

Clients & Friends Memo

2019 Year in Review: Securities Litigation and Enforcement

February 10, 2020

There was abundant federal securities litigation activity in 2019. Plaintiffs not only continued to file securities lawsuits at record numbers, but repeatedly secured victories in cases on significant issues of law. The tone was set at the top with the Supreme Court's landmark decision in *Lorenzo v. SEC*.¹ There, the Supreme Court clarified, in contrast to its 2011 decision in *Janus Capital Group, Inc. v. First Derivative Traders*,² that a person who does not "make" a fraudulent misstatement can nonetheless be held primarily liable for securities fraud under Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) and Rule 10b-5 thereunder for his or her role in disseminating the misstatement. In so ruling, the Supreme Court effectively eviscerated a popular defense in fraud lawsuits since *Janus* and reaffirmed that the antifraud provisions of the securities laws cover a "wide range of conduct."³

In multiple other cases, federal courts ruled in favor of plaintiffs and established expanded theories of liability for defendants. For example, in *North Sound Capital LLC v. Merck & Co.*,⁴ the Third Circuit held that plaintiffs who opt out of a securities class action are not precluded under the Securities Litigation Uniform Standards Act of 1998 (SLUSA) from bringing state law fraud claims in follow-on individual actions, even if federal claims are time-barred. This opens a potentially significant new avenue for plaintiffs to evade heightened federal pleading standards and limitations periods. The Tenth Circuit, in *SEC v. Scoville*,⁵ clarified that the SEC and DOJ may avail themselves of the expansive "conduct and effects" test under the Dodd-Frank Act to reach securities fraud defendants whose U.S.-based conduct affects foreign defendants or who commit frauds abroad that affect U.S. investors. Courts also adopted expansive views of a "security" subject to federal antifraud rules and

¹ 139 S. Ct. 1094 (2019).

² 564 U.S. 135 (2011).

³ 139 S. Ct. at 1101.

⁴ 938 F.3d 482 (3d Cir. 2019).

⁵ 913 F.3d 1204, 1209 (10th Cir.), *cert. denied*, No. 18-1566, 2019 WL 5686461 (U.S. Nov. 4, 2019).

registration requirements, applying the concept to an internet traffic exchange service (*Scoville*) and a new digital “coin” (*Balestra v. ATBCOIN LLC*).⁶

Plaintiffs were particularly successful in achieving certification of classes asserting securities fraud claims. In case after case, courts certified classes where plaintiffs made a threshold showing that stock traded in an efficient market, or the case primarily involved omissions of material fact. In such cases, courts broadly permitted plaintiffs to avail themselves of a presumption of class-wide “reliance” on the fraud (i.e., the *Basic* and *Affiliated Ute* presumptions, respectively), and routinely rejected defendants’ efforts to “rebut” the presumption through competing expert opinions and statistical analyses purporting to sever the link between the fraud and plaintiffs’ losses. In addition, courts virtually shut the door on defendants’ efforts under the Supreme Court’s 2013 decision in *Comcast Corp. v. Behrend*⁷ to defeat class certification by challenging plaintiffs’ ability to show class-wide damages.

But 2019 was not a clean sweep for plaintiffs. Although courts routinely quashed efforts to defeat claims on procedural or technical grounds, they balanced this pro-plaintiff stance by closely scrutinizing evidence of fraud—and dismissing claims outright—in several significant cases. Relying on the common law concept of “puffery,” the Second Circuit (*Gross v. GFI Group, Inc.*⁸ and *Singh v. Cigna Corp.*⁹) and the Eleventh Circuit (*Carvelli v. Ocwen Financial Corp.*¹⁰) rejected securities fraud claims on the basis that the alleged misstatements (for example, a commitment to compliance in a company’s code of ethics) were too “general” to be actionable. And the Southern District of New York (*Tung v. Bristol-Myers Squibb Co.*¹¹) and First Circuit (*Metzler Asset Management GmbH v. Kingsley*¹²) likewise demanded detailed factual allegations of defendants’ “scienter” (intent to deceive), and dismissed multiple suits for failure to establish a “strong inference” of scienter. Collectively, these courts sent a clear message that the paramount question in a federal securities fraud suit is whether fraudulent conduct occurred; if not, cases will be dismissed.

From an enforcement perspective, like last year, the SEC continued to focus on protecting retail investors and cyber issues. Overall, the SEC brought 862 total actions in FY 2019, 526 of which

⁶ 380 F. Supp. 3d 340 (S.D.N.Y. 2019).

