely on the inflation maintenance theory, as they increasingly do in EDSL. Plaintiffs relying on this theory argue that a misrepresentation that does not cause a stock price drop can still be actionable under section 10(b) if the misrepresentation prevented the stock’s artificially inflated price from dropping.³⁴¹ The theory’s implication is that front-end price impact is unreliable for determining whether the representation affected a stock’s price.³⁴²

Actions 4, Charles River Associates (2019), https://media.crai.com/wp-content/uploads/2020/09/16163718/Charles-River_CammerTurnoverFactor.pdf [<https://perma.cc/G6Q3-W8JK>].

337. Jared Gerber & Allison Kim, *Justices Must Weigh Class Cert. Denial Stats in Goldman Case*, LAW360 (May 18, 2021, 5:58 PM), <https://www.law360.com/articles/1385883> [<https://perma.cc/DW2V-6UY7>].

338. Kristin Feitzinger, Amir Rozen & Shaama Pandya, Cornerstone Research, *Economic Analysis at the Class Certification Stage of Exchange Act Securities Class Actions* 3 (2020), <https://www.cornerstone.com/wp-content/uploads/2022/01/Economic-Analysis-at-the-Class-Certification-Stage.pdf> [<https://perma.cc/A9TB-N23U>].

339. *Rooney v. EZCORP, Inc.*, 330 F.R.D. 439, 449 (W.D. Tex. 2019).

340. See Laurence A. Schoen & Kaitlyn A. Crowe, *Halliburton II in Action: The Impact of ‘Price Impact’ on Class Certifications*, Am. Bar Ass’n Litig. Section (Dec. 21, 2020), <https://www.americanbar.org/groups/litigation/committees/securities/articles/2020/halliburton-ii-price-impact-class-certifications/> [<https://perma.cc/Y8AD-WUNE>] (discussing conflicting decisions).

341. *In re Vivendi, S.A. Sec. Litig.*, 838 F.3d 223, 256 (2d Cir. 2016).

342. Noah Weingarten, *Halliburton II at Four: Has it Changed the Outcome of Class Certification Decisions?*, 25 FORDHAM J. CORP. & FIN. L. 459, 462 (2020).

While the inflation maintenance theory been accepted by the Second, Seventh, and Eleventh Circuits,³⁴³ by 2020 the Supreme Court had neither recognized nor even considered it. The theory is especially critical for EDSL plaintiffs, who often allege the existence of generic statements that probably have not moved a stock's price,³⁴⁴ but it is not always available. EDSL plaintiffs cannot switch to the theory at the class certification stage after omitting it from their complaint,³⁴⁵ and it is likely inapplicable in multiple factual scenarios. These scenarios include those in which the absence of upward price movement is explained by macroeconomic or company-specific confounding factors, the stock price was inflated prior to the subject misrepresentations, or defendants' conduct was a failure to disclose bad news to investors such that the omission simply maintained the status quo.³⁴⁶

Notwithstanding the foregoing, the inflation maintenance theory is often invoked and almost always fatal to defendants' efforts to defeat class certification. A 2019 review examined twenty-eight post-*Halliburton II* federal district court decisions that addressed defendants' attempt to rebut the *Basic* presumption. Twenty-seven rejected the attempt. Twenty of the opinions specifically referenced the inflation maintenance theory and in all twenty the theory was the reason the rebuttal attempt failed.³⁴⁷

The inflation theory created practical problems, some of which concern burdens. Both the Second and Seventh Circuits held that defendants bore the burden of persuasion—by a preponderance of evidence—on the lack of price impact,³⁴⁸ but by early 2021 there was no majority view. Moreover, it was unclear where the burden lay if defendants offered evidence that the price remained unchanged. Did the burden then shift to plaintiffs to demonstrate that the price would have declined but for the alleged misrepresentation?

In December 2020 the Supreme Court granted certiorari in long-running Second Circuit securities fraud litigation involving defendant Goldman

343. See *In re Vivendi, S.A. Sec. Litig.*, 838 F.3d 223, 256 (2d Cir. 2016); *Glickenhause & Co. v. Household Int'l, Inc.*, 787 F.3d 408, 419 (7th Cir. 2015); *FindWhat Inv'r Grp. v. FindWhat.com*, 658 F.3d 1282, 1314 (11th Cir. 2011). Cf. *IBEW Local 98 Pension Fund v. Best Buy Co.*, 818 F.3d 775, 782–83 (8th Cir. 2016) (rejecting application of the theory).

344. Matthew A. Schwartz & Michael R. Mayer, *Issues and Trends in Event-Driven Securities Class Actions*, 52 REV. SEC. & COMMOD. REG. 239, 244 (Nov. 20, 2019).

345. See *In re Finisar Corp. Sec. Litig.*, No. 11-cv-01252, 2019 WL 2247750, at *6 (N.D. Cal. May 24, 2019) (“Plaintiff has not previously and cannot now proceed on a price maintenance theory. . .”).

346. Schoen & Crowe, *supra* note 340.

347. Note, *Congress, the Supreme Court, and the Rise of Securities Fraud Class Actions*, 132 HARV. L. REV. 1067 (2019).

348. *In re Allstate Corp. Sec. Litig.*, 966 F.3d 595, 610 (7th Cir. 2020); *Waggoner v. Barclays PLC*, 875 F.3d 79, 103 (2d Cir. 2017).

Sachs that raised some of the key unresolved class certification issues discussed above.³⁴⁹ The litigation stemmed from a collateralized debt obligation (CDO) transaction that Goldman underwrote in 2007 that lost CDO investors \$1 billion after the bank allegedly helped a client short the CDO while simultaneously selling it elsewhere. Goldman settled an SEC enforcement action concerning its conduct for \$550 million in 2010.³⁵⁰ Plaintiffs in the securities litigation, who were Goldman shareholders, claimed that the bank's corporate statements misrepresented the transaction as being conflict-free in order to maintain an artificially inflated stock price that was deflated when the SEC enforcement action revealed conflicts.

Goldman's opening brief asked the Supreme Court to address two questions. The first was whether a defendant may rebut the *Basic* presumption by pointing to the generic nature of the alleged misrepresentations in showing that the statements had no price impact, even though the evidence is also relevant to the substantive element of materiality. The second was whether a defendant seeking to rebut the *Basic* presumption bears only a burden of production or also the ultimate burden of persuasion.³⁵¹ The Second Circuit answered the first question in the negative and answered the second question by holding that defendant bears the burden of persuasion.³⁵²

Goldman's opening brief directly targeted EDSL and argued that the Second Circuit's approach exacerbates the phenomenon of such litigation. The brief asserted that the inflation maintenance theory already seriously impedes defendants' ability to rebut the *Basic* presumption. It noted that, of the more than 2,000 securities class actions filed post-*Halliburton II*, only one produced an appellate finding that defendants successfully rebutted the presumption by showing price impact and only four produced a district court finding of even partial successful rebuttal.³⁵³ The brief then argued that the Second Circuit's decision to allow class certification on the basis of generic statements will accelerate EDSL and threaten to "convert Rule 10b-5 into a scheme of investor's insurance."³⁵⁴

The Supreme Court issued its decision in *Goldman Sachs* in June 2021.

349. *Goldman Sachs Grp. v. Ark. Teacher Ret. Sys.*, No. 20-222, 2020 WL 7296815 (U.S. Dec. 11, 2020).

350. U.S. SEC. AND EXCH. COMM'N, *Goldman Sachs to Pay Record \$550 Million to Settle SEC Charges Related to Subprime Mortgage CDO*, Press Release No. 2010-123 (July 15, 2010), <https://www.sec.gov/news/press/2010/2010-123.htm> [<https://perma.cc/Y9QS-YLT9>].

351. Brief for the Petitioners, *Goldman Sachs Grp., Inc. v. Ark. Teacher Ret. Sys.*, No. 20-222, 2021 WL 307471, at *1 (U.S. 2021).

352. *See id.* at *18–19.

353. *Id.* at *34–35.

354. *Id.* at *36 (citing *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 345 (2005)).

It vacated the class certification and held that courts may consider the generic nature of alleged misrepresentations as evidence of the lack of price impact when defendants attempt to rebut *Basic*'s presumption of class-wide reliance at the class certification stage, even if the evidence overlaps with materiality or any other merits issue.³⁵⁵ This holding reconciled *Halliburton II*, which allows rebuttal by disproving price impact, with the earlier case of *Amgen Inc. v. Connecticut Retirement Plans and Trust Funds*,³⁵⁶ which held that plaintiffs are not required to prove materiality at the certification stage. The Court also held in *Goldman Sachs* that defendants seeking to rebut the presumption of reliance bear both the burden of production and the burden of persuasion to prove lack of price impact by a preponderance of the evidence, consistent with prior decisions in the Second and Seventh Circuits.³⁵⁷ Finally, in *Goldman Sachs* the Supreme Court recognized the inflation maintenance theory for the first time ever, but declined to address its merits. In a footnote it stated: "Although some Courts of Appeal have approved the inflation-maintenance theory, this Court has expressed no view on its validity or its contours. We need not and do not do so in this case."³⁵⁸

The net impact of *Goldman Sachs* is unclear because the decision delivered both a shield to defendants and a sword to plaintiffs. On the one hand the Supreme Court recognized that an alleged misstatement's generality often will be important evidence of a lack of price impact, and this is particularly true in inflation maintenance cases where there may be less reason to infer front-end price inflation from a back-end price drop.³⁵⁹ In addition, the decision expressly allowed defendants to rebut *Basic* reliance by using merits evidence at the class certification stage. Such evidence is not limited to event studies or other economic analyses—it also includes the contents of the alleged misrepresentations and subsequent corrective disclosures. These aspects of the decision may enable more successful rebuttals³⁶⁰ by underscoring the importance of genericness and granting

355. *Goldman Sachs Grp. v. Ark. Teacher Ret. Sys.*, No. 20-222, 2021 WL 2519035, at *6 (U.S. June 21, 2021). The Supreme Court remanded to the Second Circuit, which subsequently remanded to the district court. *Ark. Teacher Ret. Sys. v. Goldman Sachs Grp., Inc.*, No. 18-3667, 2021 WL 3776297, at *4 (2d Cir. Aug. 26, 2021). The district court once again certified a class, and in March 2022 the Second Circuit granted leave to appeal the certification order. *Order, Goldman Sachs Grp., Inc. v. Ark. Teachers Ret. Sys.*, No. 1:10-cv-03461-PAC (2d Cir. Mar. 9, 2022).

356. 568 U.S. 455 (2013).

357. *Goldman Sachs Grp. v. Ark. Teacher Ret. Sys.*, No. 20-222, 2021 WL 2519035, at *7 (U.S. June 21, 2021).

358. *Id.* at *4 n.1.

359. *Id.* at *5–6.

360. Alison Frankel, *Securities Class Action Defendants Counting on SCOTUS' Goldman Ruling*, REUTERS (June 22, 2021, 4:03 PM), <https://www.reuters.com/legal/government/sec>

lower courts more discretion to deny certification based on the entire record.³⁶¹ Just two days after the Supreme Court decided *Goldman Sachs*, defendants in pending #MeToo EDSL against CBS Corporation cited the case to oppose class certification on the basis that the misrepresentations at issue were too generic to establish price impact.³⁶²

Conversely, *Goldman Sachs* made clear that the generic nature of defendants' statements does not exclude them from consideration at the class certification stage.³⁶³ The Supreme Court's refusal to shift the burden of proving price impact also aids plaintiffs. The Court observed that "the allocation of the burden is unlikely to make much difference on the ground"³⁶⁴—and generally will become dispositive only in the rare case where the evidence is in equipoise, but plaintiffs can further enhance their chances of avoiding successful *Basic* rebuttals if they rely less on generic misstatements. Alternatively, they can sidestep *Basic* and undertake the herculean task of demonstrating direct reliance by showing they were aware of, and directly misled by, misrepresentations.³⁶⁵

Finally, *Goldman Sachs* left intact for the foreseeable future the inflation maintenance theory, upon which much EDSL is premised. As Professor Coffee noted, in *Goldman Sachs* "there is enough discussion of inflation maintenance that lower courts are likely to treat it as established doctrine until if and when the court reconsiders it."³⁶⁶ On remand from the

urities-class-action-defendants-counting-scotus-goldman-ruling-2021-06-22/ [https://perma.cc/X82T-MRVB].

361. Stephen L. Ascher, Ali M. Arain & Reanne Zheng, *Supreme Court Gives More Tools for Defendants to Challenge Class Certification in Securities Fraud Cases*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 7, 2021), <https://corpgov.law.harvard.edu/2021/07/07/supreme-court-gives-more-tools-for-defendants-to-challenge-class-certification-in-securities-fraud-cases/> [https://perma.cc/E3YW-N349].

362. Notice of Supplemental Authority, *Constr. Laborers Tr. for So. Cal. v. CBS Corp.*, No. 1:18-cv-07796-VEC (S.D.N.Y. June 23, 2021).

363. See Marc Gross & Jeremy Lieberman, *Plaintiff Takeaways from High Court's Goldman Ruling*, LAW360 (July 2, 2021, 5:06 PM), <https://www.law360.com/articles/1399412> [https://perma.cc/G2SY-3FFW] (highlighting this point).

364. *Goldman Sachs Grp. v. Ark. Teacher Ret. Sys.*, No. 20-222, 2021 WL 2519035, at *7 (U.S. June 21, 2021).

365. See, e.g., *Semerenko v. Cendant Corp.*, 223 F.3d 165, 178 (3d Cir. 2000) (observing that plaintiffs can prove direct reliance by establishing they were aware of, and directly misled by, an alleged misrepresentation).

366. See Dean Seal, *Goldman Ruling Unlikely to Move Needle on Class Actions*, LAW360 (June 22, 2021, 8:07 PM), <https://www.law360.com/articles/1396441> [https://perma.cc/9WGL-JQ9T] (quoting Professor Coffee). See also *In re Allergan PLC Sec. Litig.*, No. 18 Civ. 12089 (CM)(GWG), 2021 WL 4077942, at *11 (S.D.N.Y. Sept. 8, 2021) (citing *Goldman Sachs* and certifying class in life sciences EDSL premised in part on inflation maintenance theory).

Supreme Court to the Second Circuit, and subsequent remand to the district court, plaintiffs in *Goldman Sachs* continued to rely on the inflation maintenance theory, in opposition to defendants' on-going bid to have the class decertified and not re-certified.³⁶⁷

III. SIX MAJOR EDSL CATEGORIES

The prior part analyzed seven key issues arising in EDSL. While there is no definitive list of the universe of events that generates such litigation, the next part of this Article examines those issues in the context of six major event categories: (A) the COVID-19 pandemic, (B) cannabis, (C) corruption (including violations of the Foreign Corrupt Practices Act (FCPA)),³⁶⁸ (D) antitrust, (E) #MeToo, and (F) cybersecurity. Other major categories, which are beyond the scope of this Article, include, *inter alia*, non-cyber components of environmental, social and governance (ESG)³⁶⁹—oil spills, dam collapses, mining disasters, and wildfires,³⁷⁰ opioid addiction,³⁷¹

367. See Plaintiffs-Appellees' Supplemental Brief 3, *Ark. Teacher Ret. Sys. v. Goldman Sachs Grp.*, No. 18-3667 (2d Cir. Aug. 10, 2021) (asserting theory); Lead Plaintiff' Opening Brief Regarding Class Certification on Remand from the Supreme Court and Second Circuit 3, *In re Goldman Sachs Grp., Inc. Sec. Litig.*, No. 1:10-cv-03461-PAC (S.D.N.Y. filed Oct. 5, 2021) (asserting theory).

368. Pub. L. No. 95-213, 91 Stat. 1494 (1977).

369. See Roshan Wasim, Note, *Corporate (Non)disclosure of Climate Change Information*, 119 COLUM. L. REV. 1311, 1332 (2019) (suggesting that EDSL stemming from climate change risk disclosures may proliferate); Howard B. Epstein & Theodore A. Keyes, *Climate-Change Related Losses and Other Event-Driven Litigation Risks*, N.Y. L.J., Jan. 19, 2019, <https://www.law.com/newyorklawjournal/2019/01/28/climate-change-related-losses-and-other-event-driven-litigation-risks/?sreturn=20210520192811> [<https://perma.cc/S6B9-NSSP>] (arguing that climate change-related events may be particularly well-suited to drive EDSL).

370. See, e.g., *In re Vale S.A.*, Sec. Litig., No. 15-cv-9539-GHW, 2017 WL 1102666 (S.D.N.Y. Mar. 23, 2017) (partially denying motion to dismiss in EDSL stemming from 2015 collapse of Fundão mining dam in Brazil that killed 19 people and severely polluted numerous waterways). This litigation settled for \$25 million in 2020. Peter Brush, *Mining Co.'s \$25M Dam Failure Deal Gets OK'd by Judge*, LAW360 (June 10, 2020, 6:23 PM), <https://www.law360.com/articles/1281869> [<https://perma.cc/ATY8-WJSV>]. A subsequent 2019 dam collapse in Brazil that killed at least 65 people also resulted in EDSL. Kevin LaCroix, *Latest Brazilian Dam Disaster Leads to Event-Driven Securities Suit*, D&O DIARY (Jan. 29, 2019), <https://www.dandodiary.com/2019/01/articles/securities-litigation/latest-brazilian-dam-disaster-leads-event-driven-securities-suit/> [<https://perma.cc/94MB-KEE4>].

371. See, e.g., Hailey Konnath, *Walmart Hit with Investor Suit over DOJ Opioid Crisis Probe*, LAW360 (Jan. 20, 2021, 7:23 PM), <https://www.law360.com/articles/1346823> [<https://perma.cc/A8KF-J36E>]. The *Walmart* case was one of eleven event-driven securities class actions involving opioids to be filed by March 2022. STAN. L. SCH., *Securities Class Action Clearinghouse, Current Trends in Securities Class Action Filings, Opioid Crisis*, <https://securities.stanford.edu/current-trends.html> [<https://perma.cc/ZES6-6ACU>] (last visited

airplane crashes,³⁷² and apartment building fires.³⁷³

A. COVID-19

By 2021 the COVID-19 pandemic had become the most recent significant source of EDSL.³⁷⁴ Counts vary as a function of methodology, but according to one reliable tally at least 40 coronavirus-related federal securities class actions were filed from March 2020–November 2021³⁷⁵ and approximately 80% of them included Rule 10b-5 claims.³⁷⁶ At least twelve shareholder derivative actions stemming from the virus also were filed, and virtually all of them followed the commencement of securities class action litigation.³⁷⁷ The pandemic EDSL primarily but not exclusively comprises

Mar. 23, 2022). A \$26 billion settlement announced in July 2021 ended most of the parallel opioid litigation initiated by state Attorneys General against various drug manufacturers and distributors. Emily Field, *AGs Unveil \$26B Global Opioid Deal with J&J, Distributors*, LAW360 (July 21, 2021, 2:08 PM), <https://www.law360.com/articles/1405349> [<https://perma.cc/G2DL-6GMY>].

372. See Kevin LaCroix, *First the Plane Crash, Then the Securities Lawsuit*, D&O DIARY (Nov. 29, 2018), <https://www.dandodiary.com/2018/11/articles/securities-litigation/first-plane-crash-securities-lawsuit/> [<https://perma.cc/FDA5-XK9F>] (discussing EDSL arising from October 2018 crash of Boeing 737 MAX 8 jet in Java Sea). In November 2021 derivative litigation resulting from the Java Sea crash and a second crash in Ethiopia, based on an alleged breach of the duty of oversight, settled for \$238 million. Linda Chiem, *Boeing Board Inks \$238M Deal to End 737 Max Derivative Suit*, LAW360 (Nov. 5, 2021, 10:12 PM), <https://www.law360.com/articles/1438180> [<https://perma.cc/4UHK-HRZU>].

373. See *Howard v. Arconic Inc.*, No. 17-cv-1057, 2021 WL 2561895 (W.D. Pa. June 23, 2021) (partially denying motion to dismiss second amended complaint in EDSL stemming from fire at Grenfell Tower in London, England that killed 71 and injured at least 70).

374. See Richard Zelichov & Christina Costley, *COVID-19 Securities Class Actions May Hinge on Disclosures*, LAW360 (Apr. 15, 2020, 4:55 PM), <https://www.law360.com/articles/1259356/covid-19-securities-class-actions-may-hinge-on-disclosures> [<https://perma.cc/U5HX-75J6>] (“COVID-19 might be the ultimate in event-driven securities litigation. . .”).

375. Kevin LaCroix, *Shareholder Files New Pandemic-Related Litigation Variant Suit Against Citrix Systems*, D&O DIARY (Nov. 22, 2021), <https://www.dandodiary.com/2021/11/articles/coronavirus/shareholder-files-new-pandemic-related-litigation-variant-suit-against-citrix-systems/> [<https://perma.cc/F3S5-VKCV>].

376. Jeff Lubitz & Louis Angelo M. Panis, *COVID-19 Update: Investor Related Class Actions*, ISS Securities Class Action Services (May 18, 2021), <https://insights.issgovernance.com/posts/covid-19-update-investor-related-class-actions/> [<https://perma.cc/8TGU-HPFV>].

377. Kevin LaCroix, *SEC Files COVID-19-Related Enforcement Suit Against Biotech Firm*, D&O DIARY (Aug. 23, 2021), <https://www.dandodiary.com/2021/08/articles/coronavirus/sec-files-covid-19-related-enforcement-suit-against-biotech-firm/> [<https://perma.cc/C98U-2RJU>]; Blair Connelly, Colleen C. Smith & Cindy Guan, *Securities Litigation Trends during COVID-19*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 7, 2020), <https://corpgov.law.harvard.edu/2020/11/07/securities-litigation-trends-during-covid-19/> [<https://perma.cc/RF2C-EXVG>] (identifying derivative actions).

three major case categories—those involving companies: (1) such as cruise lines and private prison systems that sustained a virus outbreak in their facilities, (2) such as vaccine manufacturers and diagnostic testing providers that trumpeted their capacity to prosper as a result of the pandemic, and (3) whose operations or financial results were impaired by pandemic-related closures or lockdown orders.³⁷⁸ Defendants likely will have the greatest difficulty obtaining dismissals of cases in the second category, which targets pharmaceutical businesses, including giant AstraZeneca³⁷⁹ and penny stock Vaxart.³⁸⁰

By late-2021 pandemic EDSL was less common than some observers—primarily defense counsel—had previously projected,³⁸¹ but still significant.³⁸² The prospect of major litigation prompted the filing with the SEC in October 2020 of a rulemaking petition by the U.S. Chamber of Commerce (Chamber) that seeks restrictions. Petitions to the SEC to issue, amend, or repeal an agency rule are authorized by Rule 192 of the SEC’s Rules of Practice.³⁸³ They are uncommon, have become more frequent in the last decade, and unlike the Chamber’s petition rarely address private securities litigation.³⁸⁴

378. See Kevin LaCroix, *COVID-19 Securities Suits Continue to Accumulate*, D&O DIARY (Apr. 25, 2021), <https://www.dandodiary.com/2021/04/articles/coronavirus/covid-19-securities-suits-continue-to-accumulate/> [<https://perma.cc/96GY-Q8QU>] (describing case categories).

379. See Rachel O’Brien, *AstraZeneca Hit with Investor Suit over COVID-19 Vaccine*, LAW360 (Jan. 29, 2021, 7:07 PM), <https://www.law360.com/articles/1350194> [<https://perma.cc/9BR5-6XS4>] (discussing pandemic EDSL against AstraZeneca); WILMERHALE, *COVID-19: Lessons from the Second Wave of Securities Fraud Class Actions* 9 (Oct. 28, 2020), <https://www.wilmerhale.com/en/insights/client-alerts/20201028-covid-19-lessons-from-the-second-wave-of-securities-fraud-class-actions> [<https://perma.cc/U7BL-YEY5>] (discussing pandemic EDSL against pharmaceutical companies).

380. See Dorothy Atkins, *Vaxart Buried Investors in ‘Avalanche of B.S.’ Judge Says*, LAW360 (Sept. 30, 2021, 5:30 PM), <https://www.law360.com/articles/1426908/vaxart-buried-investors-in-avalanche-of-b-s-judge-says> [<https://perma.cc/R2R3-ZJGC>] (reporting on oral argument on motion to dismiss in EDSL involving Vaxart).

381. Dean Seal, *Why a Surge of COVID-19 Securities Suits Hasn’t Happened*, LAW360 (Mar. 11, 2021, 9:07 PM), <https://www.law360.com/transportation/articles/1363829> [<https://perma.cc/A58E-FTUP>]; Robert Long, Elizabeth Clark & Alex Ingoglia, *What to Expect from Securities Litigation in 2021*, LAW360 (Jan. 11, 2021, 5:21 PM), <https://www.law360.com/articles/1339565> [<https://perma.cc/2YYC-VGFK>] (noting inaccuracy of early predictions concerning pandemic-related securities litigation).

382. See Dean Seal, *The Next Wave of COVID-19 Securities Litigation Is Building*, LAW360 (Jan. 3, 2021, 12:02 PM), <https://www.law360.com/articles/1338682/the-next-wave-of-covid-19-securities-litigation-is-building> [<https://perma.cc/3XJX-WMDM>] (noting significance of pandemic EDSL).

383. 17 C.F.R. § 201.192 (2021).

384. Joe Mont, *Want to Change an SEC Rule? Petition the Commission*, COMPLIANCE

The Chamber's petition provided a broad but shallow critique of EDSL, noted the continued rise of pandemic EDSL, and then identified supposed defects in the PSLRA's safe harbor provisions. The primary defects are that (1) various documents or transactions are expressly excluded from protection, including financial statements prepared according to generally accepted accounting principles, IPOs, and tender offers, and (2) the harbors are insufficient to deter the filing of meritless securities claims.³⁸⁵

The petition then urged the SEC to make at least three rule amendments. First, the Chamber asked the SEC to bar liability for statements about the impact of COVID-19 on a company's business, whether forward-looking or not, if suitable warnings were attached. Second, the Chamber cited *Omnicare* and alternatively requested that the SEC limit liability for all such statements to circumstances in which plaintiff can prove that the speaker had actual (subjective) knowledge of its falsity. Third, the Chamber requested that the SEC mandate the inclusion of certain warnings in financial statements—which are currently unprotected by the safe harbor—and then bar liability for claims based on statements that satisfy the warnings or treat them as the equivalent of opinions requiring proof of subjective knowledge of falsity in order to be actionable.³⁸⁶

The Chamber's rulemaking petition was misguided for numerous reasons. First, its hook was a mostly unfocused critique of EDSL. The Chamber's one specific criticism was that EDSL often relies upon the "tenuous" theory of materialization of risk,³⁸⁷ which requires plaintiffs to show loss causation by proving that the materialization of an undisclosed risk caused the alleged investment loss.³⁸⁸ But far from being a tenuous theory, it has been adopted or at least recognized by most of the Circuits.³⁸⁹

Second, the petition assumed that federal courts will be inundated with a wave of unjustified COVID-related EDSL. In fact, the surge of pandemic litigation has been less significant than many observers had predicted and, as of the date of the filing of the petition, no court had determined that any such lawsuit was non-meritorious. Third, whereas the petition also rested upon the dubious proposition that the PSLRA's safe harbor provisions

WEEK (Sept. 30, 2013, 8:00 PM), <https://www.complianceweek.com/want-to-change-an-sec-rule-petition-the-commission/3851.article> [<https://perma.cc/ZT5M-5FJS>] (describing petitions).