⁷ 569 U.S. 27 (2013).

⁸ 784 F. App’x 27 (2d Cir. 2019) (Summary Order).

⁹ 918 F.3d 57 (2d Cir. 2019).

¹⁰ 934 F.3d 1307 (11th Cir. 2019).

¹¹ 412 F. Supp. 3d 453 (S.D.N.Y. 2019).

¹² 928 F.3d 151 (1st Cir. 2019).

were “standalone” actions brought in federal court or as administrative proceedings.¹³ While this was a slight increase over FY 2018, a significant number of the standalone actions (95) were brought as part of the Share Class Disclosure Initiative (discussed below), which involved self-reported violations and an accelerated resolution process. Consistent with the agency’s focus on retail investors, there was a significant increase in enforcement actions brought against investment advisers and investment companies (191 total actions accounting for 36% of all actions, compared to 108 and 22% in FY 18) and an increase in enforcement actions related to issuer disclosure and accounting issues (up to 92 from 79 in FY 18).¹⁴ This past year was also a very active year for Foreign Corrupt Practices Act (FCPA) enforcement for the SEC and the DOJ. Conversely, there were large drops in the number of SEC enforcement cases against broker-dealers (down to 38 from 63 in FY 18) and insider trading cases (down to 30 from 61 in FY 18).¹⁵

We discuss these developments—as well as our predictions for 2020—in more detail below.

I. Traits and Trends

The volume of federal securities fraud class action filings in 2019 remained at near-record highs. During 2019, plaintiffs filed 428 federal securities fraud class actions, surpassing 2017’s record high of 413. This was nearly double the average number of filings over the past two decades. There were more than 1,200 filings from 2017 to 2019—a number that accounts for nearly 25% of all of the filings in the more than 20 years since 1997.¹⁶

Contributing to these high levels of filings were plaintiffs’ lawyers targeting new industries. If 2017 and 2018 were the years of cryptocurrency filings—which saw the emergence of suits targeting both established currencies and initial coin offerings—2019 may have been the year of cannabis litigation. A notable number of putative class action suits were filed this year, nearly all of which targeted Canadian-based companies that listed their shares on U.S.-based exchanges following Canada’s 2018 legalization of cannabis-related products.¹⁷ These suits mostly relied on time-tested strategies—claiming, after the announcement of a downturn in performance or unexpected regulatory

¹³ See U.S. Sec. & Exch. Comm’n Div. of Enf’t, 2019 Annual Report, at 9 [hereinafter 2019 Annual Report], <https://www.sec.gov/enforcement-annual-report-2019.pdf>; U.S. Sec. & Exch. Comm’n Div. of Enf’t, 2018 Annual Report, at 5 [hereinafter 2018 Annual Report], <https://www.sec.gov/enforcement-annual-report-2018.pdf>.

¹⁴ See 2019 Annual Report, at 15; 2018 Annual Report, at 10.

¹⁵ See *id.*

¹⁶ *Securities Class Action Filings: 2019 Year in Review*, Cornerstone Research, at 44 (2020) [hereinafter 2019 Cornerstone Report], <https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2019-Year-in-Review>.

¹⁷ See, e.g., *Perez v. Hexo Corp.*, No. 1:19-cv-10965 (S.D.N.Y. filed Nov. 26, 2019); *Wilson v. Aurora Cannabis Inc.*, No. 2:19-cv-20588 (D.N.J. filed Nov. 21, 2019); *Ortiz v. Canopy Growth Corp.*, No. 2:19-cv-20543 (D.N.J. filed Nov. 20, 2019); *Huang v. Sundial Growers, Inc.*, No. 1:19-cv-08913 (S.D.N.Y. filed Sept. 25, 2019); *Huang v. Canntrust Holdings Inc.*, No. 1:19-cv-06396 (S.D.N.Y. filed July 10, 2019).

difficulties, that the company's prior, rosier disclosures were false or misleading. They demonstrated, however, the extent to which an emerging industry can be fertile ground for putative class actions.