385. Letter from Harold Kim & Tom Quaadman to Vanessa Countryman, Sec'y, SEC, at 1–8 (Oct. 30, 2020), <https://institutelegalreform.com/petition-for-rulemaking-on-covid-19-related-litigation/> [<https://perma.cc/7DMH-8LZY>].

386. *Id.* at 9–10.

387. *Id.* at 4.

388. *McCabe v. Ernst & Young, L.L.P.*, 494 F.3d 418, 429 (3d Cir. 2007).

389. Booth, *supra* note 93, at 1792.

require revision, the Chamber provided virtually no support for this argument. Fourth, adoption of the proposed rule changes might encourage fraud, insofar as they overtly limit liability. Fifth, adoption would unwisely extend *Omnicare* to the contents of financial statements. Sixth, at least some of the proposed changes probably could—and should—only be accomplished legislatively. SEC rulemaking should not create a safe harbor for projections about the effect of the pandemic on operations and liquidity.

Some of the earliest pandemic EDSL targeted the cruise line industry and constituted a significant share of the first category of cases identified above. The cases, litigated against Carnival Cruise Line, Norwegian Cruise Line, and Royal Caribbean Cruises in the Southern District of Florida, are likely to serve as a barometer as to whether specific safety disclosures about the virus are actionable. Cruise case outcomes suggest that plaintiffs will encounter rough waters. As discussed below, in 2021 courts dismissed the actions against Carnival and Norwegian and plaintiffs voluntarily dismissed the Royal Caribbean suit.

One obvious defense tactic in pandemic EDSL is to challenge application of the FOTM theory. Post-*Basic*, if plaintiff-investors prove that their company's stock traded in an efficient market, they can invoke a presumption that the misstatement affected the stock price and they purchased the stock in reliance on the integrity of that price.³⁹⁰ Prior to class certification in a FOTM case defendant can rebut the *Basic* presumption by showing a lack of price impact, and any showing that severs the link between the alleged misrepresentation and the stock price decline will suffice.³⁹¹

Market volatility during the pandemic's early phase presents a rebuttal opportunity. From its historic peak of 3,3386.15 on February 19, 2020 the S&P 500 Index lost 34% of its value in approximately one month as the potential consequences of COVID-19 began to be incorporated into share prices, but by July 31, 2020 the Index had largely reversed its sharp decline.³⁹² This was the most dramatic quarter-to-quarter swing since 1932.³⁹³ An analysis published in November 2020 concluded that Carnival's common stock price drops on some of the alleged corrective disclosure dates

390. 485 U.S. at 247, 248 n.27.

391. *Halliburton Co. v. Erica P. John Fund, Inc.*, 573 U.S. 258, 268 (2014).

392. Andrew Roper & Clifford Ang, *How the Pandemic Is Changing Stock Volatility Calculations*, LAW360 (Sept. 15, 2020, 8:34 PM), <https://www.law360.com/articles/1307410/how-the-pandemic-is-changing-stock-volatility-calculations> [<https://perma.cc/2NW6-UVD> P].

393. John Schreiber & John Tschirgi, *Market Rebound May Curb Securities Class Actions, Damages*, LAW360 (July 31, 2020, 5:54 PM), <https://www.law360.com/articles/1295065/market-rebound-may-curb-securities-class-actions-damages> [<https://perma.cc/4ZL4-SEMP>].

were “fully explained by market and industry factors.”³⁹⁴

A second defense tool, related to the foregoing, is to argue an absence of loss causation based on an absence of price impact. Loss causation is a fact-based inquiry.³⁹⁵ If a market-wide event creates losses for most companies, and there is significant volatility—as in the early stages of the pandemic—it becomes increasingly more difficult for plaintiffs to prove causation. The 2007-08 financial crisis is instructive. Securities class action filings increased nearly 20% in 2008³⁹⁶ and the crisis litigation continued for more than a decade, with loss causation a frequently disputed issue. Multiple defendants prevailed on this issue during motion practice because their stock drops at the time of alleged corrective disclosures tracked market sector declines.³⁹⁷

The early stages of the pandemic caused the largest market decline since 2008³⁹⁸ and defendants in COVID-19 cases should take some solace from the prior litigation. Defendants should be reassured even though the pandemic cases are fundamentally different than the prior litigation, which

394. Atanu Saha & Yong Xu, *What Really Caused Carnival's COVID-19 Stock Drop?*, LAW360 (Nov. 9, 2020, 6:10 PM), <https://www.law360.com/articles/1326392> [<https://perma.cc/8WH9-AEKE>]. See also Jennifer Huckleberry, *Stock Market Volatility: The Death Knell of Section 10(b) Securities Fraud Class Certifications*, AM. BAR ASS'N (July 6, 2021), <https://www.americanbar.org/groups/litigation/committees/commercial-business/articles/2021/stock-market-volatility-section-10b-securities-fraud/> [<https://perma.cc/US2F-8REG>] (asserting that “[t]he 2020 stock market volatility, as a practical matter, eradicates plaintiffs’ ability to prove price impact”).

395. *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 174 (2d Cir. 2005).

396. TROUTMAN PEPPER HAMILTON SANDERS LLP, *The Inevitable Wave of COVID-19-Related Securities Litigation: What Public Companies Can Expect and Do to Prepare* (Apr. 6, 2020), <https://www.troutman.com/insights/the-inevitable-wave-of-covid-19-related-securities-litigation-what-public-companies-can-expect-and-do-to-prepare.html> [<https://perma.cc/RD65-YHGM>].

397. J. Timothy Mast, Pamela S. Palmer & Robert L. Hickok, *Operating in a Pandemic: Securities Litigation Risk and Navigating Disclosure Concerns*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 14, 2020), <https://corpgov.law.harvard.edu/2020/05/14/operating-in-a-pandemic-securities-litigation-risk-and-navigating-disclosure-concerns/> [<https://perma.cc/7RH8-UWEC>]. See also *In re Merrill Lynch & Co. Research Rep. Sec. Litig.*, 568 F. Supp. 2d 349, 365 (S.D.N.Y. 2008) (granting motion to dismiss in part because complaint failed to allege facts supporting inference that plaintiff’s losses were due to alleged securities fraud, rather than to collapse of Internet market sector); *Loreley Fin. (Jersey) No. 3 Ltd. v. Lynch*, No. 652732/2011, 2020 WL 2302989 (N.Y. Sup. Ct. Apr. 2, 2020) (granting summary judgment in favor of defendant Merrill Lynch and dismissing common law fraud claim arising out of investment in 2006 collateralized debt obligation arranged by defendant, because loss causation was not proven).

398. WILMER HALE, *COVID-19: An Early Look at Securities Act Litigation amid COVID-19* (May 8, 2020), <https://www.wilmerhale.com/en/insights/client-alerts/20200508-an-early-look-at-securities-act-litigation-amid-covid-19> [<https://perma.cc/4TS7-5E47>].

arose from systemic deception and was primarily confined to the financial and real estate sectors. As the Second Circuit observed, a “financial crisis may stand as an impediment to proving loss causation because it can be difficult to identify whether a particular misstatement or macroeconomic forces caused a security to lose value in the fog of a coincidental market-wide downturn.”³⁹⁹

The 2007-2008 crisis litigation confirmed that courts are generally hesitant to grant a motion to dismiss based on loss causation,⁴⁰⁰ and thus the argument probably must await subsequent stages of pandemic EDSL, when event studies can be deployed by the parties. Such studies—which constitute a statistical tool borrowed from financial economics—seek to determine whether a highly unusual price movement has occurred. If properly conducted, they rely on regression analysis to separate the price effect of information affecting only the defendant company from the price effect of information with broader implications for the overall stock market and defendant’s industry peers.⁴⁰¹

Event studies have become ubiquitous in modern securities fraud litigation,⁴⁰² playing a key role in analyzing market efficiency, price impact, loss causation, and damages notwithstanding their common misuse and multiple limitations.⁴⁰³ One pre-pandemic review concluded that “the existing event study methodology will predictably fail to find a statistically significant price impact in a substantial number of cases where actionable fraud really did occur.”⁴⁰⁴ Event studies will not inevitably preclude proof

399. Fed. Housing Fin. Agency v. Nomura Holding Am., Inc., 873 F.3d 85, 155 (2d Cir. 2017).

400. QUINN EMANUEL URQUHART & SULLIVAN, LLP, *Coronavirus Implications for Securities Litigation*, <https://www.quinnemanuel.com/media/semfs4ae/coronavirus-implications-for-securities-litigation-1.pdf> [<https://perma.cc/VV46-BVAR>] (last visited Oct. 12, 2021).

401. Allan W. Kleidon & Filipe Lacerda, *Event Studies and “Bellwether” Effects*, NAT’L L. REV. (Nov. 30, 2020), <https://www.natlawreview.com/article/event-studies-and-bellwether-effects> [<https://perma.cc/2VGL-UCCB>].

402. *In re Allergan PLC Sec. Litig.*, No. 18 Civ. 12089, 2021 WL 4077942, at *15 (S.D.N.Y. Sept. 8, 2021) (noting that event studies are the generally accepted method for measuring damages in securities fraud class actions); Perrie M. Weiner et al., *US Securities Class Actions*, CORPORATE DISPUTES, Oct.-Dec. 2019, at 69, 80 (“Event studies are commonly used and widely accepted in securities class actions.”).

403. See Jill E. Fisch, Jonah B. Gelbach & Jonathan Klick, *The Logic and Limits of Event Studies in Securities Fraud Litigation*, 96 TEX. L. REV. 553 (2018) (discussing limitations).

404. Jill E. Fisch, Jonah Gelbach & Jonathan Klick, *Toward a Better Understanding of Event Studies in Securities Litigation*, CLS BLUE SKY BLOG (Sept. 12, 2016), <https://clsbluesky.law.columbia.edu/2016/09/12/toward-a-better-understanding-of-event-studies-in-securities-litigation/> [<https://perma.cc/EH32-LGUH>].

of price impact or loss causation,⁴⁰⁵ but their constraints are magnified during periods of extreme market volatility⁴⁰⁶ and thus proof may be difficult to establish in COVID-19 EDSL. As noted *supra*, one event study determined that Carnival's common stock price drops at the time of corrective disclosure tracked market sector declines.

Because Securities Act section 11 and section 12(a)(2) do not require proof of scienter or loss causation,⁴⁰⁷ and such claims may be filed in state court, the Securities Act may offer a more fruitful path for plaintiffs to pursue pandemic EDSL. Section 11 provides a formula—constituting the exclusive method for calculations⁴⁰⁸—which provides that damages are generally measured by the difference between the price of the offering and the price on the date plaintiffs' complaint was filed.⁴⁰⁹ Defendants have a potential negative causation affirmative defense, which grants them the opportunity to disprove that a stock drop was caused by an alleged misstatement or omission.⁴¹⁰ The defense may be employed even in connection with a motion to dismiss, when negative causation is apparent on the face of the complaint.⁴¹¹ The defense is the mirror image of causation under section 10(b),⁴¹² so it may be as difficult for defendants to disprove causation under the Securities Act as it will be for EDSL plaintiffs to prove causation under the Exchange Act.⁴¹³ In general, however, the dismissal rate for section 10(b) cases involving already-public companies is significantly higher than it is for

405. See Dean Seal, *As Investor Suits Tick Up, Loss Causation May Be a Hard Sell*, LAW360 (May 4, 2020, 6:17 PM), <https://www.law360.com/articles/1269242> [<https://perma.cc/EF5T-KWYJ>] (noting existence of tools to disentangle effect of general market movements from effect of alleged securities fraud).

406. Michelle Levin & Ashwin Ram, *Securities Enforcement Activity in the COVID Era: A Backstop to Private Securities Litigation*, A.B.A. (Dec. 21, 2020), <https://www.americanbar.org/groups/litigation/committees/securities/articles/2020/securities-enforcement-activity-covid-19/> [<https://perma.cc/VP92-T72H>].

407. See, e.g., *In re Stac Elec. Sec. Litig.*, 89 F.3d 1399, 1404 (9th Cir. 1996) (“No scienter is required for liability under § 11; defendants will be liable for innocent or negligent material misstatements or omissions.”).

408. See *McMahan & Co. v. Warehouse Ent., Inc.* 65 F.3d 1044, 1048 (2d Cir. 1995) (rejecting attempt to seek benefit of the bargain damages).

409. See 15 U.S.C. § 77k(e) (setting forth damages formula).

410. See *id.* (setting forth defense).

411. Thad Behrens, Benjamin Goodman & Jasmine Tobias, *Seven on 11: Seven Avenues to Early Dismissal of Claims under Section 11 of the Securities Act*, 50 SEC. REG. L. REP. 641 (Apr. 30, 2018).

412. *Lau v. Opera Ltd.*, No. 20-cv-674, 2021 WL 964642, at *14 (S.D.N.Y. Mar. 13, 2021) (“Courts have recognized that the negative loss causation affirmative defense in the Section 11 context and the loss causation element of Section 10(b) claims are ‘mirror images.’”).

413. Scott A. Edelman et al., *Securities Class Actions Arising from the COVID-19 Pandemic* (Apr. 21, 2020), <https://www.milbank.com/en/news/securities-class-actions-arising-from-the-covid-19-pandemic.html> [<https://perma.cc/USD9-TSWU>].

sections 11 and 12 cases involving IPOs. Among securities cases filed from 2010–2019, the dismissal rate for the former is 56% and for the latter it is 39%.⁴¹⁴

Third, defendants can argue that their alleged misstatements are mere puffery, expressions of corporate optimism, or forward-looking statements protected by the PSLRA’s safe harbor.⁴¹⁵ In the first disposition of pandemic EDSL, in January 2021 a federal district court in California dismissed a section 11 case after concluding that statements in defendants’ offering documents were mere puffery.⁴¹⁶ The court also rejected plaintiff’s arguments concerning Items 303 and 105, primarily because the complaint failed to allege that defendants could have anticipated the extent of the pandemic at the time of their January 2020 IPO.⁴¹⁷

Similarly, in April 2021 a federal district court in Florida dismissed consolidated pandemic EDSL against Norwegian Cruise Line, in part because the alleged material misrepresentations were mere puffery.⁴¹⁸ Oddly, in the course of its discussion the court suggested that Norwegian’s statements about marketing strategies during the pandemic could not have been deceptive because they aligned with pronouncements about COVID-19 made by then-President Donald Trump.⁴¹⁹ Unsurprisingly, the court provided no legal support for its remarkable suggestion. Equally inexplicable is a November 2021 decision by a federal district court in California dismissing pandemic EDSL against the biopharmaceutical company Sorrento Therapeutics, albeit with leave to amend. The consolidated complaint had alleged that Sorrento and two executives misled investors with several statements about the success of a COVID-19 antibody when the product was still in a preclinical testing stage.⁴²⁰ According to the dismissal order, a statement by Sorrento’s CEO that “[t]here is a cure. There

414. Michael Klausner, Jason Hegland, Stone Kalisa & Sam Curry, *Guest Post: IPO Litigation Risk*, D&O DIARY (June 28, 2021), <https://www.dandodiary.com/2021/06/articles/securities-litigation/guest-post-ipo-litigation-risk/> [<https://perma.cc/CDQ7-LR76>].

415. Jason Halper, Nathan Bull & Matthew Karlan, *Anticipated Securities Litigation in Response to the Pandemic*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 3, 2020), <https://corpgov.law.harvard.edu/2020/05/03/anticipated-securities-litigation-in-response-to-the-pandemic/> [<https://perma.cc/R9S-PHKR>].

416. *Berg v. Velocity Fin., Inc.*, No. 2:20-cv-06780, 2021 WL 268250, at *3–9 (C.D. Cal. Jan. 25, 2021).

417. *Id.* at *9–10.

418. *Douglas v. Nor. Cruise Lines*, No. 20-21109, 2021 WL 1378296 (S.D. Fla. Apr. 12, 2021).

419. *Id.*

420. Order Granting Defendants’ Motion to Dismiss Plaintiff’s Class Action Complaint 2, *In re Sorrento Therapeutics, Inc. Sec. Litig.*, No. 20-cv-009666-AJB-DEB (S.D. Cal. Nov. 18, 2021).

is a solution that works 100 percent” was a non-actionable statement of corporate optimism.⁴²¹ It is difficult to understand this characterization.

Forward-looking statements are protected by the PSLRA when future risks are addressed explicitly and specifically. The safe harbor protected some defendants in connection with securities litigation stemming from the 2008 financial crisis,⁴²² but other defendants were left unprotected, where the allegedly misleading disclosures were statements of present risk factors, rather than forward-looking predictions about future events.⁴²³ Likewise, statements about a company’s present ability to handle COVID-19 may not be shielded by the safe harbor if they constitute a mix of present fact and future events,⁴²⁴ and forward-looking statements are highly unlikely to be protected if the accompanying cautionary language is generic.⁴²⁵ In February 2021 a federal district court handling consolidated pandemic EDSL in Pennsylvania against biotechnology firm Inovio Pharmaceuticals and its top executives mostly denied a motion to dismiss and mostly rejected application of the safe harbor because the subject statements or omissions were of present facts concerning defendants’ then-current capacity to manufacture vaccines.⁴²⁶ Plaintiffs subsequently moved for class certification in July 2021.⁴²⁷ Conversely, in *Norwegian Cruise Line* the court applied the safe harbor, even though defendants’ challenged statements related to historical and contemporaneous acts, because they rolled into forecasts of future action.⁴²⁸ And in September 2021 a federal district court partially granted and partially denied a motion to dismiss in pandemic EDSL involving a private prison defendant, after determining that many of the subject statements were forward-looking, classic puffery—”generalized, vague,

421. *Id.* at 13.

422. *See, e.g.,* *Police Ret. Sys. of St. Louis v. Intuitive Surgical, Inc.*, 759 F.3d 1051 (9th Cir. 2014) (affirming dismissal of complaint with prejudice).

423. *See, e.g., In re Bear Stearns Cos. Sec., Derivative & ERISA Litig.*, 763 F. Supp. 2d 423, 493 (S.D.N.Y. 2011) (granting in part and denying in part motion to dismiss).

424. *See, e.g., In re Quality Sys., Inc. Sec. Litig.*, 865 F.3d 1130, 1146–48 (9th Cir. 2017) (holding that mixed statements were actionable and reversing dismissal of action).

425. *See, e.g., In re Bear Stearns Cos. Sec., Derivative & ERISA Litig.*, 763 F. Supp. 2d 423, 495 (S.D.N.Y. 2011) (holding that cautionary language was generic and denying motion to dismiss in part).

426. *McDermid v. Inovio Pharm., Inc.*, No. 20-01402, 2021 WL 601159, at *8 (E.D. Pa. Feb. 16, 2021).

427. Memorandum of Law in Support of Plaintiffs’ Motion for Class Certification, *McDermid v. Inovio Pharm., Inc.*, No. 20-01402-GJP (E.D. Pa. July 29, 2021).

428. *Douglas v. Nor. Cruise Lines*, No. 20-21109, 2021 L 1378296 (S.D. Fla. Apr. 12, 2021).

428. *Id.*

nonquantifiable statements of corporate optimism,” or both.⁴²⁹

Fourth, defendants can rebut scienter allegations, in part by referencing evolving advice from the Centers for Disease Control regarding COVID-19 and asserting that plaintiffs are arguing fraud by hindsight.⁴³⁰ Prior public health crises, such as the 2014 Ebola outbreak and the 2004 H5N1 avian flu outbreak, generated securities class action litigation against biotechnology companies and medical equipment manufacturers for allegedly making false and misleading statements regarding vaccines, drugs, and medical equipment intended to stem the crises. A scienter-based argument by defendants was successful in securities litigation involving the Ebola virus.⁴³¹ Similarly, in May 2021 the federal district court dismissed the COVID-19 cruise line EDSL pending against Carnival—the world’s largest cruise ship company—in large part because plaintiffs failed to adequately plead scienter.⁴³²

Fifth, defendants can minimize potential damages under the PSLRA’s bounce-back provision, which caps damages at the difference between plaintiff’s purchase price and the mean trading price of the security during the ninety days following a corrective disclosure. If plaintiff sells before the ninety days, damages are capped at the difference between the purchase price and the mean trading price between the disclosure date and the sale date.⁴³³

The bounce-back provision was intended to limit a plaintiff’s damages to losses actually caused by the securities fraud or violation—as opposed to unrelated market conditions—by allowing the market to incorporate all relevant information and the stock price to adjust accordingly. The provision thus functions as a rescissory cap on out-of-pocket damages in securities litigation by affording the security an opportunity to recover.⁴³⁴ It can have a major impact on damages, especially when the stock price appreciates after the class period ends.

Post-PSLRA the contours of the bounce-back provision have rarely

429. *Hartel v. GEO Grp., Inc.*, No. 20-81063, 2021 WL 4397841, at *11 (S.D. Fla. Sept. 23, 2021).

430. See Edward J. “Ted” Bennett, Amanda M. McDonald & John S. Williams, *Defending Against Covid-19 Related Securities Class Actions*, BLOOMBERG LAW (Mar. 25, 2021, 4:01 AM), <https://news.bloomberglaw.com/class-action/defending-against-covid-19-related-securities-class-actions> [<https://perma.cc/9929-NB6Q>] (asserting that COVID-19 health information has been in flux and plaintiffs cannot argue fraud by hindsight).

431. See *Jackson v. Halyard Health, Inc.*, No. 16-CV-05093-LTS, 2018 WL 1621539 (S.D.N.Y. Mar. 30, 2018) (granting motions to dismiss amended class action complaint).

432. Order at 30-33, *In re Carnival Corp. Sec. Litig.*, No. 1:20-cv-22202 (S.D. Fla. May 28, 2021).

433. 15 U.S.C. § 78u-4(e)(1)-(2).

434. *In re Veritas Software Corp. Sec. Litig.*, 496 F.3d 962, 967 n.3 (9th Cir. 2007).

been adjudicated. In 2021 one of the few courts to ever apply the provision held in cybersecurity EDSL against Zoom that if there are multiple corrective disclosures there are multiple relevant look-back periods. Damages can be calculated based on an initial or a last partial corrective disclosure preceding the date that a specific plaintiff sold its shares, subject to the discretion of the court.⁴³⁵ Such an approach has the potential to significantly favor defendants by sharply reducing settlement values. In some suits the bounce-back provision can eradicate available damages.⁴³⁶

The bounce-back is somewhat inconsistent with *Basic*'s rationale, insofar as the implied premise that it requires 90 days for the market to incorporate all relevant information is incompatible with the notion of an efficient market.⁴³⁷ Nevertheless, the cap remains part of the PSLRA's quarter-century legacy. The provision was rarely invoked and rarely applicable pre-COVID-19 but it could function as a key defense tool in pandemic EDSL.⁴³⁸ Defendants can use the bounce-back early in the litigation, because a court may take judicial notice of stock price movement without converting a motion to dismiss to a motion for summary judgment.⁴³⁹ Many of the COVID securities cases began on porous ground, insofar as they were filed following modest stock price drops⁴⁴⁰ and/or proposed short class periods based on the proximity of the filings to the outbreak of the virus.⁴⁴¹ The bounce-back provision could further minimize potential damages and settlement values in these and other pandemic actions.

Likely in recognition of some of the foregoing obstacles, in February

435. See *In re Zoom Sec. Litig.*, No. 20-cv-02353-JD, 2021 WL 1375854 (N.D. Cal. Apr. 12, 2021) (denying motion for reconsideration).

436. See *In re Mego Fin. Corp. Sec. Litig.*, 213 F.3d 454, 461 (9th Cir. 2000) (observing that recoverable damages would be zero if mean trading price of security during 90-day period following corrective disclosure is greater than plaintiff's purchase price).

437. See Joseph A. Grundfest, *Damages and Reliance Under Section 10(b) of the Exchange Act*, 69 BUS. LAW. 307, 351 (2014) (advancing this argument).

438. Schreiber & Tschirgi, *supra* note 393.

439. See, e.g., *ScripsAmerica, Inc. v. Ironridge Global LLC*, 119 F. Supp. 3d 1213, 1232 (C.D. Cal. 2015) (taking judicial notice without converting motion to dismiss).

440. See Kevin LaCroix, *Tyson Foods Hit with COVID-19-Related Securities Suit*, D&O DIARY (Feb. 2, 2021), <https://www.dandodiary.com/2021/02/articles/coronavirus/tyson-foods-hit-with-covid-19-related-securities-suit/#> [<https://perma.cc/2S3G-Y63V>] (noting 2.5% price drop); Kevin LaCroix, *AstraZeneca Hit with Securities Suit over COVID-19 Vaccine Development Setbacks*, D&O DIARY (Jan. 27, 2021), <https://www.dandodiary.com/2021/01/articles/coronavirus/astrazeneca-hit-with-securities-suit-over-covid-19-vaccine-development-setbacks/> [<https://perma.cc/GL32-82V9>] (noting 5% price drop).

441. See Kevin LaCroix, *Biotech Company Hit with COVID-19-Related Securities Suit*, D&O DIARY (Mar. 18, 2021), <https://www.dandodiary.com/2021/03/articles/coronavirus/biotech-company-hit-with-covid-19-related-securities-suit/> [<https://perma.cc/3AJ4-M4TU>] (discussing pandemic EDSL).

2021 plaintiffs voluntarily dismissed (without prejudice) their pandemic EDSL against Royal Caribbean.⁴⁴² Voluntary dismissals are uncommon in traditional non-merger objection securities class action litigation,⁴⁴³ and this development thus signals a concession that the path to success against the cruise line was too steep.

COVID-19 EDSL has been accompanied by SEC activity via the issuance of guidance and the commencement of enforcement proceedings. The DOJ has been less active than the SEC in this space. In March 2020 the SEC's Division of Corporation Finance issued nonbinding guidance encouraging companies to disclose the risks and effects of COVID-19 and explain how the company and management are responding to such risks.⁴⁴⁴ The guidance recommended that companies assess how COVID-19 has affected their present and future operations by considering a non-exhaustive list of ten topics that constitute the same types of disclosures that pandemic EDSL plaintiffs are likely to focus on.⁴⁴⁵ The document also noted, somewhat equivocally, that many COVID-19 disclosures may be subject to the PSLRA's safe harbor.⁴⁴⁶ In April 2020 the SEC issued a public statement urging companies "to provide as much information as practicable regarding their current financial and operating status, as well as their future operational and financial planning."⁴⁴⁷ And in June 2020 the Division of Corporation Finance issued updated guidance.⁴⁴⁸

It has been suggested that the SEC's disclosure guidance constitutes a "litigation trap"⁴⁴⁹ and much of the pandemic private securities litigation to date would not have occurred absent issuance of the documents by the

442. Notice of Voluntary Dismissal Without Prejudice, *City of Riviera Beach Gen. Emp. Ret. Sys. v. Royal Caribbean Cruises Ltd.*, No. 1:20-cv-24111 (S.D. Fla. Feb. 25, 2021).

443. Kevin LaCroix, *Coronavirus-Related Securities Suit Against Royal Caribbean Voluntarily Dismissed*, D&O DIARY (Mar. 11, 2021), <https://www.dandodiary.com/2021/03/articles/coronavirus/coronavirus-related-securities-suit-against-royal-caribbean-voluntarily-dismissed/#> [<https://perma.cc/B2EU-KQE3>].

444. *CF Disclosure Guidance: Topic No. 9*, U.S. SEC. AND EXCH. COMM'N, DIV. OF CORP. FIN. (Mar. 25, 2020), <https://www.sec.gov/corpfin/coronavirus-covid-19> [<https://perma.cc/U7TY-473B>].

445. *Id.*

446. *Id.*

447. Jay Clayton & William Hinman, *The Importance of Disclosure—For Investors, Markets and Our Fight Against COVID-19* (Apr. 8, 2020), <https://www.sec.gov/news/public-statement/statement-clayton-hinman> [<https://perma.cc/J9QT-BQTK>].

448. *CF Disclosure Guidance: Topic No. 9A*, U.S. SEC. AND EXCH. COMM'N, DIV. OF CORP. FIN. (June 23, 2020), <https://www.sec.gov/corpfin/covid-19-disclosure-considerations> [<https://perma.cc/MNE4-G9AK>].

449. Andrew N. Vollmer, *The SEC's COVID-19 Disclosure Guidance Is a Litigation Trap*, CLS BLUE SKY BLOG (June 4, 2020), <https://clsbluesky.law.columbia.edu/2020/06/04/t-he-secs-covid-19-disclosure-guidance-is-a-litigation-trap/> [<https://perma.cc/EVW7-TQCF>].

Commission.⁴⁵⁰ Such suggestions are hyperbolic but not meritless. Pre-COVID very few companies made specific risk-factor disclosure concerning a pandemic's potential impact on their business.⁴⁵¹ Form 10-Q requires companies to disclose any material changes to the risk factors that were included in their Annual Report on Form 10-K. A review by Ernst & Young of Fortune 100 companies found that 90% included at least one new COVID-19 risk factor in their 10-Q filings between February 1 and May 31, 2020⁴⁵² and a separate review of the SEC filings by 3,644 publicly traded companies in the United States found that virtually every company (99.6%) made some level of pandemic disclosure by May 29, 2020.⁴⁵³ COVID-era disclosures encouraged by the SEC may be identified by plaintiffs as revealing prior material omissions or the disclosures may be characterized as misleading.⁴⁵⁴

The SEC's activity has not been confined to the issuance of disclosure guidance. In fiscal year 2020 the SEC opened more than 150 COVID-related inquiries or investigations⁴⁵⁵ and by July 2021 it had commenced a modest nine enforcement actions.⁴⁵⁶ Most of the actions targeted microcap and penny stock issuers engaged in routine pump-and-dump schemes based on false claims and misleading statements concerning COVID-19 tests and

450. See Robert Long, Elizabeth Clark & Alex Ingoglia, *What to Expect from Securities Litigation in 2021*, LAW360 (Jan. 11, 2021, 5:21 PM), <https://www.law360.com/articles/1339565> [<https://perma.cc/9LQD-394M>] (advancing this argument).

451. J. Timothy Mast, Pamela S. Palmer & Robert L. Hickok, *Operating in a Pandemic: Securities Litigation Risk and Navigating Disclosure Concerns*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 14, 2020), <https://corpgov.law.harvard.edu/2020/05/14/operating-in-a-pandemic-securities-litigation-risk-and-navigating-disclosure-concerns/> [<https://perma.cc/8R5G-D8P9>].

452. Pamela L. Marcogliese, Michael Levitt & Amy Fisher, *First Quarter Disclosure Trends and Second Quarter Disclosure Expectations*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 29, 2020), <https://corpgov.law.harvard.edu/2020/07/29/first-quarter-disclosure-trends-and-second-quarter-disclosure-expectations/> [<https://perma.cc/TZ36-6KKR>].

453. Daniel J. Taylor, *The Spread of Covid-19 Disclosure*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 8, 2020), <https://corpgov.law.harvard.edu/2020/07/08/the-spread-of-covid-19-disclosure/> [<https://perma.cc/V89D-FPW5>].

454. See Zelichov & Costley, *supra* note 374.

455. U.S. SEC. AND EXCH. COMM'N, DIV. OF ENF'T, 2020 ANNUAL REPORT 11–12 (2020), <https://www.sec.gov/files/enforcement-annual-report-2020.pdf> [<https://perma.cc/3K35-AXYV>].

456. Kevin LaCroix, *SEC Files COVID-19-Related Enforcement Action Against Digital Health Firm*, D&O DIARY (July 8, 2021), <https://www.dandodiary.com/2021/07/articles/coronavirus/sec-files-covid-19-related-enforcement-action-against-digital-health-firm/#> [<https://perma.cc/AN72-2MWY>]. See, e.g., Press Release No. 2021-120, U.S. Sec. & Exch. Comm'n, SEC Charges Company and Two Executives for Misleading COVID-19 Disclosures (July 7, 2021), <https://www.sec.gov/news/press-release/2021-120> [<https://perma.cc/4GWP-39WZ>] (announcing no-admit settlement, for aggregate \$185,000, of charges concerning misleading statements by digital health care company about COVID-19 screening test and PPE).

personal protective equipment (PPE).⁴⁵⁷ The SEC's enforcement focus was expected to continue as the pandemic persisted,⁴⁵⁸ and the Commission's December 2020 no-admit settlement with The Cheesecake Factory hinted at a new phase. This action—unlike the prior microcap cases—involved alleged violations of section 13(a) of the Exchange Act stemming from the issuance of materially misleading disclosures about the risk that the pandemic posed to the company's operations.⁴⁵⁹ Specifically, The Cheesecake Factory stated publicly that its restaurants were operating sustainably during the pandemic while its internal documents showed that it was losing approximately \$6 million in cash per week and that it projected it had only sixteen weeks of cash remaining. This was the SEC's first significant pandemic enforcement action, but by late-2021 it had not proven to be a harbinger of future actions against other mid- or large-cap companies.⁴⁶⁰

Pandemic-related cases comprise a significant sector of event-driven securities litigation. The next section of this Article considers EDSL in an entirely different sphere.

B. Cannabis

Another contribution to the ascent of EDSL is cannabis securities litigation, which has proliferated since 2018. Cannabis-related businesses (CRBs) historically lacked access to traditional sources of financing,⁴⁶¹ primarily because marijuana has been classified since 1970 as a Schedule I drug under the federal Controlled Substances Act.⁴⁶² Circumstances changed

457. Kevin LaCroix, *Canadian Testing Company Hit with COVID-19-Related Securities Suit*, D&O DIARY (Dec. 20, 2020), <https://www.dandodiary.com/2020/12/articles/coronavirus/canadian-testing-company-hit-with-covid-19-related-securities-suit/> [https://perma.cc/94BP-TC9Z].

458. See Giovanni A. Ferrari et al., *Event-Driven Securities Litigation in the Age of COVID-19*, SEYFARTH SHAW LLP (June 11, 2020), <https://www.seyfarth.com/news-insights/event-driven-securities-litigation-in-the-age-of-covid-19.html> [https://perma.cc/VHD9-XQ42] (predicting future pandemic EDSL and SEC enforcement actions).

459. Press Release No. 2020-306, U.S. Sec. and Exch. Comm'n, *SEC Charges the Cheesecake Factory for Misleading COVID-19 Disclosures* (Dec. 4, 2020), <https://www.sec.gov/news/press-release/2020-306> [https://perma.cc/6USZ-P8A7].

460. Robert Long & Elizabeth Clark, *Lessons from COVID Securities Rulings on Dismissal Bids*, Law360 (May 19, 2021, 4:49 PM), <https://www.law360.com/articles/1385862> [https://perma.cc/L3QF-HJZ5].

461. Chris Gismondi & Wendy Michael, *Feeling the Burn? The Plaintiffs' Securities Bar Has Set Its Sights on the Cannabis Industry*, N.Y. L.J., May 15, 2020, <https://www.law.com/newyorklawjournal/2020/05/15/feeling-the-burn-the-plaintiffs-securities-bar-has-set-its-sights-on-the-cannabis-industry/> [https://perma.cc/KW5H-38AT].

462. Comprehensive Drug Abuse Prevention and Control Act of 1970, Pub. L. No. 91-

with passage by Congress of the Agriculture Improvement Act of 2018⁴⁶³ (which decriminalized the cultivation of hemp), the legalization of adult-use recreational cannabis in Canada in 2018,⁴⁶⁴ and the accelerating legalization of medical and recreational cannabis products by individual states. By 2021 an estimated one in three Americans resided in a state with legalized recreational marijuana.⁴⁶⁵ The total economic impact from cannabis sales in the United States was projected to reach \$92 billion in 2021 and spike to \$160 billion in 2025.⁴⁶⁶ The confluence of these developments has spurred numerous CRBs—typically ancillary non-plant touching businesses—to sell shares on the NYSE and Nasdaq, and other corporations already listed on the U.S. exchanges have entered the industry.⁴⁶⁷

The advent of publicly traded cannabis corporations has attracted the attention of the plaintiffs’ securities bar, which has filed an increasing number of lawsuits alleging violations of the federal securities laws following declines in the share price for the companies. Cannabis securities class action litigation commenced in 2014⁴⁶⁸ and by March 2022 there had been at least 33 such filings.⁴⁶⁹ Twenty-three of them occurred during 2019–2021.⁴⁷⁰ This accelerating trend is expected to continue, driven in large part by industry growth, stock price volatility,⁴⁷¹ regulatory uncertainty,⁴⁷² and the

513, 84 Stat. 1236 (1970).

463. Agriculture Improvement Act of 2018, Pub. L. No. 115-334 § 10113, 132 Stat. 4490, 4908-14 (2018).

464. See Peter Bowal, Kathryn Kisska-Schulze, Richard Haigh & Adrienne Ng, *Regulating Cannabis: A Comparative Exploration of Canadian Legalization*, 57 AM. BUS. L.J. 677 (2020) (discussing legalization in Canada).

465. Stephanie Zimmerman, *A Green Wave: Successful Ballot Measures for Marijuana and Other Substances Create Opportunities for Lawyers*, 107 A.B.A J. 16, 16 (2021).

466. Andrew Long, *Marijuana Industry Expected to Add \$92 Billion to U.S. Economy in 2021*, MJBIZDAILY (May 11, 2021), <https://mjbizdaily.com/marijuana-industry-expected-to-add-92-billion-to-us-economy-in-2021/?cn-reloaded=1> [<https://perma.cc/JC2X-QJ3N>].

467. Gismondi & Michael, *supra* note 461.

468. Robert Becher & Colin Gillespie, *Quinn Emanuel Cannabis Litigation Practice Alert: Recent Stock Drop Securities Actions in the Cannabis Industry*, QUINN EMANUEL URQUHART & SULLIVAN, LLP (2019), <https://www.quinnemanuel.com/media/0gkbyflg/cannabis-securities-action.pdf> [<https://perma.cc/Y9PY-T5L7>].

469. STAN. L. SCH., *Securities Class Action Clearinghouse, Current Trends in Securities Class Action Filings, Cannabis*, <https://securities.stanford.edu/current-trends.html> [<https://perma.cc/ZES6-6ACU>] (last visited Mar. 23, 2022).

470. *Id.*

471. Stephen Lenn, *Is There a Pot-Com Bubble on the Horizon?*, 34 WESTLAW J. CORP. OFFICERS & DIRS. LIAB. (2019) (“Public cannabis stocks have been and will likely continue to be volatile. . .”).

472. Gismondi & Michael, *supra* note 461; Jeff Smith, *As Marijuana Class Action Lawsuits Surge, Experts Stress Accurate, Forthright Disclosures*, MARIJUANA BUS. DAILY (June 25, 2020), <https://mjbizdaily.com/how-marijuana-companies-can-avoid-class-action->

increasing number of public offerings in the cannabis sector. Many of the class actions to date have been piloted by the same small group of emergent plaintiffs' firms that is responsible for EDSL's overall ascent.⁴⁷³ The cannabis industry also has experienced multiple shareholder derivative actions.⁴⁷⁴ The substantial liability exposure for CRB management in class and derivative actions has been largely uninsured or underinsured.⁴⁷⁵

The cannabis EDSL trend reflects the broader phenomenon of expanding securities class action litigation against life sciences companies. In 2017 and 2018 approximately 20% of securities class action suits were filed against life sciences companies and by 2019 this share had increased to approximately 25%.⁴⁷⁶ In 2019 the number of such actions filed against life sciences companies reached historic levels. Plaintiffs filed ninety-seven securities class action lawsuits against life sciences companies that year⁴⁷⁷ and 9% of the actions were commenced against CRBs.⁴⁷⁸ Filings against life sciences companies declined to 80 in 2020, consistent with the overall pandemic-induced reduction that year, but still accounted for approximately 25% of all securities class action filings.⁴⁷⁹

As noted *supra*, life sciences companies are desirable targets for securities class action plaintiffs for multiple reasons, including the companies' high degree of regulation by the FDA.⁴⁸⁰ EDSL against CRBs

lawsuits/ [https://perma.cc/M8HS-WZWT].

473. See, e.g., *Lawless v. Aurora Cannabis Inc.*, No. 20-13819, 2021 WL 3856158 (D.N.J. Aug. 27, 2021) (appointing Pomerantz LLP and The Rosen Law Firm as co-lead counsel in putative securities class action against Aurora Cannabis Inc.); Kevin LaCroix, *A Rash of Cannabis-Related Securities Class Action Lawsuits*, D&O DIARY (Nov. 25, 2019), <https://www.dandodiary.com/2019/11/articles/securities-litigation/a-rash-of-cannabis-related-securities-class-action-lawsuits/> [https://perma.cc/ZC4M-M6MK] (“[A]ll of the 2019 cannabis-related lawsuits have been filed by the small group of plaintiffs’ firms euphemistically referred to as the ‘emerging law firms’ that have been such a significant factor contributing to the elevated levels of securities litigation.”).

474. See, e.g., Complaint, *Janis v. Earle*, No. 20-cv-00193 (N.D. Okla. May 7, 2020) (alleging, *inter alia*, that CEO of CRB Upper Street Marketing mismanaged the company and attempted to transfer its assets into another entity that he owned).

475. Kimberly E. Blair, Jonathan E. Meer & Ian A. Stewart, *Cannabis Directors and Officers Liability: Cause for Optimism?*, WILSON ELSE (July 7, 2021), <https://www.mondaq.com/unitedstates/cannabis-hemp/1088586/cannabis-directors-and-officers-liability-cause-for-optimism-> [https://perma.cc/Z6UN-QK8T].

476. David H. Kistenbroker, Joni S. Jacobsen & Angela Liu, *Insight: Life Sciences Companies Targeted for Securities Class Actions*, BLOOMBERG L. (Mar. 13, 2020, 4:00 AM), <https://news.bloomberglaw.com/us-law-week/insight-life-sciences-companies-targeted-for-securities-class-actions-1> [https://perma.cc/C5Q8-U5Q8].

477. *Id.*

478. *Id.*

479. See *Dechert 2021 Survey*, *supra* note 127, at 4 n.7.

480. Nicki Locker & Laurie B. Smilan, *2019 Life Sciences Securities Litigation Roundup*,

shares aspects of litigation against other companies in the life sciences sector, insofar as the cases often focus on defendants' communications with, and responses to actions by, the FDA.⁴⁸¹

Most of the cannabis EDSL has been filed pursuant to section 10(b) and Rule 10b-5, but other actions have included section 11 claims. The complaints usually center on disclosures related to operations, transactions, financial guidance, financial restatements, and internal controls.⁴⁸² Many of them allege that the CRB made affirmative misrepresentations about earnings prospects, or knowingly failed to disclose the minimal demand for its products,⁴⁸³ the full risk of regulatory hurdles,⁴⁸⁴ and reductions in revenue.⁴⁸⁵

Motions to dismiss are standard practice in cannabis EDSL, just as they are in other industry sectors. Motions involving section 10(b) claims frequently focus on plaintiffs' thin scienter allegations.⁴⁸⁶ Plaintiffs in cannabis cases often attempt to satisfy the scienter requirement by alleging that CRB officers had access to the truth by virtue of their executive positions within the companies, but intentionally or recklessly failed to disclose this information to CRB shareholders.⁴⁸⁷ This is an arduous pleading path. Analogous allegations in numerous non-cannabis cases were found insufficient unless plaintiffs specifically identified the reports or statements setting forth the allegedly true information.⁴⁸⁸ Thus, in EDSL involving CRB

WILSON SONSINI (Apr. 28, 2020), <https://www.wsgr.com/en/insights/2019-life-sciences-securities-litigation-roundup.html> [<https://perma.cc/W26W-YP82>].

481. Jack Queen, *Pot Investor Class Actions Doubled in Past Year*, LAW360 (Apr. 24, 2020, 4:15 PM), <https://www.law360.com/articles/1266979/pot-investor-class-actions-doubled-in-past-year> [<https://perma.cc/8FBD-XCKK>].

482. Michael Jones & Adanna Uwazurike, Goodwin Procter LLP, *Update on Securities Litigation Against Cannabis Companies* 5 (2020), <https://www.goodwinlaw.com/files/PracticeReports/Cannabis-2020-YIR/flipbook/index.html?page=1> [<https://perma.cc/WDQ8-X5TG>].

483. *See, e.g.*, Jack Queen, *Investors Press Canopy on Alleged Lies about Pot Demand*, LAW360 (Jan. 8, 2021, 9:17 PM), <https://www.law360.com/classaction/articles/1342825> [<https://perma.cc/4FLQ-JERB>].

484. *See, e.g.*, Complaint at 8, *In re Curaleaf Holdings Inc. Sec. Litig.*, No. 1:19-cv-04486 (E.D.N.Y. Aug. 5, 2019) (alleging that defendant Curaleaf, a CRB trading on the over-the-counter (OTC) market, failed to disclose that its products had not received regulatory approval).

485. *See, e.g.*, Complaint, *Ganovsky v. Tilray, Inc.*, No. 20-cv-01240 (E.D.N.Y. Mar. 6, 2020) (alleging that defendant misled investors by overstating the value of an agreement with a third-party vendor). This action was voluntarily dismissed in 2020.

486. Gismondi & Michael, *supra* note 461.

487. Gideon Mark & Laurie A. Lucas, *Symposium, Cannabis—Legal, Ethical, and Compliance Issues: Introduction*, 57 AM. BUS. L.J. 651, 672 (2020).

488. *See, e.g.*, *Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital, Inc.*, 531 F.3d 190, 196 (2d Cir. 2008) (holding that plaintiffs must specifically identify reports or

Tilray, Inc., the court granted a motion to dismiss in 2021 after observing that “scienter cannot simply be presumed from a defendant’s organizational role or professional expertise”⁴⁸⁹ and completely discounting allegations from a CW.⁴⁹⁰ Similarly, in litigation against Canopy Growth—the largest Canadian CRB—the federal district court dismissed plaintiffs’ second amended complaint in 2021 after discounting information provided by a CW and concluding that plaintiffs failed to adequately allege scienter.⁴⁹¹

Adequately alleging a material misrepresentation or omission is another steep hurdle for plaintiffs in cannabis EDSL, whether under section 10(b) or section 11. In July 2021 the New Jersey federal district court dismissed without prejudice the first amended complaint against Canadian CRB Aurora—which alleged a section 10(b) claim following a 12% stock price drop—in large part because the company had adequately disclosed the risks associated with an oversupplied market, the lack of sufficient retail stores, and a robust black market.⁴⁹² Likewise, a New York trial court, relying on federal precedent, dismissed section 11 litigation against Canadian CRB Sundial Growers in large part because Sundial had included a robust 35-page risk disclosure section in its prospectus. The court concluded that Sundial had disclosed the exact type of risk underpinning plaintiffs’ complaint—specifically, that risks are inherent in the agricultural sector and even when cultivating cannabis indoors, crops are vulnerable to the elements.⁴⁹³

The decision in *Sundial Growers* highlights another obstacle—common in post-IPO securities suits—confronted by cannabis plaintiffs in adequately alleging a material misrepresentation or omission. The decision concluded that the statements by defendant Sundial identified by plaintiff as false or misleading were corporate puffery, mere expressions of corporate optimism,

statements containing relevant information); *Industriens Pensionsforsikring A/S v. Becton, Dickinson & Co.*, No. 20-cv-02155, 2021 WL 4191467, at *19 (D.N.J. Sept. 15, 2021) (“Courts routinely reject allegations that a defendant’s ‘position’ within a company, even an important position, creates an inference of scienter.”); *Set Cap. LLC v. Credit Suisse Gr. AG*, 18 Civ. 2268 (AT) (SN), 18 Civ. 2319 (AT) (SN), 18 Civ. 4045 (AT) (SN), 2019 WL 4673433, at *6 (S.D.N.Y. Sept. 25, 2019) (holding that plaintiffs must specifically identify reports or statements containing relevant information).

489. *Kasilingham v. Tilray, Inc.*, No. 20-cv-03459, 2021 WL 4429788, at *9 (S.D.N.Y. Sept. 27, 2021).

490. *Id.* at *10.

491. *Ortiz v. Canopy Growth Corp.*, No. 2:19-cv-20543, 2021 WL 1967714, at *43 (D.N.J. May 17, 2021) (amended op.).

492. *In re Aurora Cannabis, Inc. Sec. Litig.*, No. 19-20588, 2021 WL 2821167, at *11–13 (D.N.J. July 6, 2021).

493. *In re Sundial Growers Inc. Sec. Litig.*, 127 N.Y.S.3d 699, at *6 (N.Y. Cnty. Sup. Ct. May 15, 2020).

or statements of opinion.⁴⁹⁴ As noted *supra*, puffery encompasses statements that are too inexact to cause reasonable investors to rely upon them and therefore cannot have misled them.⁴⁹⁵ In general, federal appellate courts to consider the issue have held that puffery, puffing, or statements of corporate optimism are not actionable as a matter of law and securities claims based on such statements are subject to dismissal on a motion to dismiss.⁴⁹⁶ However, if puffery is both factual and material, it may be actionable.⁴⁹⁷ Opinion statements likewise rarely are actionable.⁴⁹⁸

In *Sundial Growers* the trial court concluded that such references in Sundial's offering documents as "high quality" and "premium" cannabis were non-actionable puffery or opinions,⁴⁹⁹ and this decision was affirmed on appeal in 2021.⁵⁰⁰ However, in September 2020, a few months before the *Sundial* appellate decision was issued, securities litigation involving Canadian CRB Aphria produced a different result. Here the federal district court rejected an argument that references to an Aphria asset as "world class" or "established and successful" were non-actionable puffery or expressions of corporate optimism. According to the court, a reasonable investor could rely on such statements, when viewed in context, because they indicate that an asset is operational.⁵⁰¹ Shortly thereafter Aphria announced that it was merging with Tilray to form the largest cannabis company in the world.⁵⁰²

In another case, this one involving the collapse of Quebec-based CRB HEXO Corporation, the federal district court dismissed plaintiffs' first amended class action complaint in March 2021, in part because defendants' statements were protected by the PSLRA's safe harbor (as to the Rule 10b-5 claim) and bespeaks caution doctrine (as to the section 11 claim). As to

494. *Id.*

495. *In re Vivendi, S.A. Sec. Litig.*, 838 F.3d 223, 245 (2d Cir. 2016).

496. See Robert N. Kravitz, *Room for Optimism: The "Puffery" Defense under the Federal Securities Laws (Part 1 of 2)*, 19 SEC. LITIG. J. (2009), https://www.paulweiss.com/media/104380/PW_KravABAFeb09.pdf [<https://perma.cc/RZU9-95EH>].

497. *Longman v. Food Lion, Inc.*, 197 F.3d 675, 682 (4th Cir. 1999); *Emps.' Ret. Sys. of Baton Rouge & Parish of E. Baton Rouge v. Macrogenics, Inc.*, No. GJH-19-2713, 2021 WL 4459218, at *11 (D. Md. Sept. 29, 2021).

498. *In re Sundial Growers Inc. Sec. Litig.*, 127 N.Y.S.3d 699, at *5 (N.Y. Cnty. Sup. Ct. May 15, 2020).

499. *Id.*

500. *In re Sundial Growers Inc. Sec. Litig.*, 138 N.Y.S.3d 330 (Mem.) (N.Y. App. Div. Feb. 16, 2021).

501. *In re Aphria, Inc. Sec. Litig.*, No. 18 Civ. 11376 (GBD), 2020 WL 5819548, at *9 (S.D.N.Y. Sept. 30, 2020).

502. Emily Ruscoe, *Tilray Investor Sues over \$3.8B Pot Industry Megamerger*, LAW360 (Mar. 16, 2021, 7:43 PM), <https://www.law360.com/articles/1365341/tilray-investor-sues-over-3-8b-pot-industry-megamerger> [<https://perma.cc/99P4-WNL6>].

the latter, the court noted that HEXO's cautionary language directly addressed the relevant risk that the company was operating within a newly legalized industry in Canada.⁵⁰³ The court also rejected plaintiffs' arguments concerning Items 105 and 303.⁵⁰⁴ A few months later a New York state court judge also dismissed a proposed securities class action alleging a section 11 claim against HEXO, again in major part on the basis of the bespeaks caution doctrine.⁵⁰⁵ The court in *Canopy Growth* also concluded that most of the challenged statements by defendants were protected by the safe harbor.⁵⁰⁶ Finally, in September 2021 a federal court dismissed with prejudice section 10(b) and section 11 claims against Sundial Growers, in large part on the basis of the safe harbor.⁵⁰⁷

Overall, the decisions to date in cannabis EDSL suggest that motions to dismiss may turn in large part on the puffery issue,⁵⁰⁸ and those cases in which the subject statements are not merely general and aspirational and are unprotected by the safe harbor and bespeaks caution doctrine are more likely to proceed to discovery. In addition, adequately alleging scienter will remain a common obstacle for plaintiffs, even when CWs are available.

C. Corruption

Numerous event-driven securities class actions have been filed following the resolution of enforcement actions under the FCPA or in connection with domestic corruption. The FCPA, enacted in 1977, regulates international corruption using both accounting and anti-bribery provisions. The accounting provisions mandate regular reporting to the SEC, maintenance of accurate books, records, and accounts, and the establishment of internal accounting controls aimed at detecting and preventing FCPA violations.⁵⁰⁹ The anti-bribery provisions criminalize the transfer of money

503. *In re* HEXO Corp. Sec. Litig., 524 F. Supp. 3d 281, 303 (S.D.N.Y. 2021).

504. *Id.* at 302–03.

505. *Leung v. HEXO Corp.*, No. 150444/2020, 2021 WL 2327231 (N.Y. Sup. Ct. June 3, 2021).

506. *Ortiz v. Canopy Growth Corp.*, No. 19-cv-20543, slip op. at 34 (D.N.J. May 17, 2021) (amended op.)

507. *Sun, A Series of E Squared Inv. Fund, LLC v. Sundial Growers, Inc.*, No. 20-CV-03579, 2021 WL 4482276, at *7–8 (S.D.N.Y. Sept. 30, 2021).

508. *See, e.g.*, Civil Minutes, at 6, *In re: PharmaCielo Ltd. Sec. Litig.*, No. CV 20-2182 (C.D. Cal. Apr. 16, 2021) (granting motion to dismiss in cannabis EDSL in part based on puffery defense). A motion to dismiss the second amended complaint in *PharmaCielo* was pending in August 2021. Emilie Ruscoe, *Investors' Suit Still Too 'Vague,' Pot Co. Tells Calif. Judge*, Law360 (Aug. 3, 2021, 7:44 PM), <https://www.law360.com/articles/1408989> [<https://perma.cc/V28V-BS9P>].