Also responsible for some growth was an increase in parallel filings (whether in both federal and state court or multiple state courts) spurred by the Supreme Court's 2018 decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund*.¹⁸ *Cyan* held that securities class actions under the Securities Act of 1933 (Securities Act) can be brought in state court and are not removable to federal court, where the Private Securities Litigation Reform Act would provide for more robust procedures for consolidating parallel litigation. From 2010 to 2017, there was an average of fewer than 6 parallel actions filed per year, but in 2019, there were 22. Together, state and parallel filings constituted more than 75% of all 1933 Act filings in 2019.¹⁹

Despite the high overall volume of securities filings, M&A filings were somewhat soft in 2019 compared to recent years, with filings falling from 182 in the prior year to 160.²⁰ Included in this category were a broad range of suits challenging proposed transactions, including claims targeting a board's sales process, conflicts of interest among the directors, and the adequacy of public disclosures.²¹ It was widely believed that the increase in such filings in 2017 and 2018 stemmed from the Delaware Court of Chancery's 2016 decision in *In re Trulia, Inc. Stockholder Litigation*,²² which limited Delaware's receptiveness to non-monetary, disclosure-only settlements of actions challenging M&A transactions. From 2017 to 2019—the three years immediately following *Trulia*—the number of securities filings challenging M&A transactions brought in federal court were more than five times higher than the average from 2009 to 2016.²³ Much of that growth was in the Third Circuit—home to Delaware—which saw its M&A filings skyrocket from an average of fewer than 10 between 2010 and 2016 to 127 in 2019. The Third Circuit in 2019 dwarfed the other circuits in M&A filings: compared to its 127 filings, all other circuits combined saw only 33, and the next largest circuit was the Second Circuit, with 9.²⁴

The decline seen in 2019 in M&A filings may, therefore, reflect the federal courts' steady adoption of *Trulia's* approach in federal jurisprudence. The case of *House v. Akorn, Inc.*²⁵ is illustrative of this

¹⁸ 138 S. Ct. 1061 (2018).

¹⁹ 2019 Cornerstone Report, at 25.

²⁰ *Id.* at 5.

²¹ This category generally does not include appraisal litigation. See *Shareholder Litigation Involving Acquisitions of Public Companies*, Cornerstone Research, at 7 (2017), <https://www.cornerstone.com/Publications/Reports/Shareholder-Litigation-Involving-Acquisitions-of-Public-Companies-Review-of-2017-M-and-A-Litigation>.

²² 129 A.3d 884 (Del. Ch. 2016).

²³ 2019 Cornerstone Report, at 46.

²⁴ *Id.* at 14.

²⁵ 385 F. Supp. 3d 616 (N.D. Ill. 2019), *appeal docketed*, No. 19-2408 (7th Cir. July 24, 2019).

trend. In that case, the Northern District of Illinois rejected a proposed settlement in a putative class action challenging an impending merger. After the action was filed, the target company amended its proxy statement to moot the plaintiffs' disclosure-based claims. The plaintiffs then voluntarily dismissed their claims in exchange for attorney's fees based on the supposed benefit those disclosures conferred on the shareholders. Echoing *Trulia's* skepticism of the value of such supplemental disclosures, the court deemed the company's additional disclosures in this case to be "worthless to the shareholders" and exercised the court's "inherent authority" to reject the mootness fee settlement and order plaintiffs' counsel to return the fee award to the company.²⁶ The decision is currently on appeal to the Seventh Circuit.²⁷

On the regulatory front, the SEC enforcement program continues to prioritize retail investor protection. A particular area of focus is misconduct related to the interactions between investment professionals and investors. This not only includes traditional retail cases such as Ponzi schemes and microcap fraud but also cases against investment advisers and investment companies related to conflict of interests and the failure to adequately disclose fees and costs to investors as well as cases against broker-dealers for excess commissions. An example of this focus going forward is the Enforcement Division's Teachers Initiative in which the SEC will be "looking at the compensation and sales practices of third-party administrators of teacher retirement plans—often known as 403(b) plans—as well as the practices of their affiliated advisers and broker dealers" for potential conflicts of interest.²⁸

This past year was another busy year for cyber enforcement. The SEC brought a number of significant ICO-related enforcement actions related to digital assets, including cases related to the proper registration of coin offerings and fraudulent ICOs. Chairman Clayton has made it clear that the SEC will stay active in this space and continue to scrutinize ICOs and other digital asset securities to ensure they comply with federal securities laws.

Finally, SEC remedies for securities law violations were a hot topic in 2019 and will be in 2020. As we discuss further below, the Supreme Court agreed to review a case that will likely decide whether the SEC has the authority to seek disgorgement in enforcement actions it brings in federal court. The SEC also continues to look for ways to use remedies other than financial penalties to further its enforcement goals. The SEC brought a number of enforcement actions in 2019 where it required

²⁶ 385 F. Supp. 3d at 622–23.