509. 15 U.S.C. § 78d.

or other gifts to foreign officials and political actors with intent to influence or obtain or retain business.⁵¹⁰

Both the SEC and DOJ have enforcement authority (and the Commodity Futures Trading Commission (CFTC) recently began to assert authority),⁵¹¹ but there is no private right of action under the FCPA.⁵¹² The absence of a private right of action has spurred the filing of class actions alleging securities fraud, as an antidote. In general, plaintiffs can pursue such litigation if their allegations do not reflect an attempt to enforce the FCPA and instead are independently actionable under the Exchange Act.⁵¹³ Other collateral civil actions, including shareholder derivative actions, commercial litigation, employment and whistleblower litigation, ERISA⁵¹⁴ actions, RICO⁵¹⁵ actions, and Alien Tort Claims Act⁵¹⁶ litigation, also have followed in the wake of SEC and DOJ FCPA investigations and enforcement proceedings.⁵¹⁷ Most of these other collateral actions have failed. For example, courts have routinely dismissed FCPA-related derivative actions, often for failure to meet the demand requirement imposed by many states, including Delaware and New York.⁵¹⁸ The requirement obliges plaintiff, prior to suing derivatively, to ask the board of directors to sue on behalf of the corporation or plead demand futility with particularity in the derivative complaint.⁵¹⁹

510. 15 U.S.C. §§ 78dd-1(a), -2(a), -3(a).

511. See *FCPA Digest: Recent Trends and Patterns in the Enforcement of the Foreign Corrupt Practices Act* 26, SHEARMAN & STERLING LLP (Jan. 4, 2021), <https://www.shearman.com/perspectives/2021/01/shearman-fcpa-digest-jan-2021-recent-trends-and-patterns-in-fcpa> [<https://perma.cc/6T4X-3ZFF>] (discussing first ever CFTC matter predicated on FCPA allegations).

512. See Gideon Mark, *Private FCPA Enforcement*, 49 AM. BUS. L.J. 419 (2012) (arguing in favor of recognition of a private right of action in FCPA cases).

513. *In re VEON Ltd. Sec. Litig.*, No. 15-cv-08672, 2017 WL 4162342, at *5 (S.D.N.Y. Sept. 19, 2017).

514. Pub. L. No. 93-406, 88 Stat. 829 (1974).

515. Pub. L. No. 91-452, 84 Stat. 822 (1970) (codified at 18 U.S.C. §§ 1961-68).

516. 28 U.S.C. § 1350.

517. Max B. Chester & Michael P. Mathews, *The Rise in Litigation from FCPA Enforcement*, LAW360 (Feb. 9, 2009), <https://www.foley.com/en/insights/publications/2009/02/the-rise-in-litigation-from-fcpa-enforcement> [<https://perma.cc/95ZY-A8D2>].

518. *Courts Continue to Dismiss Shareholder Suits Based on FCPA Violations*, ROPES & GRAY (Apr. 1, 2015), <https://www.ropesgray.com/en/newsroom/alerts/2015/April/Courts-Continue-to-Dismiss-Shareholder-Suits-Based-on-FCPA-Violations> [<https://perma.cc/A87Q-XK5P>].

519. Amy Deen Westbrook, *Double Trouble: Collateral Shareholder Litigation Following Foreign Corrupt Practices Act Investigations*, 73 OHIO STATE L.J. 1217, 1230-31 (2012). See *United Food & Com. Workers Union and Participating Food Indus. Emps. Tri-State Pension Fund v. Zuckerberg*, No. 404, 2020, 2021 WL 4344361 (Del. Sept. 23, 2021) (clarifying demand futility standards).

In standard EDSL, after a company has publicly disclosed potential FCPA violations and/or settled with the federal government, plaintiff shareholders file suit alleging that the company earlier fraudulently failed to disclose, or made false or misleading disclosures regarding, the nature and scope of the company's FCPA violations or internal controls for detecting such violations. To adequately allege bribery plaintiffs must plead the "who, what, when, where, and how" of the alleged improper transaction.⁵²⁰ The complaints in these actions often rely on statements made by defendant in a deferred prosecution agreement (DPA) or settlement agreement with the SEC or DOJ, in which the company admits facts about misconduct and internal control failures and—in the case of DOJ involvement—avoids a criminal conviction.⁵²¹

Most of the putative FCPA-based securities class actions have been dismissed, typically for failure to adequately plead a material misrepresentation or omission.⁵²² However, many of them have proceeded to discovery and multiple major settlements have been finalized, often for sums that substantially exceed the penalty assessed by the DOJ and/or SEC.⁵²³ One review of 37 class action and derivative suits filed during a four-year period against companies that disclosed FCPA investigations found that 26 resulted in a monetary settlement.⁵²⁴ Resolutions have become much larger since that review was conducted more than a decade ago. Major FCPA EDSL settlements since then have included \$3 billion (Petrobras, in 2018), \$389.6 million (Cobalt International Energy, in 2019), \$160 million (Wal-Mart, in 2018), \$62.5 million (SQM, in 2020), and \$62 million (Avon, in 2015).⁵²⁵

520. *Schiro v. Cemex, S.A.B. de C.V.*, 438 F. Supp. 3d 194, 198 (S.D.N.Y. 2020) (dismissing second amended complaint with prejudice).

521. Grayson Stratton et al., *When FCPA Violations Turn into Private Securities Cases*, LAW360 (July 10, 2019, 1:05 PM), <https://www.law360.com/articles/1175610> [<https://perma.cc/E5DS-EHCV>].

522. *Id.*

523. George H. Brown, Debra Wong Yang & Matthew S. Kahn, *Strategies for Mitigating Civil Liability Consequences of FCPA Investigations & Enforcement Actions*, 9 SEC. LITIG. REP., Apr. 2012, [https://www.gibsondunn.com/wp-content/uploads/documents/publications/BrownYangKahn-StrategiesforMitigatingCivilLiabilityConsequences%20\(2\).pdf](https://www.gibsondunn.com/wp-content/uploads/documents/publications/BrownYangKahn-StrategiesforMitigatingCivilLiabilityConsequences%20(2).pdf) [<https://perma.cc/UFV8-3T9D>].

524. See Brian Grow, *Bribery Investigations Spark Shareholder Suits*, REUTERS (Nov. 1, 2010, 2:50 PM), <https://www.reuters.com/article/us-bribery-lawsuits/bribery-investigations-spark-shareholder-suits-idUSTRE6A04CO20101101> [<https://perma.cc/BW24-VAYR>].

525. See Kevin LaCroix, *Chilean Company Pays \$62.5 Million to Settle Bribery-Related Securities Suit*, D&O DIARY (Dec. 17, 2020), <https://www.dandodiary.com/2020/12/articles/securities-litigation/chilean-company-pays-62-5-million-to-settle-bribery-related-securities-suit/> [<https://perma.cc/KV2A-9V6Z>] (discussing SQM settlement); Kevin LaCroix, *A Closer Look at FCPA-Related Securities Suits*, D&O DIARY (July 17, 2019), <https://www.dandodiary.com/2019/07/articles/securities-litigation/a-closer-look-at-fcpa-related-securities-suits/>.

The Petrobras and Cobalt settlements ranked fifth and forty-fourth, respectively, among the top 100 U.S. securities class action settlements of all-time, as of December 31, 2020,⁵²⁶ and likely have encouraged plaintiffs' class action counsel to further pursue FCPA cases. For example, EDSL was commenced in August 2020 against Airbus after the aerospace giant earlier agreed to pay combined global penalties of more than \$3.9 billion to resolve foreign bribery and export control charges. This was the largest global foreign bribery resolution by 2020.⁵²⁷ The complaint in the follow-on EDSL alleged that Airbus used bribery to obtain and retain aircraft, helicopter, and defense deals, and the company's stock price dropped after regulatory investigations were disclosed and again as the scandal unfolded.⁵²⁸

Four primary categories of disclosures have been moderately fruitful for plaintiffs in FCPA EDSL. The first is statements by a company about its compliance with the law, its reputation for integrity, or its commitment to ethical conduct, often as reflected in the adoption of a code of conduct or ethics. Such general statements usually constitute non-actionable puffery,⁵²⁹ even if they are not explicitly aspirational. As noted by one court in a foreign bribery securities case, "[t]he distinguishing feature of puffery is its use of broad generalities, not its use of talismanic aspirational language."⁵³⁰ Likewise, mere code or compliance program adoption, absent statements assuring investors that a company's employees are code-compliant or the program is effective, is not misleading.⁵³¹ However, if a company uses its alleged adherence to its code of ethics or similar representations to reassure the investing public about the company's integrity, such statements may be

<https://www.dandodiary.com/2019/07/articles/foreign-corrupt-practices-act/a-closer-look-at-fcpa-related-securities-suits/> [<https://perma.cc/85G3-P77B>] (identifying settlements and noting that FCPA cases constitute "yet another example of the kind of event-driven litigation that has come to be such a significant factor in securities litigation filings in recent years").

526. *Top 100 Settlements*, *supra* note 8, at 6–10.

527. U.S. DEP'T OF JUST., *Airbus Agrees to Pay over \$3.9 Billion in Global Penalties to Resolve Foreign Bribery and ITAR Case* (Jan. 31, 2020), <https://www.justice.gov/opa/pr/airbus-agrees-pay-over-39-billion-global-penalties-resolve-foreign-bribery-and-itar-case> [<https://perma.cc/VMT9-JX5T>].

528. Rachel O'Brien, *5 Firms Eye Lead in Investors' \$4B Airbus Corruption Suit*, LAW360 (Oct. 6, 2020, 3:55 PM), <https://www.law360.com/articles/1317154> [<https://perma.cc/53CF-6EZW>].

529. *See, e.g.*, *Salim v. Mobile TeleSystems PJSC*, No. 19-CV-1589, 2021 WL 796088, at *11 (E.D.N.Y. Mar. 1, 2021) (granting motion to dismiss second amended complaint); *Das v. Rio Tinto PLC*, 332 F. Supp. 3d 786, 806–07 (S.D.N.Y. 2018) (observing that codes of ethics are inherently aspirational and granting motions to dismiss).

530. *Schiro v. Cemex, S.A.B. de C.V.*, 396 F. Supp. 3d 283, 298 n.5 (S.D.N.Y. 2019).

531. *See, e.g.*, *Doshi v. General Cable Corp.*, 386 F. Supp. 3d 815, 830 (E.D. Ky. 2019) ("The problem is that [defendant] never said it had an effective compliance program.").

actionable.⁵³²

The second category is statements from SOX certifications or SEC filings concerning the existence or effectiveness of a company's internal controls. SOX certifications do not make any explicit reassurances regarding the FCPA⁵³³ and general statements about internal controls are not actionable.⁵³⁴ But plaintiffs have been successful when the statements constitute an opinion about the effectiveness of the controls and the speaker was aware the opinion was false. This may be reflected in admissions by the company in settlement agreements with the SEC or DOJ⁵³⁵ or if the signing officers knew that an internal audit contradicted the certifications.⁵³⁶ Similarly, false or misleading statements by a company that it is in compliance with all applicable laws and regulations, and therefore it believes its controls are effective, may be actionable, rather than constituting puffery.⁵³⁷ Backward-looking statements regarding internal controls are unprotected by the safe harbor and bespeaks caution doctrine.⁵³⁸

The third category is statements by a company about its financial success, when those statements fail to disclose that success was attributable to bribes made in violation of the FCPA. While there is no general duty to disclose market or corruption risk⁵³⁹ the calculus changes when a bribing company touts specific reasons for its impressive financials without discussing the role that bribery has played. Such statements may be

532. *In re Eletrobras Sec. Litig.*, 245 F. Supp. 3d 450, 463–64 (S.D.N.Y. 2017); *In re Petrobras Sec. Litig.*, 116 F. Supp. 3d 368, 381 (S.D.N.Y. 2015).

533. *Doshi v. General Cable Corp.*, 386 F. Supp. 3d 815, 834 (E.D. Ky. 2019).

534. *Salim v. Mobile TeleSystems PJSC*, No. 19-CV-1589, 2021 WL 796088, at *11 (E.D.N.Y. Mar. 1, 2021); *Menaldi v. Och-Ziff Cap. Mgt. Grp., LLC*, 277 F. Supp. 3d 500, 513 (S.D.N.Y. 2017).

535. *Doshi v. General Cable Corp.*, 386 F. Supp. 3d 815, 834 (E.D. Ky. 2019).

536. *In re Eletrobras Sec. Litig.*, 245 F. Supp. 3d 450, 468–69 (S.D.N.Y. 2017) (concluding that SOX certifications were indicative of scienter).

537. *Villella v. Chem. & Mining Co. of Chile Inc.*, No. 15 Civ. 2106, 2017 WL 1169629, at *11 (S.D.N.Y. Mar. 28, 2017) (“The statements in the Annual Reports relay positive assurances that SQM believed it was in compliance with all applicable laws and regulations and that based on an evaluation, the CEO and CFO concluded that SQM’s controls were effective.”).

538. *In re VEON Ltd. Sec. Litig.*, No. 15-cv-08672, 2017 WL 4162342, at *9 (S.D.N.Y. Sept. 19, 2017).

539. *Doshi v. General Cable Corp.*, 386 F. Supp. 3d 815, 831–33 (E.D. Ky. 2019).

actionable,⁵⁴⁰ insofar as they place the source of revenue at issue.⁵⁴¹

The fourth category is a failure to disclose a regulatory investigation concerning potential FCPA violations. In general, as previously noted, the failure to disclose an investigation is not actionable, because companies have no obligation to disclose uncharged, unadjudicated wrongdoing, unless disclosure is necessary to prevent the corporation's other statements from becoming materially misleading.⁵⁴² The absence of a disclosure obligation encompasses unadjudicated bribery allegations.⁵⁴³ The calculus can change if, for example, the undisclosed investigation triggered a reasonable possibility of an adverse impact on the company's financial position in the form of a penalty or disgorgement order.⁵⁴⁴ It may be a best practice for a company to disclose the existence of an SEC or DOJ FCPA investigation—especially after receiving a subpoena—to guard against liability stemming from news reports that publicize the investigation and produce a stock price drop.⁵⁴⁵ But generally this is not a reporting obligation. Indeed, one court held in 2021 that if a company discloses a DOJ investigation it has no further obligation to disclose that such investigation is for possible FCPA violations, at least where the disclosure acknowledges the potential FCPA exposure.⁵⁴⁶ In that case the court dismissed plaintiffs' second amended complaint,⁵⁴⁷ filed in the aftermath of defendant Mobile TeleSystems PJSC's \$850 million

540. See *In re Braskem S.A. Sec. Litig.*, 246 F. Supp. 3d 731, 761 (S.D.N.Y. 2017):

Braskem was certainly not obliged to publicly address the components and determinants of the prices it paid Petrobras for naphtha. It was entitled to stay mum on that point. But, having opened up that subject for discussion, it was not at liberty to selectively omit what the SAC fairly alleges as a central determinant of that price: the corrupt arrangement Braskem had struck with the Petrobras officials it bribed.

541. *In re VEON Ltd. Sec. Litig.*, No. 15-cv-08672, 2017 WL 4162342, at *6 (S.D.N.Y. Sept. 19, 2017).

542. *In re Braskem S.A. Sec. Litig.*, 246 F. Supp. 3d 731, 752 (S.D.N.Y. 2017).

543. *Ulbright v. Ternium S.A.*, No. 18-CV-6801, 2020 WL 5517313, at *10 (E.D.N.Y. Sept. 14, 2020).

544. See *Menaldi v. Och-Ziff Cap. Mgt. Grp., LLC*, 277 F. Supp. 3d 500, 515 (S.D.N.Y. 2017) (discussing disclosure obligation in context of Accounting Standards Codification 450, which governs contingencies—"essentially, situations involving uncertainty as to a possible gain or loss"). ASC 450 is relevant, because SEC regulations specify that where financial statements are not prepared in compliance with Generally Accepted Accounting Principles, they are presumed to be misleading or inaccurate. 17 C.F.R. 210.4–01(a)(1) (2021).

545. Mauricio Espana, Hector Gonzalez & Brendan Herrmann, *A Setback for FCPA-Based Securities Class Actions*, LAW360 (Apr. 17, 2018, 3:26 PM), <https://www.law360.com/articles/1034244> [<https://perma.cc/534N-ZHW2>].

546. *Salim v. Mobile TeleSystems PJSC*, No. 19-CV-1589, 2021 WL 796088, at *9 (E.D.N.Y. Mar. 1, 2021).

547. *Id.* at *15.

parallel resolutions with the DOJ and SEC concerning FCPA violations.

Corruption-based EDSL is not limited to extraterritorial conduct. Increasingly, event-driven cases are based on domestic bribery or kickbacks. For example, in 2020 a federal district court declined to dismiss EDSL based on alleged kickbacks made by pharmaceutical company AbbVie to doctors who prescribed AbbVie's flagship immunosuppressant drug Humira. The details of the alleged kickback scheme, which involved cash, alcohol, trips, and an elaborate network of "nurse ambassadors," became public beginning in early 2018, after which the company's stock price fell. In declining to dismiss the court held that statements in AbbVie's Code of Business Conduct were actionable, because they were unqualified representations about the company's conduct and not merely aspirational.⁵⁴⁸

Another case is EDSL stemming from bribery by Commonwealth Edison (ComEd)—the largest electric utility in Illinois and a controlled subsidiary of Exelon Utilities—that benefitted former Illinois Democratic House Speaker Mike Madigan and his allies. The bribery scheme spanned the years 2011–2019 and was designed to secure the passage of legislation favorable to ComEd and Exelon. In 2020 ComEd entered into a DPA and agreed to pay \$200 million to resolve a federal bribery investigation,⁵⁴⁹ the disclosure of which sent Exelon's stock price tumbling.⁵⁵⁰ In 2021 defendants' motions to dismiss the ensuing EDSL were mostly denied. The court cited a line of recent cases holding that Items 105 and 303 impose a duty to disclose regulatory non-compliance in Forms 8-K and 10-Q and concluded that plaintiffs adequately alleged a failure by Exelon to disclose the Illinois bribery in its earlier SEC filings.⁵⁵¹ The court also held that certain statements in Exelon's Code of Business Conduct were actionable because they were unqualified and not merely aspirational. One such statement was that "[w]e never request, offer or accept any form of payment intended to improperly influence a decision."⁵⁵²

In 2020 EDSL also was commenced against Ohio electric utility FirstEnergy Corporation in connection with approximately \$60 million in

548. *Holwill v. AbbVie Inc.*, No. 1:18-cv-06790, 2020 WL 5235005, at *4 (N.D. Ill. Sept. 9, 2020).

549. Celeste Bott, *ComEd to Pay \$200M for Bribery Tied to Ill. House Speaker*, LAW360 (July 17, 2020, 10:17 AM), <https://www.law360.com/articles/1293102> [<https://perma.cc/LM65-55YT>].

550. Clark Mindock, *Exelon Wants Investor Suit Over Bribe Investigation Tossed*, LAW360 (Nov. 19, 2020, 4:45 PM), <https://www.law360.com/articles/1330513> [<https://perma.cc/2HTS-6TX5>].

551. *Flynn v. Exelon Corp.*, No. 19 C 8209, 2021 WL 1561712, at *8 (N.D. Ill. Apr. 21, 2021).

552. *Id.* at *9.

bribes paid to members of the Ohio General Assembly. *FirstEnergy's* facts are remarkably similar to *Exelon's* facts. A criminal complaint preceding the securities litigation alleged that FirstEnergy bankrolled the 2018 election of Ohio Republican House Speaker Larry Householder, an effort by Householder to pass a \$1.3 billion bill subsidizing two troubled FirstEnergy nuclear power plants, and a campaign to defeat a 2019 referendum to repeal the bill. Following the arrests of Householder and four others, FirstEnergy's stock price plunged 45% and EDSL followed.⁵⁵³ A motion to dismiss a parallel civil RICO suit filed by ratepayers was denied in February 2021.⁵⁵⁴ Motions to dismiss the securities litigation were pending in July 2021, when FirstEnergy entered into a DPA and agreed to pay a \$230 million penalty.⁵⁵⁵ Subsequently, in March 2022 the court mostly denied ten separate motions to dismiss filed by FirstEnergy and various officers, directors, and underwriters in the EDSL.⁵⁵⁶

A fourth example is consolidated securities litigation stemming from bribery by Fiat Chrysler executives of senior officials of the United Auto Workers (UAW) that generated a sprawling federal investigation and numerous guilty pleas.⁵⁵⁷ Fiat bribed the UAW officials with cash and gifts to score favors during collective bargaining. Many of the allegations in the EDSL appear to have been lifted from a RICO suit, filed by Fiat rival General Motors, that was dismissed in 2020.⁵⁵⁸ While that dismissal was on appeal,

553. Complaint ¶¶ 1–5, *Owens v. FirstEnergy Corp.*, No. 20-cv-03785, 2020 WL 6973421 (S.D. Ohio July 28, 2020); Jessie Balmert & Jackie Borchardt, *Ohio Energy Probe: FirstEnergy Admits it Gave \$56.6 Million to Nonprofit that Pleaded Guilty*, CINCINNATI.COM (Mar. 12, 2021, 10:00 PM), <https://www.cincinnati.com/story/news/politics/2021/03/12/ohio-bribery-probe-firstenergy-admits-gave-millions-generation-now-pleaded-guilty/4673740001/> [<https://perma.cc/XK5R-KVCM>].

554. *Smith v. FirstEnergy Corp.*, 518 F. Supp. 3d 1118 (S.D. Ohio 2021). Subsequently the court certified a ratepayer class and then vacated the certification order. *Smith v. FirstEnergy Corp.*, Lead Case No. 20-cv-3987, 2021 WL 5416540 (S.D. Ohio Nov. 19, 2021).

555. See S. DIST. OF OHIO, U.S. ATTY'Y'S OFF., U.S. DEP'T OF JUSTICE, *FirstEnergy Charged Federally, Agrees to Terms of Deferred Prosecution Settlement* (July 22, 2021), <https://www.justice.gov/usao-sdoh/pr/firstenergy-charged-federally-agrees-terms-deferred-prosecution-settlement> [<https://perma.cc/B7PX-QJUD>].

556. *In re FirstEnergy Corp. Sec. Litig.*, Nos. 2:20-cv-3785 & 2:20-cv-4287, 2022 WL 681320 (S.D. Ohio Mar. 7, 2022). Related state and federal derivative litigation settled for \$180 million in February 2022, subject to judicial approval. Dean Seal, *Judge Demands Names of FirstEnergy Execs Who Paid Bribes*, LAW360 (Mar. 22, 2022, 8:54 PM), <https://www.law360.com/articles/1476370/judge-demands-names-of-firstenergy-execs-who-paid-bribes>.

557. See Linda Chiem, *Fiat Chrysler Rips Investors' Fraud Claims in UAW Bribes Suit*, LAW360 (Dec. 15, 2020, 5:50 PM), <https://www.law360.com/articles/1337863> [<https://perma.cc/9JBW-TQZ4>] (reporting guilty pleas and prison sentences for three former Fiat Chrysler employees).

558. See Linda Chiem, *Stellantis Inks \$5M Deal to End Investor FCA-UAW Bribes Suit*,

Stellantis NV—formed by the merger of Fiat Chrysler and Peugeot parent Groupe PSA—agreed in 2021 to pay \$5 million to settle the EDSL.⁵⁵⁹

A fifth case is EDSL against Energy Transfer, a Dallas-based energy company that operates some of the largest oil and gas pipelines in the United States. Energy Transfer's stock price dropped following news in 2019 of a federal bribery investigation concerning the grant of permits for construction of the company's 350-mile Mariner East pipeline carrying highly volatile natural gas across Pennsylvania, and securities litigation ensued.⁵⁶⁰ Motions to dismiss were largely denied in 2021, in part on the basis of actionable statements in Energy Transfer's Code of Ethics,⁵⁶¹ and a motion for class certification followed.⁵⁶²

In a sixth example, in 2020 a federal district court applied the *Basic* presumption and certified a class of Novo Nordisk investors in EDSL alleging the global healthcare company misled shareholders about the source of its financial success while concealing a scheme to pay kickbacks to pharmacy benefit managers in exchange for access to the U.S. insulin market.⁵⁶³ Certification followed denial of a motion to dismiss. In declining to dismiss the court rejected application of the PSLRA's safe harbor because defendants' cautionary language was inadequate.⁵⁶⁴ The case settled for \$100 million in September 2021.⁵⁶⁵

What are the lessons of EDSL based on domestic bribery and kickbacks? In most of the foregoing actions motion practice was in an early stage at the time of this writing. However, *AbbVie*, *Exelon*, and *Novo Nordisk* collectively suggest that many of the same considerations discussed above in connection with FCPA-based EDSL will apply in domestic cases.

LAW360 (May 17, 2021, 2:04 PM), <https://www.law360.com/articles/1385162> [<https://perma.cc/KT4F-85FA>] (discussing allegations allegedly cribbed from RICO suit).

559. *Id.*

560. *See* Allegheny Cty. Emps.' Ret. Sys. v. Energy Transfer LP, No. 20-200, 2020 WL 1888950, at *1–2 (E.D. Pa. Apr. 16, 2020) (denying motion to transfer action to Northern District of Texas).

561. Memorandum at 38-39, Allegheny Cty. Emps.' Ret. Sys. v. Energy Transfer LP, No. 20-200 (E.D. Pa. Apr. 6, 2021).

562. Nathan Hale, *Investors Seek Class Approval in Suit Over \$3B Pa. Pipeline*, LAW360 (Sept. 20, 2021, 5:47 PM), <https://www.law360.com/articles/1423246> [<https://perma.cc/53ZJ-B4FE>].

563. *In re Novo Nordisk Sec. Litig.*, No. 17-cv-00209, 2020 WL 502176 (D.N.J. Jan. 31, 2020).

564. *In re Novo Nordisk Sec. Litig.*, No. 17-cv-00209, 2018 WL 3913912, at *8–9 (D.N.J. Aug. 16, 2018).

565. Sarah Jarvis, *Novo Nordisk to Pay \$100M to Settle Investor Class Action*, LAW360 (Sept. 24, 2021, 7:26 PM), <https://www.law360.com/articles/1425225/novo-nordisk-to-pay-100m-to-settle-investor-class-action> [<https://perma.cc/BT6S-Y942>].

D. Antitrust

The phenomenon of securities class action litigation following regulatory, state, criminal, and/or other investigations for allegedly anticompetitive conduct was noted at least as early as 2009,⁵⁶⁶ but the practice did not become commonplace until years later, as an aspect of EDSL's escalation.⁵⁶⁷ Securities cases following antitrust investigations typically allege that, in violation of federal securities laws, the defendant company failed to disclose that it was engaged in the underlying anticompetitive conduct.⁵⁶⁸ These cases are distinguished from those in which plaintiffs seek to dress securities allegations in antitrust garb in order to circumvent the PSLRA's procedural requirements. The Supreme Court rejected this latter approach in 2007 in *Credit Suisse Securities (USA) LLC v. Billing*.⁵⁶⁹

Event-driven securities cases seek to accomplish the reverse of the pleading practice that was forbidden in *Billing*. Plaintiffs in the event cases seek to dress allegations of anticompetitive conduct in the regalia of securities class actions.⁵⁷⁰ They often succeed. For example, in June 2021 antitrust EDSL premised on anticompetitive conduct in the interior molded doors market settled for nearly \$40 million, following certification of an investor class and settlement of the parallel price-fixing litigation for more than \$60 million.⁵⁷¹

Antitrust-driven securities fraud cases have raised several key issues. One concerns the appropriate pleading standard to be applied when deciding a motion to dismiss. Courts have generally concluded that the applicable standard is supplied by the PSLRA and Rule 9(b) of the Federal Rules of

566. See Kevin M. LaCroix, *Alleged Anticompetitive Behavior and Follow-On Securities Litigation*, D&O DIARY (Apr. 10, 2009), <https://www.dandodiary.com/2009/04/articles/securities-litigation/alleged-anticompetitive-behavior-and-follow-on-securities-litigation/> [<https://perma.cc/6ZX7-Z5DQ>] (noting increasing frequency of this practice).

567. See Samuel Groner & Andrew Cashmore, *Trends in Securities Cases Based on Antitrust Allegations*, LAW360 (July 5, 2018, 1:19 PM), <https://www.law360.com/articles/1060044> [<https://perma.cc/S5SZ-ZERG>] (noting that antitrust-based securities litigation is an example of EDSL and such litigation has “become commonplace”).

568. *Id.*

569. *Credit Suisse Sec. (USA) LLC v. Billing*, 551 U.S. 264 (2007).

570. Kevin M. LaCroix, *Alleged Anticompetitive Behavior and Follow-On Securities Litigation*, D&O DIARY (Apr. 10, 2009), <https://www.dandodiary.com/2009/04/articles/securities-litigation/alleged-anticompetitive-behavior-and-follow-on-securities-litigation/> [<https://perma.cc/PG3T-8RYA>].

571. Christopher Cole, *Doormaker Settles Investors' Stock-Drop Claims for \$40M*, LAW360 (June 7, 2021, 5: 07 PM), <https://www.law360.com/articles/1391509/doormaker-settles-investors-stock-drop-claims-for-40m> [<https://perma.cc/AUR3-4VZN>].

Civil Procedure,⁵⁷² and falsity must be pled with particularity as to dual allegations that federal securities laws have been breached⁵⁷³ and defendant engaged in the underlying anticompetitive conduct.⁵⁷⁴ This conclusion also encompasses other kinds of underlying illegality,⁵⁷⁵ including foreign bribery. However, some courts have declined to resolve the issue⁵⁷⁶ or held that plaintiff must merely state a “plausible claim” that the underlying conduct occurred.⁵⁷⁷ A second issue is whether it suffices to plead scienter or loss causation for plaintiff to merely allege the existence of a government investigation—often by the DOJ—concerning anti-competitive conduct. In general, it does not suffice as to either element.⁵⁷⁸ A third issue concerns puffery and the impact of corporate codes of conduct.

The foregoing issues arose in EDSL stemming from private antitrust litigation targeting the poultry industry, which is vertically integrated and characterized by high barriers to entry.⁵⁷⁹ The antitrust litigation commenced in 2016 when food distributor Maplevale Farms sued 27 defendants in the Northern District of Illinois, alleging a conspiracy to fix chicken prices.⁵⁸⁰ This was followed by other antitrust class actions initiated on behalf of new

572. FED. R. CIV. P. 9. Rule 9(b) imposes a heightened pleading requirement of factual particularity with respect to fraud allegations.

573. See, e.g., *In re Tyson Foods Inc. Sec. Litig.*, 275 F. Supp. 3d 970, 996 (W.D. Ark. 2017) (applying PSLRA’s heightened pleading standards).

574. See, e.g., *Gamm v. Sanderson Farms, Inc.*, 944 F.3d 455, 465 (2d Cir. 2019) (“In practical terms, the pleading standard required appellants to have alleged the basic elements of an underlying antitrust conspiracy. . .”).

575. See Samuel P. Groner & Fara M. Saathoff, *Securities Litigation Premised on Failure to Disclose Alleged Underlying Illegal Conduct*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 26, 2020), <https://corpgov.law.harvard.edu/2020/12/26/securities-litigation-premised-on-failure-to-disclose-alleged-underlying-illegal-conduct/> [<https://perma.cc/UT5X-4EGY>] (stating that holding of *Gamm v. Sanderson Farms, Inc.*, 944 F.3d 455 (2d Cir. 2019) “applies no matter the nature of the underlying allegedly illegal acts”).

576. See, e.g., *In re Mylan N.V. Sec. Litig.*, No. 16-CV-7926, 2018 WL 1595985, at *15 n.11 (S.D.N.Y. Mar. 28, 2018) (declining to resolve the issue).

577. *Roofer’s Pension Fund v. Papa*, No. 16-2805, 2018 WL 3601229, at *11 (D.N.J. July 27, 2018).

578. See, e.g., *DeLuca v. GPB Auto. Portfolio, LP*, No. 19-cv-10498, 2020 WL 7343788, at *17 n.190 (S.D.N.Y. Dec. 12, 2020) (scienter); *Lipow v. Net 1 UEPS Techs., Inc.*, 131 F. Supp. 3d 144, 167 (S.D.N.Y. 2015) (scienter); *Lloyd v. CVB Fin. Corp.*, 811 F.3d 1200, 1203 (9th Cir. 2017) (reaffirming that announcement of investigation is insufficient to allege loss causation, unless investigation relates to an alleged misrepresentation and inaccuracy of misrepresentation is subsequently disclosed).

579. *Gamm v. Sanderson Farms, Inc.*, 944 F.3d 455, 458 (2d Cir. 2019).

580. Kevin LaCroix, *Poultry Producers Hit with Antitrust Suits, Follow-On Securities Litigation*, D&O DIARY (Oct. 31, 2016), <https://www.dandodiary.com/2016/10/articles/securities-litigation/poultry-producers-hit-antitrust-suits-follow-securities-litigation/> [<https://perma.cc/FF6V-GEKR>].

plaintiffs, including restaurant chains and restaurant supply companies.⁵⁸¹ Ultimately, dozens of private chicken price-fixing cases were filed.⁵⁸² In 2019 the DOJ revealed that it was investigating potential anticompetitive conduct in the industry⁵⁸³ and indictments followed in 2020.⁵⁸⁴

Some defendants in the antitrust actions are privately held companies, but many others are publicly traded. The shares of the public companies plunged early in the antitrust litigation and securities class actions followed. The poultry ESDL has fared poorly for plaintiffs, typically sinking in connection with the issues noted above. In one decision, issued in 2019, the Second Circuit affirmed the dismissal of an action against defendants Sanderson Farms, Inc. and its officers.⁵⁸⁵ The Second Circuit held that where a section 10(b) action is based on non-disclosure of illegal activity (such as price-fixing), the facts of the underlying activity must be pleaded with particularity under the PSLRA and Rule 9(b).⁵⁸⁶ In practical terms, this required plaintiffs to allege with particularity the elements of an antitrust conspiracy: (1) a contract, combination, or conspiracy; (2) in restraint of trade; (3) affecting interstate commerce.⁵⁸⁷ In this case, plaintiffs failed to satisfy their pleading burden. District courts in other poultry EDSL have similarly granted motions to dismiss because plaintiffs failed to plead with particularity the facts of the underlying antitrust violation.⁵⁸⁸

581. *Id.*

582. Dave Simpson, *DOJ Subpoenas Tyson Amid Chicken Industry Antitrust Probe*, LAW360 (Aug. 5, 2019, 11:11 PM), <https://www.law360.com/articles/1185150> [<https://perma.cc/3VR9-W4BJ>].

583. Matthew Perlman, *DOJ Probing Chicken Industry for Anti-Competitive Conduct*, LAW360 (June 25, 2019, 7:46 PM), <https://www.law360.com/articles/1172909> [<https://perma.cc/8TAP-TMTN>]. Some of the cases have settled. Christopher Cole, *Three More Chicken Cos. Settle Price-Fix Suit for \$13M*, LAW360 (Dec. 12, 2019, 6:39 PM), <https://www.law360.com/articles/1227712> [<https://perma.cc/XWA8-GKQA>]. Other cases were centralized in 2020 in the Eastern District of Oklahoma. See *In re Broiler Chicken Grower Antitrust Litig.* (No. II), 509 F. Supp. 3d 1359 (J.P.M.L. 2020).

584. See Tom Polansek, *U.S. Indicts Six More Chicken-Industry Executives over Alleged Price-Fixing*, REUTERS (Oct. 7, 2020, 11:11 PM), <https://www.reuters.com/article/us-usa-poultry-charges/u-s-indicts-six-more-chicken-executives-over-alleged-price-fixing-idINKBN26S31M> [<https://perma.cc/T3CW-BJTE>] (reporting issuance of expanded superseding indictment).

585. *Gamm v. Sanderson Farms, Inc.*, 944 F.3d 455 (2d Cir. 2019).

586. *Id.* at 466–67.

587. *Maric v. St. Agnes Hosp. Corp.*, 65 F.3d 310, 313 (2d Cir. 1995).

588. See *In re Tyson Foods, Inc. Sec. Litig.*, No. 16-cv-5340, 2018 WL 1598670, at *9 (W.D. Ark. Mar. 31, 2018) (dismissing action with prejudice in part because proposed amended complaint failed to allege with particularity facts forming bedrock of alleged antitrust conspiracy); *Hogan v. Pilgrim's Pride Corp.*, No. 16-cv-02611-RBJ, 2018 WL 1316979 (D. Colo. Mar. 14, 2018) (dismissing action mainly because plaintiff failed to plead underlying antitrust conspiracy with sufficient particularity). The court subsequently

Class actions alleging securities violations by companies in the generic drug industry that are the subject of DOJ and state price-fixing investigations and enforcement actions further illustrate key issues that arise in this category of EDSL.⁵⁸⁹ The generic drug market in the United States is huge—approximately 90% of prescriptions filled are for generic drugs,⁵⁹⁰ which are as safe and effective as their brand-name equivalents.⁵⁹¹ The U.S. generic drug market was valued at approximately \$130 billion in 2020⁵⁹² and the top five generic companies—measured by global market share—are Teva, Sandoz, Mylan, Pfizer, and Sun.⁵⁹³

The DOJ began investigating the generic drug industry for anti-competitive conduct at least as early as November 2014, subpoenas were issued to several manufacturers and individual executives shortly thereafter,⁵⁹⁴ and by 2020 the DOJ had indicted five companies and multiple pharmaceutical industry executives. Most of the federal enforcement actions against defendant drug companies have been resolved with DPAs that spare the companies criminal convictions, while executives have typically entered

dismissed plaintiffs' second amended complaint in *Pilgrim's Pride*, based on the statute of repose. *Hogan v. Pilgrim's Pride Corp.*, No. 16-cv-02611, 2021 WL 1534602 (D. Colo. Apr. 16, 2021). *See also* *United Food and Commercial Workers Int'l Union Local 464A v. Pilgrim's Pride Corp.*, No. 20-cv-01966-RM-MEH, 2022 WL 684169 (D. Colo. Mar. 8, 2022) (dismissing consolidated amended class action complaint with prejudice, in a similar case involving some of the same parties).

589. *See generally* Kevin LaCroix, *Generic Drug Companies Hit with Antitrust Enforcement Follow-On Securities Suits*, D&O DIARY (Nov. 9, 2016), <https://www.dandodiary.com/2016/11/articles/securities-litigation/generic-drug-companies-hit-antitrust-enforcement-follow-securities-suits/> [<https://perma.cc/6DSY-NKX7>] (discussing generic drug EDSL).

590. *Generic Drugs*, U.S. FOOD & DRUG ADMIN. (Nov. 21, 2019), <https://www.fda.gov/drugs/buying-using-medicine-safely/generic-drugs> [<https://perma.cc/AHJ2-JB7G>].

591. Andrew W. Mulcahy, *Price-Fixing Case Reveals Vulnerability of Generic Drug Policies*, RAND BLOG (July 15, 2019), <https://www.google.com/search?q=Price-Fixing+Case+Reveals+Vulnerability+of+Generic+Drug+Policies&aq=Price-Fixing+Case+Reveals+Vulnerability+of+Generic+Drug+Policies&qs=chrome..69i57.5551j0j4&sourceid=chrome&ie=UTF-8> [<https://perma.cc/MWZ8-D7UF>].

592. IMARC, *US Generic Drug Market Industry Trends, Share, Size, Growth, Opportunity and Forecast 2021–2026*, <https://www.imarcgroup.com/us-generics-market> (last visited Oct. 12, 2021) [<https://perma.cc/82VV-998C>].

593. Charles-André Brouwers, Lu Chen, Mark Lubkeman & Brian Bush, Boston Consulting Group, *The Paths to Value for US Generics* (Jan. 10, 2020), <https://www.bcg.com/en-us/publications/2020/paths-to-value-for-united-states-generics> [<https://perma.cc/SZC2-BXBL>].

594. *See* Kevin LaCroix, *Generic Drug Companies Hit with Antitrust Enforcement Follow-On Securities Suits*, D&O DIARY (Nov. 9, 2016), <https://www.dandodiary.com/2016/11/articles/securities-litigation/generic-drug-companies-hit-antitrust-enforcement-follow-securities-suits/> [<https://perma.cc/E8BL-JXAA>] (discussing generic drug EDSL).

guilty pleas.⁵⁹⁵

The DOJ did not act alone. The Attorneys General of 20 states filed a civil action in 2016⁵⁹⁶ and subsequently filed two amended complaints alleging market allocation and price fixing in the generic drug market. The most recent amended complaint, filed in June 2020, identified 46 states, the District of Columbia, and four U.S. territories as plaintiffs and 26 companies and ten individuals as defendants. Whereas the DOJ criminal action encompassed a narrow subset of generic drugs,⁵⁹⁷ the civil action was expansive. The amended complaint by the Attorneys General added 80 additional generic drugs to the existing lengthy list of pharmaceuticals—including those used to treat HIV, cancer, and depression—for which most of the industry was accused of fixing prices.⁵⁹⁸ The litigation to some extent modeled prior tobacco and opioid cases and has been described as targeting “most likely the largest cartel in the history of the United States.”⁵⁹⁹ The litigation is proceeding as an MDL that also includes private plaintiffs.⁶⁰⁰

Share prices of the pharmaceutical companies receiving DOJ subpoenas sharply declined and securities class actions followed, beginning in 2016.⁶⁰¹ The complaints in the EDSL often allege that during the class period defendants artificially inflated their share price by falsely attributing their excellent financial results to astute business strategies rather than collusive increases in generic drug prices.⁶⁰²

595. Jeffrey May, *Antitrust News: Fifth Pharmaceutical Company Charged in Generic Drug Price Fixing Probe*, WOLTERS KLUWER ANTITRUST LAW DAILY (July 6, 2020).

596. Bryan Koenig, *AGs Pile on Generic Cos. with 3rd Price-Fixing Complaint*, LAW360 (June 10, 2020, 7:41 PM), <https://www.law360.com/articles/1281659/ags-pile-on-generics-cos-with-3rd-price-fixing-complaint> [<https://perma.cc/N9R9-DWJK>]

597. Bryan Koenig, *Glenmark, Teva Say DOJ ‘Rewriting’ Price-Fixing Indictment*, LAW360 (Aug. 9, 2021, 9:56 PM), <https://www.law360.com/articles/1410990> [<https://perma.cc/T4AB-A4M9>].

598. Bryan Koenig, *AGs Pile on Generic Cos. with 3rd Price-Fixing Complaint*, LAW360 (June 10, 2020, 7:41 PM), <https://www.law360.com/articles/1281659> [<https://perma.cc/5ZH A-23ZP>].

599. Christopher Rowland, *Generic Drug Industry Is Riddled with Price-Fixing Schemes, Investigators Say*, L.A. TIMES (Dec. 13, 2018, 4:15 AM), <https://www.latimes.com/business/la-fi-generic-drugs-prices-20181213-story.html> [<https://perma.cc/XMT4-GZTN>] (quoting Joseph Nielsen, Connecticut Assistant Attorney General).

600. *In re Generic Pharm. Pricing Antitrust Litig.*, No. 2:16-md-02724 (E.D. Pa. July 13, 2020).

601. Kevin LaCroix, *Generic Drug Companies Hit with Antitrust Enforcement Follow-On Securities Suits*, D&O DIARY (Nov. 9, 2016), <https://www.dandodiary.com/2016/11/articles/securities-litigation/generic-drug-companies-hit-antitrust-enforcement-follow-securities-suits/> [<https://perma.cc/2P86-YTJ9>].

602. *See, e.g., Ontario Teachers’ Pension Plan Board v. Teva Pharm. Indus. Ltd.*, 432 F. Supp. 3d 131, 143 (D. Conn. 2019):

Plaintiffs have fared significantly better in this line of EDSL than in the poultry cases. Some of the litigation settled early.⁶⁰³ Numerous other cases proceeded after denials of motions to dismiss and some classes were certified. In March 2021 the federal district court in Connecticut certified a class of investors in Teva Pharmaceuticals in antitrust EDSL. Teva also is a defendant in the state antitrust litigation and its U.S. subsidiary was criminally charged in August 2020 by the DOJ for conduct relating to its alleged collusion to fix certain generic drug prices.⁶⁰⁴ Plaintiffs in the certified class allege that Teva was able to leverage its stock price, inflated by its collusive behavior, to help finance a \$40 billion purchase in 2016 of Actavis, which is the worldwide generics business of Allergan.⁶⁰⁵

Prior to certification the court largely denied defendants' motion to dismiss. The court determined that Teva, incorporated in Israel, failed to comply with Item 5 of SEC Form 20-F (which is applicable to certain foreign private issuers and requires the same disclosures as Item 303) by failing to disclose the price-based nature of its profits.⁶⁰⁶ The court also rejected arguments that (1) Teva's statements were forward-looking, insofar as they discussed past performance but omitted pricing as a profit factor, and (2) mere puffery, insofar as statements that the company faced "fierce competition" were actionable, given the collusive nature of the generic drug market.⁶⁰⁷ However, the court rejected the argument that Teva was obligated to disclose two subpoenas from the DOJ and Connecticut Attorney General, because federal securities laws do not require disclosure of uncharged, unadjudicated misconduct, and the case subsequently settled for \$420 million in January 2022.⁶⁰⁸

Plaintiffs basically allege that the defendants implemented 'a strategy to systematically raise generic drug prices across a large swath of Teva's generic drug portfolio,' which the plaintiffs refer to as the 'Price-Hike Strategy. . . . According to the plaintiffs, however, the defendants failed to reveal the actual reason for the company's financial success, and attributed the growth to 'fundamental business strategies' such as cost-cutting and 'good product management.'

603. See, e.g., Jeff Montgomery, *Lannett Drug Price-Fixing Settlement Gets Del. Judge's OK*, LAW360 (Oct. 23, 2020, 10:56 PM), <https://www.law360.com/articles/1322250> [<https://perma.cc/86GR-3438>] (describing settlement in generic drug EDSL against Lannett Company).

604. *In re Teva Sec. Litig.*, No. 17-cv-558, 2021 WL 872156 (D. Conn. Mar. 9, 2021).

605. *Id.* at *2.

606. *Ontario Teachers' Pension Plan Bd. v. Teva Pharm. Indus. Ltd.*, 432 F. Supp. 3d 131, 163–64 (D. Conn. 2019).

607. *Id.* at 166.

608. *Id.* at 167; Order Preliminarily Approving Settlement and Providing for Class Notice, *In re Teva Sec. Litig.*, No. 3:17-cv-00558 (SRU) (Jan. 27, 2022).

The federal district court in New Jersey denied a motion to dismiss the second amended complaint in a different securities class action that named as defendants Allergan, six of its top executives, and the board of directors.⁶⁰⁹ The amended complaint alleged that Allergan conspired to increase the prices of six generic drugs—some by as much as 7,000%—and made materially false statements or omissions about the conspiracy.⁶¹⁰ In resolving the motion to dismiss the court first determined that plaintiffs plausibly alleged that Allergan participated in a price-fixing conspiracy.⁶¹¹ The court so held without applying a stricter standard requiring specificity in pleading the underlying anticompetitive conduct.

The *Allergan* court next examined whether plaintiffs adequately alleged material misstatements or omissions, premised on defendants' failure to disclose the underlying alleged anticompetitive conduct. The court, citing *Matrixx*, rejected defendants' argument that Allergan's statements were non-actionable puffery and concluded that plaintiffs' allegations sufficed.⁶¹² Allergan had made repeated representations that its ability to raise prices was attributable to such factors as its strong supply chain, the reliability of high-quality supply, its diverse portfolio, and the uniqueness of its pipeline and product line, when its price-fixing scheme was driving the price increases for its generic drugs.⁶¹³ The court held, consistent with a line of prior decisions,⁶¹⁴ that statements crediting revenues to legitimate business factors put the source of the revenue at issue, thereby making the company's failure to disclose a source of that revenue misleading.⁶¹⁵ As noted *supra*, this same issue has arisen in the foreign bribery event-driven cases. The court also held that Allergan's statements minimizing the significance of the on-going federal investigation were misleading, and, if the company was engaged in price-fixing for *any* drugs, a federal investigation into such conduct would be material.⁶¹⁶

609. *In re Allergan Generic Drug Pricing Sec. Litig.*, Civ. Action No. 16-9449, 2019 WL 3562134 (D.N.J. Aug. 6, 2019).

610. *Id.* at *6–9.

611. *Id.* at *6.

612. *Id.* at *7–11.

613. *Id.*

614. *See, e.g., Steiner v. MedQuist, Inc.*, No. 04-5487, 2006 WL 2827740, at *16 (D.N.J. Sept. 29, 2006) (holding that statements attributing revenues to legitimate business factors such as increased sales were misleading because they failed to disclose defendants' illicit billing scheme).

615. 2019 WL 3562134, at *10.

616. *Id.* In January 2021 the DOJ moved to intervene in this litigation. *See* Bill Wichert, *Feds Want in on Allergan Collusion Suit amid Criminal Probe*, LAW360 (Jan. 6, 2021, 3:02 PM), <https://www.law360.com/lifesciences/articles/1342188/feds-want-in-on-allergan-collusion-suit-amid-criminal-probe> [<https://perma.cc/2LKW-NN4K>].

In July 2021 *Allergan* settled for \$130 million while the investors' motion for class certification was pending.⁶¹⁷ This was the first such deal struck in the generic drug price-fixing EDSL,⁶¹⁸ and it likely constituted a harbinger of future outcomes in other such cases. To date, federal district court decisions in at least four other actions in the generic drug EDSL have been mostly favorable to plaintiffs, and additional settlements would be unsurprising.

First, in litigation against generic manufacturer Taro, the court largely denied the motion to dismiss, after crediting information supplied by CWs and holding that Taro had placed the source of its profitability at issue without disclosing the underlying collusion.⁶¹⁹ Second, in litigation against Mylan and several of its officers, the court rejected plaintiffs' argument that the company's Code of Conduct and Business Ethics—which stated that Mylan was committed to complying with applicable antitrust and fair competition laws—was materially misleading for failing to disclose the company's anticompetitive conduct.⁶²⁰ The court categorized this statement as non-actionable puffery.⁶²¹ However, the court also held that Mylan's statements about its net income and revenue were materially misleading insofar as such metrics were inflated by virtue of its anticompetitive activity,⁶²² and it found information supplied by a CW adequate to support an allegation of scienter as to price-fixing.⁶²³ The court later certified an investor class in 2020.⁶²⁴

Third, in litigation against McKesson Corporation (a pharmaceutical wholesaler), the court denied a motion to dismiss after holding that defendant had a duty to disclose that some portion of its increased profits was attributable to collusive activity.⁶²⁵ The key to this holding was that

617. Bill Wichert, *Allergan Strikes \$130M Deal over Drug Price-Fixing Claims*, LAW360 (July 12, 2021, 4:18 PM), <https://www.law360.com/newjersey/articles/1402298> [<https://perma.cc/7PZF-NP92>].

618. *Id.* The court subsequently denied a motion to dismiss in opt-out litigation against Allergan. *TIAA-CREF Large-Cap Growth Fund v. Allergan PLC*, No. 17-cv-11089, 2021 WL 4473156 (D.N.J. Sept. 30, 2021).

619. *Speakes v. Taro Pharm. Indus., Ltd.*, No. 16-cv-08318 (ALC), 2018 WL 4572987, at *6–7 (S.D.N.Y. Sept. 24, 2018).

620. *In re Mylan N.V. Sec. Litig.*, No. 16-CV-7926, 2018 WL 1595985, at *10 (S.D.N.Y. Mar. 28, 2018).

621. *Id.*

622. *Id.* at *6.

623. *Id.* at *17.

624. *In re Mylan N.V. Sec. Litig.*, No. 16-CV-7926, 2020 WL 1673811 (S.D.N.Y. Apr. 6, 2020).

625. *Evanston Police Pension Fund v. McKesson Corp.*, 411 F. Supp. 3d 580, 599–600 (N.D. Cal. 2019).

McKesson had placed the source of its profitability at issue without disclosing the underlying illegality.⁶²⁶ The court also held that scienter was adequately pled, in large part on the basis of the so-called core operations doctrine.⁶²⁷ Specifically, the magnitude of the price-fixing conspiracy and its significance to McKesson's revenues, in combination with the defendant executives' leadership roles at the company (CEO and CFO, respectively) and their statements touting their knowledge of the generics markets, sufficed to warrant application of the doctrine.⁶²⁸

Finally, a trio of decisions by the federal district court in antitrust EDSL against Lannett Company and its former CEO and CFO also underscores the key issues discussed above. In the first decision, issued in 2018, the court granted a motion to dismiss after steeply discounting information supplied by CWs and rejecting application of the core operations doctrine.⁶²⁹ In the second decision, issued in 2019, the court denied a motion to dismiss plaintiffs' third amended complaint, which asserted a modified theory of liability. This time plaintiffs abandoned their argument that defendants misrepresented their own anticompetitive conduct in favor of the successful allegation that defendants misled investors by stating that generic drug price increases were the result of competitive market forces, despite knowing that the market was being driven by their competitors' antitrust violations.⁶³⁰ The

626. *Id.*

627. See Michael J. Kaufman & John M. Wunderlich, *Messy Mental Markers: Inferring Scienter from Core Operations in Securities Fraud Litigation*, 73 OHIO ST. L.J. 507 (2012) (analyzing core operations doctrine).

628. McKesson Corp., 411 F. Supp. 3d at 601. Subsequently, an investor class was certified and McKesson was granted partial summary judgment, with respect to one of two corrective disclosures. *Evanston Police Pension Fund v. McKesson Corp.*, No. 18-cv-06525-CRB, 2021 WL 4902420 (N.D. Cal. Oct. 21, 2021).

629. *Utesch v. Lannett Co.*, 316 F. Supp. 3d 895, 904–06 (E.D. Pa. 2018).