²⁷ *House v. Akorn, Inc.*, No. 19-2408 (7th Cir. appeal docketed July 24, 2019).

²⁸ Stephanie Avakian, U.S. Sec. & Exch. Comm'n Div. of Enf't, *What You Don't Know Can Hurt You*, Keynote Remarks at the 2019 SEC Regulation Outside the United States Conference (Nov. 5, 2019), <https://www.sec.gov/news/speech/speech-avakian-2019-11-05>.

parties to comply with detailed undertakings to further the SEC's remedial objectives and address the wrongdoing at issue and this trend will likely continue.

II. Threshold Issues

In 2019, defendants frequently sought dismissal of securities actions at the pleadings stage, arguing not that plaintiffs failed to allege fraudulent conduct, but that the parties or the alleged conduct did not fall within the ambit of the federal securities laws. In almost every such instance where a major issue of law was in dispute, however, courts rejected defendants' efforts and affirmed the broad scope of the federal securities laws.

A. Who May Be Liable for Securities Fraud? Makers vs. Schemers

In perhaps the most significant securities decision of the year, the Supreme Court, in *Lorenzo v. SEC*,²⁹ held that a person who does not "make" a fraudulent statement may nonetheless be held primarily liable under Section 10(b) of the Exchange Act and Rule 10b-5(a) and (c) for disseminating it. In so ruling, the Court substantially diminished (if not eliminating outright) the relevance of its 2011 decision in *Janus Capital Group, Inc. v. First Derivative Traders*,³⁰ which held that a person who does not have "ultimate authority" over an alleged misstatement may not be held primarily liable under Rule 10b-5(b).

In *Lorenzo*, the SEC brought an administrative proceeding against Francis Lorenzo, the vice president of an investment bank, who allegedly emailed fraudulent statements to potential investors regarding the value of a company involved in a debenture offering. The SEC determined that Lorenzo's actions violated Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 and imposed sanctions, including a civil penalty and a lifetime industry bar. Relying on *Janus*, the D.C. Circuit held that Lorenzo did not have "ultimate authority" over the statements in his investor emails and so could not be held liable under Rule 10b-5(b) for making those statements. The individual with "ultimate authority" was the employee's supervisor, who not only supplied the content of the email messages, but approved each message before it was sent.³¹ The court nevertheless concluded that, even though the vice president did not "make" the misstatement, he still could be held liable for his role in participating in the fraudulent scheme to send the emails under Rule 10b-5(a) or (c).³²

²⁹ 139 S. Ct. 1094.

³⁰ 564 U.S. 135.

³¹ *Lorenzo v. SEC*, 872 F.3d 578, 587-88 (D.C. Cir. 2017), *aff'd*, 139 S. Ct. 1094 (2019).

³² *Id.* at 591.

A 6-2 majority of the Supreme Court affirmed, holding that even if a person does not “make” a misstatement, the person’s participation in disseminating the misstatement falls within the scope of other provisions Rule 10b-5.³³ Writing for the majority, Justice Breyer rooted the Court’s decision in the text of subsections (a) and (c) of Rule 10b-5, which make it unlawful to “employ any device, scheme, or artifice to defraud” and “engage in any act, practice, or course of business” that “operates . . . as a fraud or deceit.”³⁴ “[T]he words in these provisions are, as ordinarily used, sufficiently broad to include within their scope the dissemination of false or misleading information with the intent to defraud.”³⁵ Lorenzo argued that the majority’s rationale would render Rule 10b-5(b)—which makes it unlawful “[t]o make any untrue statement of material fact or to omit to state a material fact”—“superfluous” because, he argued, subsections (a) and (c) of Rule 10b-5 would cover the conduct prohibited by Rule 10b-5 rather than a “separate type of conduct.”³⁶ But the Court rejected this argument, explaining that the Court and SEC “have long recognized considerable overlap among the subsections of [Rule 10b-5] and related provisions of the securities laws.”³⁷ As the Court saw it, “Congress intended to root out all manner of fraud in the securities industry” and “gave to the Commission the tools to accomplish that job.”³⁸

In a dissenting opinion, Justice Thomas cautioned that the majority’s “sweeping” holding “eviscerates” *Janus* and renders that decision a “dead letter.”³⁹ According to Justice Thomas, the majority’s decision could subject individuals only “tangentially” involved in the misconduct (like a secretary instructed to send a fraudulent email) to private securities fraud liability, which would abrogate the distinction between primary and secondary liability (for which no private right of action exists under the federal securities laws).⁴⁰ Under *Lorenzo*, the focus of the inquiry becomes an individual’s “intent to defraud” and active participation in a “scheme” or “course of business” designed to defraud, rather than on whether the individual was responsible for making a fraudulent misstatement.