630. *Utesch v. Lannett Co.*, 385 F. Supp. 3d 408, 418–21 (E.D. Pa. 2019). *But see* Plymouth Cnty. Ret. Sys. v. Patterson Cos., Inc., No. 18-cv-871, 2019 WL 3336119, at *15 (D. Minn. July 25, 2019), *report and recommendation adopted as modified*, 2019 WL 4277302 (Sept. 10, 2019) (rejecting argument that where defendants touted their success in “highly competitive” dental supply market, they were required to disclose their scheme to fix dental supply prices). It is difficult to understand how defendants' statement was not misleading in this case. *Cf. Pelletier v. Endo Int'l PLC*, 439 F. Supp. 3d 450, 465–66 (E.D. Pa. 2020) (citing first two decisions in *Utesch*, rejecting argument that defendants' failure to disclose their participation in conspiracy to fix generic drug prices constituted securities fraud, and accepting argument that defendants' statements about market conditions, sources of revenue, and pricing decisions were actionable). The court subsequently certified an investor class in *Endo*. See *Pelletier v. Endo Int'l PLC*, No. 17-cv-5114, 2021 WL 2023608 (E.D. Pa. May 20, 2021) (certifying class). The *Endo* litigation settled for \$63 million in October 2021. Craig Clough, *Endo Investors Ink \$63M Deal in Generics Stock Inflation Suit*, LAW360 (Oct. 15, 2021, 10:23 PM), <https://www.law360.com/articles/1431670> [<https://perma.cc/MVZ5-76L7>].

court also rejected defendants' arguments that their statements were mere puffery and the core operations inference was inapplicable.⁶³¹ In the third decision, issued in August 2021, the court certified the class.⁶³²

To date, the generic drug EDSL has produced a single appellate decision, which was favorable to plaintiffs. In a pair of lower court decisions in securities litigation against generic drug manufacturer Impax Laboratories the Northern District of California granted motions to dismiss, ultimately with prejudice. In the first decision the court rejected application of the core operations inference, because the complaint failed to allege that defendant executives knew of the alleged collusion.⁶³³ In the second decision, issued after plaintiffs filed a second amended complaint, the court deemed plaintiff's loss causation allegations insufficient as to price-fixing, because neither the issuance of a DOJ subpoena for four generic medications nor the disclosure of an investigation constituted the requisite corrective disclosures linked to stock price declines.⁶³⁴ But on appeal the Ninth Circuit reversed in part, in 2021, holding that plaintiffs had adequately pleaded loss causation as to their price-fixing theory.⁶³⁵ The litigation subsequently settled for \$33 million.⁶³⁶

What conclusions can be drawn from the antitrust EDSL? First, one of the primary obstacles for plaintiffs in these cases is the requirement to prove an antitrust conspiracy—a case within a case. If plaintiffs must plead with particularity the underlying collusive conduct this may be outcome-determinative for motions to dismiss. Second, there has been non-uniform application by courts of the core operations doctrine, likely because its contours are poorly defined. Third, successful use by plaintiffs of CWs to allege scienter can hinge on whether courts accept the proposition that information supplied by such witnesses should always be deeply discounted. Fourth, a fruitful falsity theory is likely to be that defendants placed the source of their profitability at issue without disclosing the underlying

631. *Utesch v. Lannett Co.*, 385 F. Supp. 3d 408, 421-24 (E.D. Pa. 2019).

632. *Utesch v. Lannett Co.*, No. 16-5932, 2021 WL 35609949, at *19 (E.D. Pa. Aug. 12, 2021) (certifying class).

633. *Fleming v. Impax Labs. Inc.*, No. 16-cv-06557-HSG, 2018 WL 4616291, at *4 (N.D. Cal. Sept. 7, 2018).

634. *New York Hotel Trades Council & Hotel Ass'n of New York City, Inc. Pension Fund v. Impax Labs Inc.*, No. 16-cv-06557-HSG, 2019 WL 3779262, at *2-3 (N.D. Cal. Aug. 12, 2019).

635. *New York Hotel Trades Council & Hotel Ass'n of New York City, Inc. Pension Fund v. Impax Labs Inc.*, No. 19-16744, 2021 WL 81719 (9th Cir. Jan. 11, 2021).

636. Melissa Angell, *Impax Inks \$33M Deal with Investors in Price-Fixing Suit*, LAW360 (Aug. 2, 2021, 7:55 PM), <https://www.law360.com/articles/1408921> [<https://perma.cc/H676-967Z>].

collusion. Fifth, it does not suffice to plead scienter for plaintiffs to merely allege the existence of a government investigation concerning anti-competitive conduct, and the disclosure of such investigations does not establish loss causation. Sixth, plaintiffs are likely to prevail on the puffery argument if defendants' statements directly conflict with the collusive nature of the product market.

E. #MeToo

The #MeToo movement simultaneously has had a major impact on corporate America and has constituted another EDSL catalyst.⁶³⁷ The movement began on a limited basis in 2007⁶³⁸ but did not become prominent until 2017, when sexual assault allegations against entertainment mogul Harvey Weinstein surfaced. Even before the movement coalesced, shareholders pursued occasional derivative and securities fraud class actions in response to sexual harassment scandals. These pioneering actions—commencing in 1998 with a derivative suit involving ICN Pharmaceuticals⁶³⁹ and continuing with both derivative and class action litigation involving Hewlett-Packard in 2012—failed.⁶⁴⁰

The #MeToo movement and recent scandals in a spectrum of industries have sparked a new, somewhat more successful generation of litigation⁶⁴¹ that constitutes a significant subset of EDSL. In 2019, at least ten new actions asserting securities law claims based on corporate sexual misconduct were commenced, consistent with both the rate of filings in 2018 and 2017⁶⁴²

637. Karen Y. Bitar & Sarah Fedner, Seyfarth Shaw LLP, *Recent Developments in Securities Litigation: The “Event Driven” #MeToo Lawsuit* (June 10, 2019), <https://www.seyfarth.com/print/content/22734/recent-developments-in-securities-litigation-the-event-driven-metoo-lawsuit.pdf> [<https://perma.cc/XW2S-D75X>].

638. Deborah Tuerkheimer, *Beyond #MeToo*, 94 N.Y.U. L. REV. 1146, 1147 n.2 (2019).

639. *See White v. Panic*, 783 A.2d 543 (Del. 2001) (affirming dismissal of derivative action involving alleged sexual misconduct by CEO of ICN).

640. *See Retail Wholesale & Dep’t Store Union Local 338 Ret. Fund v. Hewlett-Packard Co.*, 52 F. Supp. 3d 961 (N.D. Cal. 2014), *aff’d*, 845 F.3d 1268 (9th Cir 2017) (affirming dismissal of securities fraud action involving sexual misconduct by former Hewlett-Packard CEO); *Zucker v. Andreessen*, No. 6014-VCP, 2012 WL 2366448 (Del. Ch. 2012) (dismissing derivative action).

641. *See Jyotin Hamid, Tricia Sherno & Brooke Willig, #MeToo’s Unexpected Implications for Shareholder Litigation*, LAW360 (May 15, 2020, 5:28 PM), <https://www.law360.com/articles/1269565> [<https://perma.cc/QK6U-BP8V>] (describing evolution of litigation).

642. Susan L. Saltzstein & Jocelyn E. Strauber, *#MeToo Litigation: The Changing Landscape, a Year Later*, N.Y. L.J. (Mar. 13, 2020). <https://www.law.com/newyorklawjournal/2020/03/27/metoo-litigation-the-changing-landscape-a-year-later/> [<https://perma.cc/Q2AT4KW8>] [hereinafter *A Year Later*].

and predictions made when the #MeToo movement began in earnest.⁶⁴³ Additional actions began in subsequent years. For example, the S&P 500 video gaming giant, Activision Blizzard (responsible for Call of Duty, World of Warcraft, and Candy Crush), and three of its top executives were targets of #MeToo EDSL that kicked off in August 2021 after news about alleged pervasive sexual discrimination and harassment at the company surfaced and its share price dropped 6%.⁶⁴⁴ The foregoing judicial developments have taken place in tandem with legislative activity. Since 2017, at least fifteen states have passed new laws protecting against workplace sexual harassment.⁶⁴⁵

EDSL in the #MeToo sector typically concerns public statements issued by a corporation—often in codes of conduct—with respect to company values, integrity, and adherence to ethical standards, compared with directors’ and officers’ alleged knowledge of behavior and practices within the company that undercut such policies.⁶⁴⁶ The complaints often allege that subsequent disclosure of the true facts led to a stock price decline and harmed investors. Alternatively, the complaints allege that the company engaged in a cover-up of the abuse, failed to take adequate steps to address it, or failed to truthfully disclose what steps it did or did not take to deter, investigate, or curb the problem after allegations of abuse became public.

In contrast, the derivative actions generally allege that the company’s directors and officers breached their fiduciary duties or wasted corporate assets when they ignored the hostile work environment caused by sexual harassment, failed to remedy the situation, and then incurred subsequent severance and settlement payments and litigation costs. Derivative actions based on #MeToo misconduct have been filed against Google’s parent company Alphabet, CBS, Liberty Tax, Lululemon Athletica, McDonald’s, National Beverage, Nike, Twenty-First Century Fox, Victoria’s Secret parent company L Brands, and Wynn Resorts, among others.⁶⁴⁷ The

643. See Dunstan Prial, *Attorneys Predict Wave of #MeToo Investor Suits*, LAW360 (Feb. 14, 2018, 7:01 PM), <https://www.law360.com/articles/1012534> [<https://perma.cc/E865-AQPY>] (reporting expected wave of #MeToo EDSL).

644. See Complaint, *Cheng v. Activision Blizzard, Inc.*, No. 21-cv-06240 (C.D. Cal. filed Aug. 3, 2021). The company confirmed in September 2021 that an SEC investigation was proceeding in tandem with the securities litigation. See Amanda Ottaway, *A Cheat Sheet for Activision Blizzard’s Legal Woes*, LAW360 (Sept. 21, 2021, 9:41 PM), <https://www.law360.com/articles/1423693> [<https://perma.cc/CE8Z-PEL7>] (reporting SEC investigation).

645. Erik A. Christiansen, *How Are the Laws Sparked by #MeToo Affecting Workplace Harassment?*, 45 ABA LITIG. NEWS 11, 11 (2020).

646. Susan L. Saltzstein & Jocelyn E. Strauber, *#MeToo Litigation: The Changing Landscape*, N.Y. L.J., Mar. 1, 2019, <https://www.law.com/newyorklawjournal/2019/02/28/mctoo-litigation-the-changing-landscape/> [<https://perma.cc/6PDB-US3V>].

647. See Scott Carlton, ABA Practice Points, *The #MeToo Movement and the Shareholder*

derivative action involving Alphabet settled in 2020 for a nominal \$310 million—which in dollar terms was the largest-ever shareholder derivative settlement,⁶⁴⁸ the derivative action against L Brands settled in 2021 for a nominal \$90 million,⁶⁴⁹ and the derivative action against Fox settled in 2017 for \$90 million.⁶⁵⁰

In multiple instances dual class and derivative actions have been filed against the same company based on overlapping #MeToo factual allegations, consistent with a recent pattern in securities litigation. In 2020, 55% of settled securities class actions involved an accompanying derivative action.⁶⁵¹ The #MeToo derivative settlements also reflect another recent trend in derivative litigation overall—beginning in the mid-2010s—in which settlements include a significant cash payment. Historically, such settlements only encompassed defendant’s agreement to adopt certain governance reforms and to pay plaintiffs’ attorneys’ fees.⁶⁵² Now such settlements often include those features as well as a major cash payment. In *L Brands*, for example, defendant agreed in July 2021 to adopt multiple management and governance reforms—including supplementation of its existing code of conduct with standalone policies on sexual harassment—

Derivative Action, American Bar Ass’n (Apr. 24, 2019), <https://www.americanbar.org/groups/litigation/committees/class-actions/practice/2019/me-too-movement-lawsuits-shareholder-derivative-action/> [<https://perma.cc/AJV2-QZBU>] (discussing multiple #MeToo derivative actions); Hailey Konnath, *Victoria’s Secret Plagued by ‘Abusive’ Culture, Investor Says*, LAW360 (June 18, 2020, 10:48 PM), <https://www.law360.com/articles/1284003> [<https://perma.cc/LA7C-E9TF>] (discussing L Brands #MeToo derivative actions in Ohio and Delaware); J. Edward Moreno, *New McDonald’s Suit Widens Stockholder Sex Scandal Probe*, LAW360 (Aug. 6, 2021, 7:14 PM EDT), <https://www.law360.com/delaware/articles/1410576> [<https://perma.cc/5SSX-PMPP>] (discussing McDonald’s litigation).

648. Kevin LaCroix, *Alphabet Establishes \$310 Million Fund in Google Sexual Misconduct Lawsuit Settlement*, D&O DIARY (Sept. 27, 2020), <https://www.dandodiar.com/2020/09/articles/shareholders-derivative-litigation/alphabet-agrees-to-310-million-fund-in-google-sexual-misconduct-lawsuit-settlement/> [<https://perma.cc/6FEZ-37UD>]. The settlement will be funded over ten years, so the present value is less than \$310 million.

649. Stipulation and Agreement of Settlement, *Rudi v. Wexner*, No. 2:20-cv-3068 (S.D. Ohio filed July 30, 2021).

650. Mark Lebovitch, *Settlement of Workplace Harassment Suit at 21st Century Fox*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 19, 2017), <https://corpgov.law.harvard.edu/2017/12/19/settlement-of-workplace-harassment-suit-at-21st-century-fox/> [<https://perma.cc/LKL6-CZ8V>].

651. CORNERSTONE RESEARCH, SECURITIES CLASS ACTION SETTLEMENTS: 2020 REVIEW AND ANALYSIS 10 (2021), <https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Settlements-2020-Review-and-Analysis> [<https://perma.cc/W8GG-SZK5>].

652. See Priya Cherian Huskins, *Five Types of Derivative Suits with Massive Settlements*, Woodruff Sawyer (Oct. 13, 2020), <https://woodrufflaw.com/do-notebook/five-derivative-suits-types-massive-settlements> [<https://perma.cc/KK2C-VLLV>] (observing that vast majority of derivative suits settle with no cash payment other than payment of attorneys’ fees).

and to fund these reforms with \$90 million over the course of at least five years.⁶⁵³

Not coincidentally, the number of public companies mentioning “sexual harassment” in risk factor disclosures also has spiked in recent years, despite the absence of any specific securities law requirement to disclose internal sexual harassment investigations. More than half of such disclosures in the last two decades (approximately 60 of 117) appeared after 2017.⁶⁵⁴ Companies make such non-mandatory disclosures for multiple practical reasons, including a desire to preemptively shape the narrative about the alleged abusive conduct.⁶⁵⁵

The disclosure rules most likely applicable to sexual harassment investigations include Items 103 and 303, but even these provisions may have little significance. Item 103 requires disclosure of both material legal proceedings currently pending against a company and any such proceedings known to be contemplated by governmental authorities, but it does not specifically require disclosure of internal sexual misconduct investigations.⁶⁵⁶ Moreover, no disclosure is required if there is a proceeding involving primarily a claim for damages but the amount involved does not exceed 10% of the current assets of the company and its subsidiaries.⁶⁵⁷ An aggregation rule requires companies to count toward the 10% threshold all proceedings that present in large degree the same legal and factual issues,⁶⁵⁸ but very few #MeToo cases will involve damage claims that exceed the 10% threshold, even if aggregated.⁶⁵⁹

Item 303 requires disclosure of known trends and uncertainties that that have had or that the company reasonably expects will have a material favorable or unfavorable impact on net sales or revenues from continuing

653. Stipulation and Agreement of Settlement, *Rudi v. Wexner*, No. 20-cv-3068 (S.D. Ohio filed July 30, 2021).

654. *A Year Later*, *supra* note 642.

655. Deborah Birnbach, Jennifer Fay & Dylan Schweers, *The Securities Law Questions Raised by #MeToo*, LAW360 (Feb. 28, 2018, 3:05 PM), <https://www.law360.com/articles/1015772> [<https://perma.cc/2945-77ZV>].

656. Spencer Feldman, Securities Law Blog, *Reporting Sexual Misconduct Allegations May Not Be Ready for SEC Disclosure Yet but Should Be Part of the Conversation*, OLSHAN (Dec. 12, 2017), <https://www.olshanlaw.com/pp/blogpost-reporting-sexual-misconduct-allegations-may-not-be.pdf?79491> [<https://perma.cc/V9KE-L9YS>] (observing that adverse investigatory findings concerning sexual misconduct “neither rise to the level of pending legal proceedings for purposes of Item 103, nor are they deemed to constitute the initial stage of pending legal proceedings”).

657. 17 C.F.R. § 229.103(b)(2) (2021).

658. *Id.*

659. Hemel & Lund, *supra* note 231, at 1650–51.

operations.⁶⁶⁰ Allegations of sexual harassment against a CEO or other top executive may have such an effect and thus be subject to mandatory disclosure.⁶⁶¹ This conclusion is suggested by research demonstrating that sexual harassment leads to lower productivity and higher rates of employee absenteeism and turnover,⁶⁶² as well as by the potential litigation costs stemming from #MeToo claims.

One analysis, published in 2018, concluded that “the viability of securities law claims against companies that fail to disclose the extent of corporate sexual misconduct will be case specific,” and plaintiffs are likely to fare best in those cases in which defendants have made inaccurate specific statements about ongoing litigation.⁶⁶³ With the benefit of hindsight we can assess the accuracy of that conclusion by examining how plaintiffs fared in #MeToo EDSL from 2018–2020.

The results have been decidedly mixed, with decisions rendered in separate putative class actions involving defendants CBS, Liberty Tax, National Beverage, Papa John’s, Signet Jewelers, Uber, and Wynn Resorts. Plaintiffs achieved their greatest success in the *Signet* litigation, which settled for \$240 million in 2020⁶⁶⁴ after the federal district court denied defendants’ motion to dismiss the fifth amended complaint⁶⁶⁵ and motion for judgment on the pleadings,⁶⁶⁶ and then certified an investor class.⁶⁶⁷ Signet sought leave to appeal to the Second Circuit in an effort to obtain a *Cigna*-esque ruling, and the Second Circuit granted leave, but the appeal was withdrawn following a successful mediation.⁶⁶⁸ As of December 31, 2020, the *Signet* settlement ranked among the top seventy-five securities class action settlements of all-time.⁶⁶⁹

The primary issue presented by the motion for judgment on the pleadings was whether statements in Signet’s Code of Conduct and Code of

660. 17 C.F.R. § 229.303(2021).

661. Birnbach, Fay & Schweers, *supra* note 655.

662. Hemel & Lund, *supra* note 231, at 1652.

663. *Id.* at 1654–55.

664. Dean Seal, *Signet’s \$240M Investor Settlement Gets Final OK*, LAW360 (July 21, 2020, 7:18 PM), <https://www.law360.com/articles/1294237> [<https://perma.cc/ZS97-97PX>] [hereinafter *Signet Settlement*].

665. *In re Signet Jewelers Ltd. Sec. Litig.*, No. 16 Civ. 6728 (CM), 2018 WL 6167889 (S.D.N.Y. Nov. 26, 2018).

666. *In re Signet Jewelers Ltd. Sec. Litig.*, 389 F. Supp. 3d 221 (S.D.N.Y. 2019).

667. *In re Signet Jewelers Ltd. Sec. Litig.*, No. 16 Civ. 6728, 2019 WL 3001084 (S.D.N.Y. July 10, 2019).

668. *Signet Settlement*, *supra* note 664.

669. Sarah Jarvis, *Investor Settlements Held Steady in 2020 Despite Pandemic*, LAW360 (Feb. 25, 2021, 9:50 PM), <https://www.law360.com/banking/articles/1358941> [<https://perma.cc/H3H5-PV4X>].

Ethics constituted non-actionable puffery and were therefore immaterial as a matter of law, pursuant to the decision in *Cigna*, which had been issued by the Second Circuit a few months earlier. The federal district court firmly rejected Signet's argument, stating:

Cigna did not purport to change the well-established law regarding materiality. It did not announce a new legal rule, let alone one deeming an entire category of statements — those contained in a company's code of conduct — *per se* inactionable. . . . Significantly, *Cigna* did not rule (as Defendants imply) that all statements in codes of conduct qualify as 'puffery.'⁶⁷⁰

The district court concluded that context matters, consistent with the Supreme Court's decisions in *TSC Industries, Inc. v. Northway, Inc.*⁶⁷¹ and *Basic Inc. v. Levinson*.⁶⁷² And in *Signet*, the facts starkly differed from those alleged in *Cigna*. The statements in *Cigna*'s Code of Conduct were not actionable because they were exceptionally vague and aspirational. In sharp contrast, in the face of credible allegations (in a prior lawsuit) that Signet suffered from rampant sexual harassment, the company sought to reassure the investing public that it did not operate a toxic workplace. It did so by, *inter alia*, including representations in its periodic SEC filings that it expressly denied the allegations in the prior litigation and by falsely affirming its fidelity to internal policies which committed the company to making hiring decisions solely on the basis of merit, disciplining misconduct in its ranks, and providing employees with a means to report sexual harassment without fear of reprisal.⁶⁷³ As the court previously noted when it denied defendants' motion to dismiss the fifth amended complaint, "statements contained in a code of conduct are actionable where they are directly at odds with the conduct alleged in a complaint."⁶⁷⁴ When the court denied the motion to dismiss it likewise found that plaintiff adequately alleged that defendants made materially false or misleading statements in violation of Item 103, insofar as the public disclosures made by Signet mischaracterized the prior litigation, which alleged pervasive sexual harassment that reached the highest offices in the company.⁶⁷⁵

Plaintiffs also experienced some success in the #MeToo EDSL involving defendant CBS. In 2020 the federal district court denied in part

670. *In re Signet Jewelers Ltd. Sec. Litig.*, 389 F. Supp. 3d 229–30 (S.D.N.Y. 2019).

671. *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438 (7th Cir. 1976).

672. 389 F. Supp. 3d at 230–31.

673. *Id.* at 231.

674. *In re Signet Jewelers Ltd. Sec. Litig.*, No. 16 Civ. 6728, 2018 WL 6167889, at *17 (S.D.N.Y. Nov. 26, 2018).

675. *Id.*

and granted in part a motion to dismiss the amended complaint in that case, which concerned alleged sexual misconduct by former CBS CEO and Chairman of the Board, Les Moonves.⁶⁷⁶ The court acknowledged that “it is not the case that all statements in a code of conduct are categorically immaterial puffery.”⁶⁷⁷ It then identified three situations in which courts allowed statements in a code of conduct to survive a motion to dismiss: (1) a company wielded its code to reassure investors that nothing was amiss when faced with suspicions of internal malfeasance, (2) statements in the code were sufficiently detailed and concrete that a reasonable investor could rely upon them, and (3) the code included statements that were so anathema to the alleged internal wrongdoing that, even if general or aspirational, they were materially false.⁶⁷⁸

The *CBS* court then distinguished *Signet* and held that most of the statements in CBS’s Business Conduct Statement (BCS) were mere puffery, because they were far too general and aspirational to invite reasonable reliance, and none were alleged to be false or misleading.⁶⁷⁹ The same was true with respect to statements in CBS’s Code of Ethics.⁶⁸⁰ This holding is dubious, because the court concluded that even such factual BCS statements as CBS “will . . . take all steps” [and] “remedial action” [to stop] “sexual harassment” were too general and disconnected from plaintiffs’ central theory of securities fraud to be material.⁶⁸¹ According to the court, no reasonable investor would rely on these statements.⁶⁸² It is not obvious that this is correct.

The court also rejected plaintiffs’ argument that Item 303 imposed on CBS an affirmative duty to disclose its executives’ sexual misconduct. Item 303 requires disclosure where a trend, demand, commitment, event, or uncertainty is both (1) presently known to management and (2) reasonably likely to have material effects on the registrant’s financial conditions or results of operations.⁶⁸³ Disclosure is required only with respect to those trends and other topics that the registrant actually knows of when it files the relevant report with the SEC.⁶⁸⁴ Item 303 disclosures most often relate to micro- and macroeconomic issues, such as erosion of the registrant’s market

676. *Constr. Laborers Pension Tr. for So. Cal. v. CBS Corp.*, No. 18-CV-7796, 2020 WL 248729 (S.D.N.Y. Jan. 15, 2020).

677. *Id.* at *7.

678. *Id.*

679. *Id.* at *8–9.

680. *Id.* at *10.

681. *Id.*

682. *Id.*

683. *Stratte-McClure v. Morgan Stanley*, 776 F.3d 94, 101 (2d Cir. 2015).

684. *Indiana Pub. Ret. Sys. v. SAIC, Inc.*, 818 F.3d 85, 95 (2d Cir. 2016).

share.⁶⁸⁵

In *CBS* the court rejected both defendants' argument that information about workplace sexual misconduct is categorically exempt from disclosure under Item 303 and plaintiffs' argument that Item 303 requires disclosure of foreseeable events, such as the negative impact on CBS's earnings or revenues caused by the departure of Moonves. Defendants' argument was misplaced because Item 303 is intentionally general,⁶⁸⁶ and plaintiffs' argument was misplaced because Item 303 only requires disclosure of uncertainties that are more than foreseeable or possible.⁶⁸⁷ The court concluded that CBS had no duty to disclose either the company's alleged hostile culture toward women or the percolating #MeToo accusations against Moonves, because the amended complaint did not allege that the uncertain futures of Moonves and other executives were reasonably likely to have an impact on the company's financial performance.⁶⁸⁸

So how did the amended complaint in *CBS* survive? The court allowed the action to proceed based on a statement by Moonves at a major industry event that “[#MeToo] is a watershed moment. . . . It's important that a company's culture will not allow for this. And that's the thing that's far-reaching. There's a lot we're learning. There's a lot we didn't know.”⁶⁸⁹ The court held that plaintiffs adequately alleged that this was a misleading statement of material fact,⁶⁹⁰ and the statement could be imputed to CBS. In effect, the amended complaint was saved by an allegation suggesting that Moonves was deceptively trying to cover-up his own misconduct. In 2020 plaintiffs moved for class certification,⁶⁹¹ and that motion was pending in 2021.

Plaintiffs barely survived the motion to dismiss in *CBS*, but in numerous event-driven cases saving even one claim is plaintiffs' primary objective. Once the case proceeds beyond this juncture settlement odds dramatically shorten. However, apart from *Signet* and *CBS*, plaintiffs have fared poorly in #MeToo EDSL since 2018. Dismissals were granted (and sometimes affirmed) in separate cases involving defendants Liberty Tax,⁶⁹² National

685. 2020 WL 248729, at *14.

686. *Id.* at *15.

687. *Id.*

688. *Id.*

689. *Id.* at *13.

690. *Id.*

691. Reenat Sinay, *CBS Investors Seek Class Cert. in #MeToo Suit Over Moonves*, LAW360 (Aug. 3, 2020, 5:24 PM), <https://www.law360.com/articles/1297627> [<https://perma.cc/X2YJ-KLA4>].

692. *In re Liberty Tax, Inc. Sec. Litig.*, 828 Fed. App'x 747 (2020).

Beverage,⁶⁹³ Papa John's,⁶⁹⁴ Uber,⁶⁹⁵ and Wynn Resorts,⁶⁹⁶ although leave to amend was generally allowed.

Most of the foregoing decisions rejected as puffery those non-specific or aspirational statements about corporate culture or representations set forth in corporate codes of conduct, codes of ethics, or earnings calls. This was true in *Liberty Tax*,⁶⁹⁷ *Papa John's*,⁶⁹⁸ and *Wynn Resorts*.⁶⁹⁹ In *Papa John's*, the federal district court held that the “statements in the Code are quintessential puffery,”⁷⁰⁰ rejected plaintiffs’ Item 303 argument because the #MeToo risk was not a risk known to management,⁷⁰¹ and dismissed the first amended complaint. Leave to amend was granted, but in 2021 the court dismissed the second amended complaint—this time with prejudice—on the same grounds as before.⁷⁰²

In *Wynn Resorts* the federal district court in Nevada granted defendants’ motion to dismiss the first amended complaint. The court held that statements in the company’s Code of Conduct were merely aspirational and, citing the Ninth Circuit, stated that “investors do not rely on puffery when making investment decisions.”⁷⁰³ Again, it is not clear that this latter point is always true. Indeed, contrary empirical evidence suggests that investors do not ignore vague optimism when making investment decisions.⁷⁰⁴ In any event, the court granted leave to amend, and in July 2021 a different federal judge granted in part and denied in part defendants’ motion to dismiss plaintiffs’ second amended complaint. The court held that “[a]spirational statements in a code of conduct are not misleading,”⁷⁰⁵ but it found that two specific statements not set forth in the code were actionable. One was the statement by defendant Stephen Wynn that “[t]he idea that I ever assaulted

693. *Luczak v. Nat’l Bev. Corp.*, 812 Fed. App’x 915 (11th Cir. 2020).

694. *Oklahoma Law Enf. Ret. Sys. v. Papa John’s Int’l, Inc.*, 444 F. Supp. 3d 550 (S.D.N.Y. 2020).

695. *Irving Firemen’s Relief & Ret. Fund v. Uber Tech.*, 398 F. Supp. 3d 549 (N.D. Cal. 2019).

696. *Ferris v. Wynn Resorts Ltd.*, 462 F. Supp. 3d 1101 (D. Nev. 2020).

697. 828 Fed. App’x at 750–51.

698. 444 F. Supp. 3d at 560.

699. 462 F. Supp. 3d at 1120–22.

700. 444 F. Supp. 3d at 560.

701. *Id.* at 564.

702. *Oklahoma Law Enf. Ret. Sys. v. Papa John’s Int’l, Inc.*, No. 198-CV-7927 (KMW), 2021 WL 371401 (S.D.N.Y. Feb. 3, 2021).

703. 462 F. Supp. 3d at 1120 (citing *In re Cutera Sec. Litig.*, 610 F.3d 1103, 1111 (9th Cir. 2010)).

704. See Stefan J. Padfield, *Is Puffery Material to Investors? Maybe We Should Ask Them*, 10 U. PA. J. BUS. L. 339 (2008) (critiquing the puffery doctrine).

705. *Ferris v. Wynn Resorts Ltd.*, No. 18-cv-00479, 2021 WL 3216462, at *10 (D. Nev. July 28, 2021).

any woman is preposterous,” made in response to a *Wall Street Journal* article revealing allegations about his sexual misconduct.⁷⁰⁶ As to loss causation, the court, *inter alia*, found to be persuasive cases accepting the inflation maintenance theory, in the absence of guidance from the Ninth Circuit.⁷⁰⁷

In the meantime, the parallel Wynn Resorts #MeToo derivative action settled for a cash payment of \$41 million, plus corporate therapeutics and governance reforms that plaintiffs’ expert valued at an additional \$49 million.⁷⁰⁸ In addition, Wynn Resorts was fined \$55 million for covering up or ignoring the sexual abuse allegations against Wynn, its former CEO, following investigations by the Nevada Gaming Control Board and the Massachusetts Gaming Commission.⁷⁰⁹

Sexual harassment is pervasive in the workplace.⁷¹⁰ Claims against directors and officers arising from such misconduct can expose their employers to EDSL, as well as to massive costs encompassing reputational harm, consumer boycotts, declines in market capitalization, loss of corporate opportunities, and legal expenses for internal investigations, regulatory proceedings, and employment litigation.⁷¹¹ What are the lessons of #MeToo EDSL to date? Primarily, it is difficult for a complaint to survive in these cases. Most of the allegations concerning codes of conduct and ethics will be treated as mere puffery and the outcome will often turn on whether the subject statements are specific misrepresentations, rather than vague and aspirational commentary. Items 101 and 303 are unlikely to be helpful to plaintiffs.

Still, the litigation and the #MeToo movement have spurred fundamental changes in corporate conduct. As noted, disclosures regarding sexual harassment have become significantly more common. In the M&A environment, representations in transaction documents that no harassment or

706. *Id.* at *7.

707. *Id.* at *19.

708. Kevin LaCroix, *Dismissal Motion Granted in Wynn Resorts #MeToo-Related Securities Suit*, D&O DIARY (June 1, 2020), <https://www.dandodiary.com/2020/06/articles/securities-litigation/dismissal-motion-granted-in-wynn-resorts-metoo-related-securities-suit/> [<https://perma.cc/3D9G-YPDE>].

709. Sarah Jarvis, *Wynn Resorts Can’t End Investors’ Revived Suit over Ex-CEO*, LAW360 (July 30, 2021, 3:48 PM), <https://www.law360.com/articles/1408074> [<https://perma.cc/J86Q-XKFF>].

710. See Michael D. Rebeck, Note, *Sexual Misconduct & Securities Disclosure in the “#MeToo” World*, 75 N.Y.U. ANN. SURV. AM. L. 85, 105 (2020) (summarizing survey data concerning harassment).

711. Kelly Bryant Thorig, Pamela S. Palmer & Susan K. Lessack, *#MeToo: Is Your Company Covered?*, TROUTMAN PEPPER (Nov. 2018), <https://www.troutman.com/insights/metoo-is-your-company-covered.html> [<https://perma.cc/M4AX-3R4C>].

assault allegations have been made against the acquired company's senior employees also have proliferated.⁷¹² From 2017–2020, the number of S&P 1500 corporations with all-male boards of directors dipped from 179 to 30, and by 2020 no S&P 500 company retained an all-male board.⁷¹³ Employment agreements for CEOs of S&P 1500 companies increasingly include termination provisions that identify sexual harassment and discrimination as grounds for cause.⁷¹⁴ And the #MeToo movement has been described as “stunningly effective in removing perpetrators from positions of power.”⁷¹⁵

The massive settlement in *Signet* may serve to attract additional litigation in this sector, but potential #MeToo EDSL plaintiffs should be cognizant that the magnitude of the *Signet* settlement was in large part a function of the compelling allegations of misrepresentations and omissions concerning losses in Signet's in-house jewelry customer lending program that accompanied the #MeToo allegations.⁷¹⁶ #MeToo securities class actions not involving accounting or financial fraud are unlikely to yield a *Signet*-size settlement. Finally, it is important to underscore that derivative suits stemming from #MeToo allegations also have produced multiple plaintiff-friendly outcomes.⁷¹⁷

F. Cybersecurity

The final category of EDSL analyzed herein concerns cybersecurity. In 2021 the World Economic Forum identified cybersecurity failure as a top “clear and present danger” and critical global threat.⁷¹⁸ Cyber threats are

712. *A Year Later*, *supra* note 642.

713. Mary Billings, April Klein & Yanting Shi, *Investors' Response to the #MeToo Movement: Does Corporate Culture Matter?*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Sept. 20, 2021), <https://corpgov.law.harvard.edu/2021/09/20/investors-response-to-the-metoo-movement-does-corporate-culture-matter/> [<https://perma.cc/6VCV-EY88>].

714. Rachel Arnow-Richman, James Hicks & Steven Davidoff Solomon, *Anticipating Harassment: #MeToo and the Changing Norms of Executive Contracts*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 19, 2021), <https://corpgov.law.harvard.edu/2021/04/19/anticipating-harassment-metoo-and-the-changing-norms-of-executive-contracts/> [<https://perma.cc/7M-MC-ALK2>].

715. Jessica A. Clarke, *The Rules of #MeToo*, 2019 U. CHI. LEGAL F. 37, 46.

716. See Kevin LaCroix, *Signet Jewelers Settles #MeToo-Related Securities Suit for \$240 Million*, D&O DIARY (Mar. 29, 2020), <https://www.dandodiary.com/2020/03/articles/securities-litigation/signet-jewelers-settles-metoo-related-securities-suit-for-240-million/#> [<https://perma.cc/HKZ2-MTXX>] (highlighting the loan portfolio allegations in the *Signet* EDSL).

717. *Id.*

718. WORLD ECONOMIC FORUM, GLOBAL RISKS REPORT 2021, at 11 (16th ed. 2021),

increasing in both scope and frequency, in part because the COVID-19 pandemic generated an abrupt transition to fully remote work for many companies.⁷¹⁹ According to one survey, at least 20% of companies, including some of the world's largest, suffered data breaches in 2020.⁷²⁰ A second survey identified 1,108 data compromises in 2020, up from 785 in 2015 but down from 1,632 in 2019.⁷²¹ A third survey identified 846 compromises in the first half of 2021, which projected to an annualized total that would be the largest during the period 2015–2021.⁷²²

More than a quarter of companies that have been victimized by cyberattacks have been victimized more than once, and by 2020 five large companies had experienced seven or more cyberattacks—Facebook, Sony, Amazon, Comcast, and T-Mobile.⁷²³ Indeed, large companies with a market capitalization of at least \$10 billion were most at risk for a cyberattack during the period 2011–2021,⁷²⁴ and they now regard cyber breaches as a cost of doing business. Item 105 of Regulation S-K requires a description of material risks that impact a business, and a majority of companies choose to disclose cybersecurity risks in the risk factors section of their periodic reports. A 2020 survey of cybersecurity disclosures for 76 of the Fortune 100 companies from 2018 to May 2020 found that all of the companies disclosed cybersecurity as a risk factor and only one company in 2020 did not disclose data privacy as a risk factor.⁷²⁵ Cybersecurity also has become

http://www3.weforum.org/docs/WEF_The_Global_Risks_Report_2021.pdf [<https://perma.cc/N6FW-J9A8>].

719. Cara Peterman & Sierra Shear, *Key Trends in Recent Cyber-Related Securities Class Actions*, LAW360 (Sept. 24, 2021, 4:16 PM), <https://www.law360.com/articles/1423957> [<https://perma.cc/JV5L-KZA9>].

720. GIBSON, DUNN & CRUTCHER LLP, *U.S. Cybersecurity and Data Privacy Outlook and Review—2021*, at 30 (2021), <https://www.gibsondunn.com/us-cybersecurity-and-data-privacy-outlook-and-review-2021/> [<https://perma.cc/3EMA-MKGA>].

721. IDENTITY THEFT RESOURCE CENTER, *Data Breach Report: 2020 in Review* (Jan. 2021), <https://www.idtheftcenter.org/identity-theft-resource-centers-2020-annual-data-breach-report-reveals-19-percent-decrease-in-breaches/> [<https://perma.cc/3XW5-JM7Y>].

722. IDENTITY THEFT RESOURCE CENTER, *First Half 2021 Data Breach Analysis: Data Compromises are Up, Individuals Impacted are Down 1* (July 2021), <https://notified.idtheftcenter.org/s/2021-first-half-data-breach-analysis> [<https://perma.cc/64XM-P5FC>].

723. AUDIT ANALYTICS, *Trends in Cybersecurity Breach Disclosures 10* (2020), <https://www.auditanalytics.com/audit-analytics-reports> [<https://perma.cc/K4QM-Y2AZ>].

724. John Cheffers, *Guest Post: Cybersecurity Incident and Litigation Review 2021*, D&O DIARY (Aug. 10, 2021), <https://www.dandodiary.com/2021/08/articles/cyber-liability/guest-post-cybersecurity-incident-and-litigation-review-2021/> [<https://perma.cc/2N8J-GDWW>].

725. Steve W. Klemash, Jamie C. Smith & Chuck Seets, *What Companies are Disclosing About Cybersecurity Risk and Oversight*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 25, 2020), <https://corp.gov.law.harvard.edu/2020/08/25/what-companies-are-disclosing-about-cybersecurity-risk-and-oversight/> [<https://perma.cc/Y4YM-F6CC>].

a core component of ESG and sustainability-related frameworks.⁷²⁶

Cyber breaches have spawned substantial EDSL.⁷²⁷ From 2018–2019 approximately 50 securities lawsuits—many of which were class actions—were filed following data security incidents,⁷²⁸ with plaintiffs alleging inadequate pre-breach disclosure of cyber risks, overstatement of cyber strengths, or delayed disclosure to the market following breach detection.⁷²⁹ Additional actions were commenced in 2020 and six cyber-related securities class actions were filed from January–July 2021.⁷³⁰

One example is the securities class action filed in January 2021 after the world’s most audacious and sophisticated cyberattack took place. This attack was launched with the likely backing of the Russian government against defendant SolarWinds, a network infrastructure management company whose 300,000 global clients include most of the Fortune 500 as well as all five branches of the U.S. military.⁷³¹ The networks of approximately 18,000 SolarWinds clients (including at least nine U.S. federal agencies) were compromised, and in mid-2021—while the EDSL was pending—the SEC was investigating whether corporate victims failed to disclose the effects of the espionage on their businesses.⁷³² The motion to

726. John F. Savarese, Sarah K. Eddy & Sabastian V. Niles, *Cybersecurity Oversight and Defense—A Board and Management Imperative*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 14, 2021), <https://corpgov.law.harvard.edu/2021/05/14/cybersecurity-oversight-and-defense-a-board-and-management-imperative/> [<https://perma.cc/9WLL-VV3Q>].

727. See Peter Halprin, Pamela Woods & Nicole Pappas, *Cybersecurity Event-Driven Securities Litigation Has Arrived*, LAW360 (Jan. 12, 2021, 5:59 PM), <https://www.law360.com/articles/1343650> [<https://perma.cc/DPJ4-2QHA>] (observing that EDSL “appears to have arrived in the cybersecurity liability context”).

728. Brian Scarbrough, Caroline Meneau & Huiyi Chen, *How to Navigate a Hardening D&O Insurance Market*, LAW360 (Oct. 6, 2020, 3:51 PM), <https://www.law360.com/articles/1317119> [<https://perma.cc/U2JQ-J7BC>].

729. See, e.g., *In re Equifax Inc. Sec. Litig.*, 357 F. Supp. 3d 1189, 1205 (N.D. Ga. 2019) (“Specifically, the Plaintiff alleges that the Defendants made multiple false or misleading statements and omissions about the sensitive personal information in Equifax’s custody, the vulnerability of its internal systems to cyberattack, and its compliance with data protection laws and cybersecurity best practices.”).

730. CORNERSTONE RESEARCH, *Securities Class Action Filings: 2021 Midyear Assessment 5* (July 2021), <https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2021-Midyear-Assessment.pdf> [<https://perma.cc/H6SC-VFJN>].

731. Complaint, *Bremer v. SolarWinds Corp.*, No. 21-cv-00002 (W.D. Tex. filed Jan. 4, 2021); Allison Grande, *SolarWinds Hit with Shareholder Suit Over Nation-State Hack*, LAW360 (Jan. 4, 2021, 10:55 PM), <https://www.law360.com/articles/1341546/solarwinds-hit-with-shareholder-suit-over-nation-state-hack> [<https://perma.cc/T2AK-3V3M>]; Ben Kochman, *6 Cybersecurity Events that Have Defined 2021*, LAW360 (July 12, 2021, 6:43 PM), <https://www.law360.com/articles/1397884> [<https://perma.cc/BZ7B-JNSY>].

732. U.S. SEC. & EXCH. COMM’N, *In the Matter of Certain Cybersecurity-Related Events (HO-14225) FAQs* (June 25, 2021), <https://www.sec.gov/enforce/certain-cybersecurity->

dismiss by SolarWinds, filed in August 2021, condemned the consolidated complaint—which relied on information provided by ten CWs—as part of the growing trend of event-driven securities litigation, “where any calamity that befalls a public company is framed as a violation of the securities laws. . . .”⁷³³ Derivative litigation against SolarWinds also ensued, based on an alleged breach of the duty of oversight.⁷³⁴

Another recent example of cyber EDSL is the May 2021 litigation that followed a cybersecurity breach at Ubiquiti, which develops and markets equipment and technology platforms for high-capacity Internet access.⁷³⁵ One report concluded that “[s]ecurities class actions are now routinely filed by shareholders after the announcement of a data breach.”⁷³⁶

Most of the cybersecurity EDSL has been based on section 10(b) and Rule 10b-5.⁷³⁷ Plaintiffs in these cases generally raise—but sometimes conflate—two distinct securities fraud claims that correspond to two distinct investor classes. One class includes shareholders who purchased stock after the company made affirmative statements about the company’s cybersecurity regime and commitment to data privacy but before the breach occurred. The second class includes investors who bought after the breach but prior to the public disclosure,⁷³⁸ which has often been delayed.

related-events-faqs [<https://perma.cc/L9QG-P2EW>] (offering amnesty to companies which addressed outstanding disclosure violations in response to SolarWinds attack prior to responding to SEC’s request for information).

733. Defendants’ Motion to Dismiss Consolidated Complaint 6, *In re SolarWinds Corp. Sec. Litig.*, Master File No. 21-CV-138-RP (W.D. Tex. Aug. 2, 2021).

734. See Katryna Perera, *SolarWinds Hit with Del. Derivative Suit over Sunburst Hack*, LAW360 (Nov. 5, 2021, 7:55 PM), <https://www.law360.com/articles/1438188> [<https://perma.cc/TF58-MEPK>] (reporting derivative action). Similarly, a data breach derivative suit implicitly based on an alleged breach of the duty of oversight was filed against T-Mobile USA in November 2021. Kevin LaCroix, *Data Breach-Related Derivative Suit Filed Against T-Mobile USA Board*, D&O DIARY (Nov. 30, 2021), <https://www.dandodiary.com/2021/11/articles/cyber-liability/data-breach-related-derivative-suit-filed-against-t-mobile-usa-board/> [<https://perma.cc/M7ZP-QDXJ>].

735. Complaint, *Molder v. Ubiquiti, Inc.*, No. 21-CV-04520 (S.D.N.Y. filed May 19, 2021).

736. CLEARY GOTTlieb, *2019 Cybersecurity Developments: A Year in Review* 11 (Jan. 2020), <https://www.clearygottlieb.com/news-and-insights/publication-listing/2019-cybersecurity-developments-a-year-in-review> [<https://perma.cc/9TFH-J3KM>].

737. Daniel J. Marcus, Note, *The Data Breach Dilemma: Proactive Solutions for Protecting Consumers’ Personal Information*, 68 DUKE L.J. 555, 570 (2018).

738. Avi Gesser, Patrick Blakemore & Peter Bozzo, *Reducing Risk in the Dawn of Equifax and Other Cyber-Related Securities Fraud Class Actions*, CYBERSECURITY L. REP. (Feb. 13, 2019), <https://www.davispolk.com/publications/reducing-risk-dawn-equifax-and-other-cyber-related-securities-fraud-class-actions> [<https://perma.cc/572N-QWTU>].

The SEC issued non-binding guidance in 2011⁷³⁹ and 2018⁷⁴⁰ concerning cybersecurity risks, cyber incidents, and the disclosure of data breaches. A 2014 study concluded that the 2011 guidance had “resulted in a series of disclosures that rarely provide differentiated or actionable information for investors.”⁷⁴¹ The 2018 guidance was an updated repackage. The SEC’s two documents collectively emphasized the need to promptly disclose any cybersecurity incidents that are material to investors. However, they were mostly non-specific,⁷⁴² failed to clarify a company’s duty to update disclosures following the occurrence of a significant cyber event, failed to “create a specific obligation to disclose all cybersecurity incidents in a current report filing,”⁷⁴³ and by late-2021 had not been codified in SEC rules.⁷⁴⁴ The SEC also published at least one ancillary advisory concerning the development of cybersecurity risk governance standards.⁷⁴⁵

In 2017 the SEC’s Division of Enforcement created a dedicated Cyber

739. U.S. SEC. & EXCH. COMM’N, DIV. OF CORP. FIN., *CF Disclosure Guidance: Topic No. 2 (Cybersecurity)* (Oct. 13, 2011), <https://www.sec.gov/divisions/corpfm/guidance/cfguidance-topic2.htm> [<https://perma.cc/ZH3N-V4J7>].

740. U.S. SEC. & EXCH. COMM’N, *Commission Statement and Guidance on Public Company Cybersecurity Disclosures* (Feb. 21, 2018), <https://www.sec.gov/rules/interp/2018/33-10459.pdf> [<https://perma.cc/47DR-VR2X>].

741. Investor Responsibility Research Center, *What Investors Need to Know About Cybersecurity: How to Evaluate Investment Risks* 5 (June 2014), <http://www.advisorselect.com/transcript/what-investors-need-to-know-about-cybersecurity-how-to-evaluate-invest%ADment-risks/what-investors-need-to-know-about-cybersecurity-how-to-evaluate-investment-risks> [<https://perma.cc/R25W-U5RU>].

742. Tash Bottum, Note, *Material Breach, Material Disclosure*, 103 MINN. L. REV. 2095, 2124–25 (2019).

743. William Johnson, Scott Ferber & Matthew Hanson, *SEC Returns Spotlight to Cybersecurity Disclosure Enforcement*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 1, 2021), <https://corpgov.law.harvard.edu/2021/08/01/sec-returns-spotlight-to-cybersecurity-disclosure-enforcement/> [<https://perma.cc/4RBY-TJMR>].

744. The SEC had been expected to release proposed new rules in October 2021 that would mandate disclosures about cybersecurity risk governance. See Vivek Mohan, David Simon & Richard Rosenfeld, *SEC Increasingly Turns Focus Toward Strength of Cyber Risk Disclosures*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 25, 2021), <https://corpgov.law.harvard.edu/2021/07/25/sec-increasingly-turns-focus-toward-strength-of-cyber-risk-disclosures/> [<https://perma.cc/6LTJ-LSQ7>]. Subsequently, that target date was extended, and the SEC finally released proposed new guidance in March 2022. See GIBSON, DUNN & CRUTCHER LLP, *SEC Proposes Rules on Cybersecurity Disclosure* (Mar. 11, 2022), <https://www.gibsondunn.com/wp-content/uploads/2022/03/sec-proposes-rules-on-cybersecurity-disclosure-1.pdf?1> [<https://perma.cc/E2JN-EP34>] (summarizing proposed amendments, which, inter alia, require companies to disclose material cybersecurity incidents within four business days of making a materiality determination).

745. Ira Rosner & Shardul Desai, *Managing Risk After SEC’s Cyber Enforcement Action*, LAW360 (June 28, 2021, 4:24 PM), <https://www.law360.com/newyork/articles/1397789/managing-risk-after-sec-s-cyber-enforcement-action> [<https://perma.cc/97RC-BCD5>].

Unit,⁷⁴⁶ but cybersecurity enforcement actions have been rare,⁷⁴⁷ consistent with the Commission's general perspective that such actions contravene the public interest when a company has been victimized by a cyber incident.⁷⁴⁸ Indeed, the Division has stated that “[w]e do not second-guess good faith exercises of judgment about cyber-incident disclosure.”⁷⁴⁹ Prior to mid-2021, the SEC appears to have commenced only two cyber enforcement actions, and in both of them disclosure of the cybersecurity vulnerability lagged awareness of the vulnerability by approximately two years.⁷⁵⁰

Enforcement accelerated beginning in June 2021,⁷⁵¹ and the SEC has underscored that deficient cybersecurity disclosure controls and procedures can generate an enforcement action even in the absence of a disclosure violation, data breach, or third-party intrusion.⁷⁵² In addition, it is clear that

746. U.S. Sec. and Exch. Comm'n, Press Release No. 2017-176, *SEC Announces Enforcement Initiatives to Combat Cyber-Based Threats and Protect Retail Investors* (Sept. 25, 2017), <https://www.sec.gov/news/press-release/2017-176> [<https://perma.cc/MWD9-VAAN>].

747. See Matthew Bacal, Robert Cohen & Joseph Hall, *SEC Enforcement Action Highlights Need for Internal Communications About Cybersecurity Problems*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 12, 2021), <https://corpgov.law.harvard.edu/2021/07/12/sec-enforcement-action-highlights-need-for-internal-communications-about-cybersecurity-problems/> [<https://perma.cc/6DXB-PT9N>] (observing that “the SEC has filed few cases involving cybersecurity-related disclosures”).

748. John F. Savarese, Wayne M. Carlin & Sabastian V. Niles, *A New Angle on Cybersecurity Enforcement from the SEC*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 26, 2021), <https://corpgov.law.harvard.edu/2021/06/26/a-new-angle-on-cybersecurity-enforcement-from-the-sec/> [<https://perma.cc/8U3T-2AWG>].

749. U.S. Sec. & Exch. Comm'n, Press Release No. 2018-71, *Altaba, Formerly Known as Yahoo!, Charged with Failing to Disclose Massive Cybersecurity Breach; Agrees to Pay \$35 Million* (Apr. 24, 2018), <https://www.sec.gov/news/press-release/2018-71> [<https://perma.cc/VR4M-HD3S>].

750. William Johnson, Scott Ferber & Matthew Hanson, *SEC Returns Spotlight to Cybersecurity Disclosure Enforcement*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 1, 2021), <https://corpgov.law.harvard.edu/2021/08/01/sec-returns-spotlight-to-cybersecurity-disclosure-enforcement/> [<https://perma.cc/R9V7-HT66>]. This tally excludes a few actions commenced under SEC Regulation S-P, which requires regulated financial services firms to safeguard the personal data of their customers. *Id.*

751. See Paul Ferrillo, Bob Zukis & George Platsis, *Cybersecurity and Disclosures*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 4, 2021), <https://corpgov.law.harvard.edu/2021/10/04/cybersecurity-and-disclosures/> [<https://perma.cc/SET4-SM2U>] (discussing two recent Consent Orders); Michael Osnato, Allison Bernbach & William LeBas, *Key Takeaways from Recent SEC Cybersecurity Charges*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 1, 2021), <https://corpgov.law.harvard.edu/2021/10/01/key-takeaways-from-recent-sec-cybersecurity-charges/> [<https://perma.cc/8NMM-KGKA>] (discussing SEC cyber settlements with eight registered investment advisers and broker-dealers).

752. See, e.g., U.S. SEC. AND EXCH. COMM'N, Press Release No. 2021-102, *SEC Charges Issuer with Cybersecurity Disclosure Controls Failures* (June 15, 2021), <https://www.sec.gov/news/press-release/2021-102> [<https://perma.cc/NG6Q-Q9MW>] (announcing settlement

courts may consider the SEC's 2018 guidance when evaluating whether an omission relating to cybersecurity is materially misleading under Rule 10b-5.⁷⁵³

The cyber breach disclosure lag has been significant in the absence of more specific SEC guidance and strict SEC enforcement. A survey of public companies that disclosed cyber breaches from 2011–2019 found that a mean 108 days elapsed before companies discovered the breach and another 49 days, on average, before the breach was announced.⁷⁵⁴ More recently, in 2020 the discovery window was truncated but the disclosure window was longer. In 2020 it took a mean 44 days to discover a breach and a mean 53 days to disclose it after discovery.⁷⁵⁵ This dichotomy suggests that firms' cybersecurity controls have improved but disclosures frequently remain untimely. When disclosure does occur it typically does not occur in an SEC filing. Fewer than 30% of public companies with a cyber breach from 2011–2020 disclosed the breach in such a filing.⁷⁵⁶

Scienter and loss causation are the two elements of section 10(b) claims that have presented the stiffest obstacles to cybersecurity EDSL plaintiffs. The disclosure of a massive data breach suffered by Equifax in September 2017 prompted securities litigation after the company's stock price plunged by almost 36%.⁷⁵⁷ A motion to dismiss was mostly denied in 2019,⁷⁵⁸ and this decision marked the first time that scienter and loss causation allegations survived a motion to dismiss in a cybersecurity event-driven case.⁷⁵⁹

Loss causation allegations in prior cybersecurity cases often suffered from the defect that disclosures of even large breaches were unaccompanied by a significant stock price decline.⁷⁶⁰ A 2016 study by Georgetown University's Security and Software Engineering Research Center analyzed

with First American Financial Corporation, a Fortune 500 company that provides title insurance and other financial services).

753. *In re Alphabet, Inc. Sec. Litig.*, No. 20-15638, 2021 WL 2448223, at *8 (9th Cir. June 16, 2021).

754. AUDIT ANALYTICS, *Trends in Cybersecurity Breach Disclosures 5* (May 2020), <https://www.auditanalytics.com/audit-analytics-reports> [<https://perma.cc/W5EV-8YN8>].

755. Derryck Coleman, *Audit Analytics Releases Third Annual Cybersecurity Report* (Apr. 6, 2021), <https://blog.auditanalytics.com/audit-analytics-releases-third-annual-cybersecurity-report/> [<https://perma.cc/E8F9-PDM2>].

756. *Id.*

757. *In re Equifax Inc. Sec. Litig.*, 357 F. Supp. 3d 1189, 1214 (N.D. Ga. 2019).

758. *Id.* at 1252.

759. Gesser, Blakemore & Bozzo, *supra* note 738.

760. CLEARY GOTTlieb STEEN & HAMILTON LLP, *Cyber Breaches: Lessons Learned from Shareholder Derivative and Securities Fraud Litigation 1* (2018), <https://www.clearygottlieb.com/-/media/files/alert-memos-2018/cyber-breaches-lessons-learned-from-shareholder-derivative-and-securities-fraud-litigation-pdf> [<https://perma.cc/7TZ4-KBR4>].

the impact of disclosed breaches by 64 publicly traded companies and concluded that “the announcement of data breaches does not have a meaningful impact on the volatility of equities across industries, and does not meaningfully depress the stock longer than a week.”⁷⁶¹

More recently, the market has reacted to data breaches. As noted, Equifax’s share price plunged more than 35% following disclosure of the company’s breach, and other major adverse price movements following breach disclosures have occurred at Yahoo and elsewhere. For example, a 2021 survey of 34 large companies that experienced one or more data breaches found that three years after the breach their average share prices underperformed the Nasdaq by -15.6%.⁷⁶² These negative price movements have helped shape some sizable settlements. The *Equifax* EDSL settled for \$149 million in 2020, and this resolution was accompanied by a \$32.5 million settlement in a parallel derivative suit.⁷⁶³ The company also agreed to pay a combined \$700 million to resolve federal and state claims and hundreds of civil consumer fraud class actions.⁷⁶⁴ Earlier, in 2018 the *Yahoo* EDSL settled for \$80 million, the related Yahoo derivative suits settled for \$29 million,⁷⁶⁵ and Yahoo settled with the SEC for \$35 million in the agency’s first enforcement action based on a cybersecurity disclosure violation.⁷⁶⁶ The SEC’s dedicated Cyber Unit was responsible for the investigation that led to charges against Yahoo.⁷⁶⁷

The foregoing settlements may encourage plaintiffs’ class action

761. See Russell Lange & Eric Burger, *S²ERC Project: Market Implications of Data Breaches* 12 (Dec. 16, 2016); Cara Peterman, *The Rise of Cyber-Related Securities Class Actions*, LAW360 (Mar. 12, 2018), <https://www.law360.com/articles/1019321> [<https://perma.cc/8ZTS-8M2Q>] (quoting the study).

762. Paul Bischoff, *How Data Breaches Affect Stock Market Share Prices*, COMPARITECH (Feb. 9, 2021), <https://www.comparitech.com/blog/information-security/data-breach-share-price-analysis/> [<https://perma.cc/3V4A-C9HV>].

763. Emilie Ruscoe, *Equifax Investors’ Attys Will Earn \$29.6M Fee in Stock Suit*, LAW360 (July 2, 2020, 4:09 PM), <https://www.law360.com/articles/1288773> [<https://perma.cc/Q5NB-FG4H>].

764. *Id.*

765. Kevin LaCroix, *Equifax Data Breach-Related Securities Suit Settled for \$149 Million*, D&O DIARY (Feb. 17, 2020), <https://www.dandodiary.com/2020/02/articles/securities-litigation/equifax-data-breach-related-securities-suit-settled-for-149-million/> [<https://perma.cc/Z9MY-8V46>].

766. Craig A. Newman, *SEC Cyber Agenda: Actions Taken in 2018 Forecast 2019’s Priorities*, BLOOMBERG LAW 4 (2018), <https://www.pbwt.com/content/uploads/2018/12/Bloomberg-Law-SEC-Cyber-Agenda-Patterson-Belknap.pdf> [<https://perma.cc/57YL-KYE4>].

767. U.S. SEC. & EXCH. COMM’N, Press Release No. 2018–71, *Altaba, Formerly Known as Yahoo!, Charged with Failing to Disclose Massive Cybersecurity Breach; Agrees to Pay \$35 Million* (Apr. 24, 2018), <https://www.sec.gov/news/press-release/2018-71> [<https://perma.cc/4P4A-8JDD>] [hereinafter *Yahoo Settlement*].

counsel to pursue future cybersecurity event-driven litigation. However, *Equifax* may be an outlier, insofar as the data breach was vast (it exposed the personal information of 150 million U.S. consumers), the breach revealed particularly sensitive data, and the impact on the company and its share price was immense.⁷⁶⁸ Equifax's stock made a partial recovery, but three months after the breach was disclosed the company's market capitalization still was down approximately \$3 billion.⁷⁶⁹ In addition, by the time the operative class action complaint was filed in *Equifax*, plaintiffs had compiled a treasure trove of relevant evidence, including congressional testimony by former senior Equifax executives and numerous investigative media reports.⁷⁷⁰ This combination of critical factors will rarely occur in other cases.

To gauge the prospects of future cybersecurity EDSL it is useful to examine the decisions on motions to dismiss in *Equifax* and other data breach cases. The *Equifax* opinion is particularly instructive. To begin, the Georgia federal district court rejected defendants' argument—which, as noted *supra*, is often lodged against EDSL in general—that plaintiffs merely alleged non-actionable corporate mismanagement. As the court properly held, allegations that defendants made misleading statements or omissions concerning corporate mismanagement at Equifax could support a section 10(b) claim.⁷⁷¹ The court also distinguished *Heartland Payment Systems*, a prior case that over the years had become a poster child for failed data breach securities litigation. *Heartland* was dismissed in large part because plaintiffs attempted to show falsity merely by alleging that defendant had suffered a security breach after stating that it placed a high emphasis on maintaining a high level of security.⁷⁷² In contrast, in *Equifax*, plaintiffs alleged falsity by characterizing defendants' data security system as dangerously deficient and falling far short of industry standards.⁷⁷³ The *Equifax* opinion also rejected defendants' puffery defense because their statements about security were not

768. Newman, *supra* note 766.

769. Avi Gesser, Patrick Blakemore & Peter Bozzo, *Lessons from Equifax on How to Mitigate Post-Breach Legal Liability*, CYBERSECURITY L. REP. (Sept. 11, 2019), https://www.davispolk.com/sites/default/files/lessonsfromequifax_cslr_reprint.pdf [<https://perma.cc/TJ8S-XV3Q>].

770. See, e.g., Hamza Shaban, 'This Is a Travesty': Lawmakers Grill Former Equifax Chief Executive on Breach Response, WASH. POST (Oct. 3, 2017), <https://www.washingtonpost.com/news/the-switch/wp/2017/10/02/what-to-expect-from-equifaxes-back-to-back-hearings-on-capitol-hill-this-week/> [<https://perma.cc/K6L8-XP6R>] (describing testimony of former Equifax CEO Richard Smith).

771. 357 F. Supp. 3d at 1217–18.

772. *In re Heartland Payment Sys., Inc. Sec. Litig.*, No. 09-1043, 2009 WL 4798148, at *5 (D.N.J. Dec. 7, 2009).

773. 357 F. Supp. 3d at 1221.

obviously unimportant to a reasonable investor.⁷⁷⁴ Finally, the court concluded that plaintiffs adequately alleged loss causation, although it declined to accept the materialization of risk theory in the absence of endorsement by the Eleventh Circuit.⁷⁷⁵

Other decisions have been mostly negative for plaintiffs. In data breach EDSL against Federal Express involving a Russian cyberattack on the company's European shipping subsidiary TNT, the court dismissed the complaint in 2021 after defendants accused plaintiffs of attempting to "exploit this recent trend towards 'event-driven' litigation."⁷⁷⁶ The court dismissed partly because information provided by a CW was insufficiently specific to establish the falsity of defendants' statements, which also were protected by at least two of the three prongs of the PSLRA's safe harbor.⁷⁷⁷

Similarly, in 2021 the court dismissed data breach EDSL against software company Zendesk, because plaintiffs failed to adequately plead both scienter and a material misstatement or omission. The court granted leave to file a third amended complaint,⁷⁷⁸ but plaintiffs opted to appeal and the Ninth Circuit affirmed the dismissal in 2022.⁷⁷⁹ Earlier, in 2020, the Ninth Circuit affirmed the dismissal of cybersecurity EDSL against PayPal, based on plaintiffs' failure to adequately allege scienter,⁷⁸⁰ after the district court had concluded that statements by plaintiffs' CWs were insufficiently indicative of scienter.⁷⁸¹

Cybersecurity EDSL against Facebook also was dismissed in 2020, with leave to amend. Prior to the dismissal Facebook agreed in 2019 to pay a \$5 billion penalty imposed by the Federal Trade Commission (FTC) in connection with the company's violation of a 2012 consent decree concerning data privacy practices.⁷⁸² The civil penalty was one of the largest ever assessed by the federal government for any violation and dwarfed all prior fines by the FTC in a privacy case. Simultaneously, Facebook settled

774. *Id.* at 1224.

775. *Id.* at 1250.

776. Sarah Jarvis, *FedEx Beats Investors' Cyberattack Suit for Good*, LAW360 (Feb. 4, 2021, 7:58 PM), <https://www.law360.com/articles/1352280> [<https://perma.cc/49VL-N4BA>].

777. *In re Fed Ex Corp. Sec. Litig.*, Master File No. 19-cv-05990, 2021 WL 396423, at *10–11 (S.D.N.Y. Feb. 4, 2021).

778. *Reidinger v. Zendesk, Inc.*, No. 19-cv-06968-CRB, 2021 WL 796261, at *7–10 (N.D. Cal. Mar. 2, 2021).

779. *Local 353, I.B.E.W. Pension Fund v. Zendesk, Inc.*, No. 21-15785, 2022 WL 614235 (9th Cir. Mar. 2, 2022).

780. *Eckert v. PayPal Holdings, Inc.*, 831 F. App'x 366 (9th Cir. 2020).

781. *Sgarlata v. PayPal Holdings, Inc.* 409 F. Supp. 3d 846, 856–59 (N.D. Cal. 2019).

782. Marshall L. Miller & Jeohn Salone Favors, *The Facebook Settlement*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 29, 2019), <https://corpgov.law.harvard.edu/2019/07/29/the-facebook-settlement/> [<https://perma.cc/R568-ME42>].

with the SEC for \$100 million in connection with the Cambridge Analytica scandal,⁷⁸³ in which the personal data of millions of Facebook users was collected without their consent by the British consulting firm. Facebook also agreed in 2020 to pay \$550 million in the largest-ever cash settlement resolving privacy-related private litigation, in connection with the company's use of biometric software.⁷⁸⁴ So Facebook was no stranger to data privacy issues. However, in the cybersecurity EDSL, which also involved the Cambridge Analytica scandal, Facebook prevailed. The court held that various statements by defendants were protected by the PSLRA's safe harbor, other statements were not false, and plaintiffs had failed to adequately plead loss causation.⁷⁸⁵

In contrast, in 2021 the Ninth Circuit largely reversed the district court's dismissal of consolidated cybersecurity EDSL against Google, parent company Alphabet, and some of their top executives. Security vulnerabilities in the Google+ social network had exposed user data from more than 50 million accounts—although apparently no actual breach occurred—and securities litigation ensued, with Rhode Island designated as lead plaintiff. The district court dismissed Rhode Island's amended complaint with leave to further amend, after holding that defendants' statements about the importance of privacy to users and Alphabet's general commitment to the protection of its users' data were non-actionable puffery and plaintiffs had failed to adequately allege scienter.⁷⁸⁶ Plaintiffs declined to amend and instead appealed after the district court entered judgment.⁷⁸⁷ This strategy succeeded. The Ninth Circuit cited *Matrixx* and the SEC's 2018 cybersecurity disclosure guidance and concluded that statements made by Alphabet in two of its 2018 10-Qs were materially misleading insofar as they omitted to mention the Google+ security vulnerabilities of which Google then was aware.⁷⁸⁸ According to the court, the 10-Q omissions "significantly altered the total mix of information available for decisionmaking [sic] by a reasonable investor."⁷⁸⁹ The Ninth Circuit also

783. *Id.*

784. *In re Facebook Biometric Information Privacy Litig.*, No. 15-cv-03747-JD, 2021 WL 757025 (N.D. Cal. Feb. 26, 2021); Kevin LaCroix, *Facebook to Pay \$550 Million in Largest-Ever Privacy Settlement*, D&O DIARY (Jan. 30, 2020), <https://www.dandodiary.com/2020/01/articles/privacy/facebook-to-pay-550-million-in-largest-ever-privacy-settlement/> [<https://perma.cc/P447-6AJC>].

785. *In re Facebook, Inc. Sec. Litig.*, 477 F. Supp. 3d 980, 1028 (N.D. Cal. 2020).

786. *In re Alphabet, Inc., Sec. Litig.*, No. 18-cv-06245-JSW, 2020 WL 2564635, at *4 (N.D. Cal. Feb. 5, 2020).

787. *In re Alphabet, Inc., Sec. Litig.*, 1 F.4th 687 (9th Cir. 2021).

788. *Id.* at 703.

789. *Id.* at 704–05.

concluded that plaintiffs had adequately alleged scienter, notwithstanding the absence of allegations from CWs.⁷⁹⁰

Plaintiffs also prevailed in the earlier consolidated cybersecurity EDSL against Yahoo, which involved two separate significant data breaches in 2013 and 2014. Plaintiffs alleged that Yahoo misled investors by failing to disclose the breaches in its public filings while touting the strength of its cybersecurity practices, and indeed the breaches were not disclosed until 2016.⁷⁹¹ The litigation settled for \$80 million in 2018 after the court denied as moot motions to dismiss, leave to amend was granted, and an amended complaint was filed.⁷⁹² This was the first major recovery in a section 10(b) action based on a company's alleged failure to adequately disclose cybersecurity incidents and risks.

Yahoo, like *Equifax*, might constitute an outlier. The Yahoo double breaches, disclosed almost two years after the fact, were massive and had a material impact on the company. The breaches compromised all of Yahoo's three billion user accounts and were not disclosed to the investing public until Yahoo was in the process of closing the acquisition of its core operating Internet business by Verizon Communications.⁷⁹³ Post-disclosure, the business was acquired by Verizon for \$350 million less than the \$4.83 billion it previously had offered.⁷⁹⁴ This specific fact pattern also is unlikely to replicate in future cases.

Still, *Equifax*, *Yahoo*, and *Google* no doubt serve to encourage plaintiffs' class action counsel to pursue additional cybersecurity EDSL. In late-2021 such litigation was pending against multiple other companies, including Zoom and Capital One.⁷⁹⁵ Plaintiffs in these cases and future

790. *Id.* at 707. The Ninth Circuit subsequently denied the request by Alphabet and Google for an *en banc* rehearing. Order, *In re Alphabet, Inc.*, Sec. Litig., No. 20-15638 (9th Cir. July 23, 2021).

791. *In re Yahoo! Inc.* Sec. Litig., Nos. 17-CV-00373-LHK, 17-CV-01525-LHK, 2018 WL 4283377 (N.D. Cal. Sept. 7, 2018).

792. Kevin LaCroix, *Yahoo Settles Data Breach-Related Securities Suit for \$80 Million*, D&O DIARY (Mar. 15, 2018), <https://www.dandodiary.com/2018/03/articles/securities-litigation/yahoo-settles-data-breach-related-securities-suit-80-million/> [<https://perma.cc/GG2M-GRH9>].

793. *See Yahoo Settlement*, *supra* note 767.

794. Irina Ivanova, *Verizon Slashes Offer Price for Yahoo over Data Breaches*, CBS NEWS (Feb. 21, 2017, 3:10 PM), <https://www.cbsnews.com/news/verizon-yahoo-merger-price-data-breaches/> [<https://perma.cc/QG7A-EKWU>].

795. *See, e.g., In re Zoom Sec. Litig.*, No. 20-cv-02353 (N.D. Cal. Apr. 7, 2020) (EDSL arising from Zoom's alleged false and misleading statements concerning its data privacy and security risks). In February 2022 the federal district court granted in part and denied in part defendants' motion to dismiss in the Zoom EDSL, with leave to amend. *In re Zoom Sec. Litig.*, No. 20-cv-02353-JD, 2022 WL 484974 (N.D. Cal. Feb. 16, 2022).

actions likely will encounter many of the same issues that were dispositive in the unsuccessful litigation discussed above. Indeed, in September 2021 a federal district court in California dismissed cyber EDSL against First American Financial Corporation, a Fortune 500 company, after concluding that various of defendants' subject statements were non-actionable puffery.⁷⁹⁶

Likewise, in June 2021 the federal district court in Maryland dismissed with prejudice both consolidated securities class actions and consolidated derivative actions against Marriott stemming from a massive data breach in the hotel giant's Starwood guest reservation system. Hackers stole the personal information of up to 500 million guests and a raft of litigation ensued. In the securities class actions the court applied both the safe harbor and the bespeaks caution doctrine, distinguished *Equifax* and concluded that Marriott's statements concerning a commitment to safeguard customer privacy were non-actionable puffery, and, *inter alia*, discounted information concerning scienter provided by seven CWs.⁷⁹⁷ In the federal derivative actions the federal securities claims were dismissed primarily because plaintiff failed to own Marriott shares during the relevant time period.⁷⁹⁸ A separate derivative action arising from the same cyberattack was dismissed by the Delaware Chancery Court in October 2021.⁷⁹⁹ The *Marriott* and *First American* litigation more generally reflect the fate of cybersecurity EDSL to date than do *Equifax*, *Yahoo*, and *Google*.⁸⁰⁰

IV. PROPOSED SOLUTIONS TO THE PERCEIVED PLAGUE OF EDSL

Multiple solutions to the perceived problem of EDSL have been proposed. This part briefly critiques some of the major proposals. At the outset, however, it should be emphasized that, as demonstrated above, there

796. Order Granting Defendants' Motion to Dismiss 16–17, *In re* First American Fin. Corp. Sec. Litig., No. CV 20-9781 DSF (C.D. Cal. Sept. 22, 2021). However, leave to amend was granted. *Id.* at 21.

797. *In re: Marriott Int'l, Inc. Customer Data Security Breach Litig. (Sec. Actions)*, MDL No. 19-md-2879, 2021 WL 2407518 (D. Md. June 11, 2021)

798. *In re: Marriott Int'l, Inc. Customer Data Security Breach Litig. (Derivative Actions)* at 19, MDL No. 19-md-2879 (D. Md. June 11, 2021)

799. *Firemen's Ret. Sys. of St. Louis v. Sorenson*, C.A. No. 2019-0965-LWW, 2021 WL 45937777 (Del. Ch. Oct. 5, 2021).

800. An appeal in the *Marriott* EDSL was pending in late-2021. See Caleb Drickey, *Investors Urge 4th Circ. To Revive Marriott Data Breach Suit*, LAW360 (Nov. 15, 2021, 6:59 PM), <https://www.law360.com/articles/1440228> [<https://perma.cc/GR3R-5BCC>] (reporting appeal).

is no substantial problem in search of a solution. A careful examination suggests that much event-driven litigation has merit and courts are well-equipped to dismiss the chaff.

Five reform proposals are addressed herein. First, as noted *supra*, in 2020 the U.S. Chamber of Commerce filed a rulemaking petition with the SEC seeking to restrict pandemic EDSL. The Chamber asked the SEC, *inter alia*, to bar liability for statements about the impact of COVID-19 on a company's business, whether forward-looking or not, so long as suitable warnings were attached. For the reasons discussed, the Chamber's petition was misguided. It rested upon a broad, shallow critique of event-driven litigation that was tied in part to a rejection of plaintiffs' use of the widely accepted materialization of risk theory to show loss causation. The petition also falsely assumed that courts would be inundated by a wave of unjustified pandemic cases, and it weakly argued that the PSLRA's safe harbor requires revision.

A second proposal is for Congress to permit interlocutory appeals of denials of motions to dismiss, either as of right or based upon a discretionary standard. Multiple state courts, including New York, allow such appeals. In contrast, under the Federal Rules of Civil Procedure, the denial of a motion to dismiss does not qualify as a final decision (and thus there is no appeal as of right), and discretionary appeals generally land outside the scope of 28 U.S. § 1292(b). That statute requires district court certification that the order involves a controlling question of law as to which there is substantial ground for a difference of opinion, and for which an immediate appeal may materially advance the ultimate termination of the litigation. The appellate court then must exercise its discretion to allow the appeal.⁸⁰¹

Unsurprisingly, section 1292(b) has been applied "relatively sparingly and in exceptional cases."⁸⁰² For example, in the *Equifax* EDSL the court denied Equifax's request to file an interlocutory appeal of the order on the motion to dismiss.⁸⁰³ The proposal to revise the Federal Rules stems from the critical role that motions to dismiss play in securities litigation. If motions are denied, "class certification and settlement virtually always follow."⁸⁰⁴ The *Equifax* settlement that followed denial of the motion to

801. 28 U.S.C. § 1292(b).

802. Katayoun Donnelly & Blain Myhre, *Pushing Pause: Interlocutory Appeals under 28 U.S.C. § 1292(b)*, American Bar Ass'n (June 3, 2019), <https://www.americanbar.org/groups/litigation/committees/appellate-practice/articles/2019/spring2019-pushing-pause-interlocutory-appeals-under-28-usc-1292b/> [<https://perma.cc/97H6-8TWD>].

803. *In re Equifax Inc. Sec. Litig.*, No. 17-CV-3463-TWT, 2019 WL 3449673 (N.D. Ga. July 29, 2019).

804. Pincus, *supra* note 70, at 5.

dismiss and denial of interlocutory appeal was the largest to date in cybersecurity EDSL. Similarly, FCPA-related EDSL against Cognizant Technology Solutions Corporation settled for \$95 million in September 2021⁸⁰⁵ after the federal district court refused to certify an interlocutory appeal of an order denying motions to dismiss.⁸⁰⁶ However, a fundamental problem with this reform proposal is that expanding appeals as of right or on a discretionary basis likely would flood the Circuits with meritless appeals. One of the primary objectives of section 1292(b) is to preserve the institutional efficiency of the federal court system.⁸⁰⁷ A torrent of appeals, many of them meritless, would undermine that objective.

A third proposal is for Congress to amend the PSLRA and simultaneously strengthen the statute's pleading standard and discovery stay.⁸⁰⁸ Such a proposal is unsupported by any compelling evidence that the onerous pleading standard fails to separate the wheat from the chaff, or that the strict discovery stay has failed to accomplish its intended purpose. Indeed, the universal use by plaintiffs of confidential witnesses⁸⁰⁹ essentially proves that the stay is operating as designed. In the absence of a powerful stay provision reliance on CWs would be unnecessary.

A fourth proposal is for Congress to enact a cap on damages in non-IPO cases because securities class actions simply shift money from current shareholders to plaintiff shareholders.⁸¹⁰ This proposal also seems misguided. As noted, the PSLRA already includes a bounce-back provision which caps damages at the difference between plaintiff's purchase price and the mean trading price of the security during the 90 days following a corrective disclosure. The provision functions as a rescissory cap on out-of-pocket damages in securities fraud litigation and it can eradicate recovery. The larger debate about the benefits of securities class action litigation⁸¹¹ is

805. Melissa Angell, *Cognizant Inks \$95M Deal to End Investors' Bribery Action*, LAW360 (Sept. 7, 2021, 11:10 PM), <https://www.law360.com/articles/1419573> [<https://perm.a.cc/59PV-FRFJ>].

806. *In re Cognizant Tech. Solutions Corp. Sec. Litig.*, No. 16-6509, 2021 WL 1016111 (D.N.J. Mar. 17, 2021).

807. Donnelly & Myhre, *supra* note 802.

808. Pincus, *supra* note 70, at 5. The PSLRA imposes an automatic stay of all discovery and other proceedings during the pendency of a motion to dismiss, absent application of one of two exceptions—when particularized discovery is necessary to preserve evidence or to prevent undue prejudice to the party seeking relief. 15 U.S.C. § 78u-4(b)(3)(B).

809. *See, e.g., In re Bofl Holding, Inc. Sec. Litig.*, Case No. 15-CV-02324-GPC-KSC, 2016 WL 5390533, at *16 (S.D. Cal. Sept. 27, 2016) (“The Court is aware that confidential witnesses have become a staple of securities litigation.”).

810. Pincus, *supra* note 70, at 5.

811. *See, e.g., John C. Coffee, Jr., Reforming the Securities Class Action: An Essay on Deterrence and its Implementation*, 106 COLUM. L. REV. 1534 (2006).

beyond the scope of this Article. Here, it suffices to note that an effective damages cap already exists, and since fewer than 1% of securities cases proceed to trial the imposition of a further cap seems superfluous, with potential major drawbacks that include a chilling effect on the filing of meritorious cases.

A fifth proposal is to adopt a rule requiring plaintiffs in securities litigation who lose motions to dismiss to pay the prevailing defendants' attorneys' fees, under the theory that fee-shifting would re-align the cost-benefit analysis for investors considering pursuing tenuous claims.⁸¹² Such a requirement would contravene the solid policy rationales justifying the long-standing American Rule,⁸¹³ pursuant to which prevailing parties are not entitled to recover their attorneys' fees. A major drawback to the fifth proposal is the inherent inequity of making fee-shifting one-directional. A second drawback is, again, the substantial chilling effect the new rule would have on meritorious securities class action litigation. In 2015 Delaware's state legislature amended the Delaware General Corporation Law to prohibit Delaware stock corporations from including in their charters or bylaws loser-pays provisions in connection with "internal corporate claims" brought by stockholders.⁸¹⁴ This prohibition, encompassing those claims typically brought in M&A and corporate governance litigation, was adopted in large part to address the chilling impact that loser-pays provisions could have on the enforcement by stockholders of fiduciary duties. The Delaware amendment is instructive in the EDSL context, even if it does not clearly cover federal securities claims.

CONCLUSION

Securities class action litigation has experienced a major transformation in recent years. Whereas securities cases previously focused on financial or accounting fraud, increasingly such actions are based on the alleged concealment or misrepresentation of substantial adverse events. The new focus is the defining characteristic of event-driven securities litigation. EDSL has raised numerous difficult issues that have recurred across some of

812. See Reed & Lloyd, *supra* note 141, at 3 (arguing that fee-shifting would alter the risk/benefit analysis for plaintiffs and their counsel).

813. See Albert H. Choi, *Fee-Shifting and Shareholder Litigation*, 104 VA. L. REV. 59 (2018) (arguing in favor of allowing fee-shifting provisions in corporate charters and bylaws, but only subject to robust judicial oversight); Peter Karsten & Oliver Bateman, *Detecting Good Public Policy Rationales for the American Rule: A Response to the Ill-Conceived Calls for "Loser Pays" Rules*, 66 DUKE L.J. 729 (2016) (arguing against fee-shifting).

814. Del. Code Ann. Tit. 8, § 102(f), Del. Code Ann. Tit. 8, § 109(b).

the major categories of the litigation, including COVID-19, cannabis, foreign and domestic corruption, antitrust, #MeToo, and cybersecurity. Careful examination of EDSL suggests that much of it has merit. Recent proposals to restrict the litigation either legislatively or judicially are mostly unjustified. Courts already are well-equipped to weed out the meritless cases, and many of the restrictive proposals seem designed merely to sharply tilt the litigation playing field in favor of corporate defendants.