Post-*Lorenzo* decisions have lent credence to Justice Thomas’s concerns, repeatedly holding that a defendant may be liable for securities fraud even if he or she did not have “ultimate authority” over—and thus did not “make”—an alleged misstatement. In *SEC v. Weaver*,⁴¹ for example, the Ninth Circuit

³³ *Lorenzo*, 139 S. Ct. 1094.

³⁴ *Id.* at 1100 (quoting 17 C.F.R. § 240.10b-5, 15 U.S.C. § 78j(b), and 15 U.S.C. § 77q(a)).

³⁵ *Id.* at 1101.

³⁶ *Id.* at 1102; 17 C.F.R. § 240.10b-5(b).

³⁷ 139 S. Ct. at 1102.

³⁸ *Id.* at 1104.

³⁹ *Id.* at 1106, 1110 (Thomas, J., dissenting).

⁴⁰ *Id.* at 1110-11.

⁴¹ 773 F. App’x 354 (9th Cir. 2019).

held that the defendant who did not “make” a misstatement could be liable under *Lorenzo* because the “undisputed facts show that [his] ‘own conduct contributing to the transaction or overall scheme . . . had a deceptive purpose and effect.’”⁴² In multiple cases, the Southern District of New York also relied on *Lorenzo* to sustain fraud claims on the pleadings despite the failure to “allege a deceptive act that is distinct from misstatements,” holding that deceptive conduct alone is sufficient to expose a defendant to “scheme liability” under Rule 10b-5(a) and (c).⁴³ Moreover, although *Lorenzo* only addressed claims under Rule 10b-5, in *Malouf v. SEC*,⁴⁴ the Tenth Circuit held that it applies with equal force to claims under Section 17(a)(3) of the Securities Act, which prohibits anyone from “engag[ing] in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.”⁴⁵ In *Malouf*, the Tenth Circuit explained that *Lorenzo* applies to such claims because Section 17(a)(3) “is virtually identical to Rule 10b-5(c).”⁴⁶

These decisions illustrate that, as Justice Breyer observed in *Lorenzo*, Section 10(b) and Rule 10b-5 “capture a wide range of conduct.”⁴⁷ Even if a misstatement is involved, a defendant still may face primary liability for his or her participation in a fraudulent “scheme” involving the misstatement. Given *Lorenzo*, we expect fraud defendants to gradually stop invoking the *Janus*-based defense that they are not liable because they lacked “ultimate authority” over an alleged misstatement, which had become increasingly popular, and instead to turn their focus to testing the outer bounds of “scheme” liability.

B. Federal Preemption

Congress has engaged in two major legislative efforts to curb perceived abuses in securities filings. In 1995, Congress passed the Private Securities Litigation Reform Act (PSLRA), which imposed various procedural hurdles on Section 10(b) claims, including, for example, dismissal of unsubstantiated suits without discovery, sanctions for frivolous actions, and safe harbors for certain forward-looking statements.⁴⁸ Given the obstacles placed in front of federal securities plaintiffs by the PSLRA, plaintiffs responded by refashioning such claims as state-law fraud claims—and filing such suits in state court where the PSLRA does not apply—wherever possible. To stem this practice and reassert federal control over such claims, in 1998, Congress passed the Securities Litigation Uniform Standards Act (SLUSA), which amended portions of both the Securities Act and the

⁴² *Id.* at 356.

⁴³ *SEC v. SeeThruEquity, LLC*, No. 18 Civ. 10374 (LLS), 2019 WL 1998027, at *5 (S.D.N.Y. Apr. 26, 2019); *SEC v. Fiore*, No. 18-CV-5474 (KMK), 2019 WL 4688538, at *7 (S.D.N.Y. Sept. 25, 2019).

⁴⁴ 933 F.3d 1248 (10th Cir. 2019), *pet. for cert. filed*, No. 19-909 (U.S. Jan. 17, 2020).

⁴⁵ *Id.* at 1260.

⁴⁶ *Id.*

⁴⁷ *Lorenzo*, 139 S. Ct. at 1101.

⁴⁸ The Private Securities Litigation Reform Act of 1995, 15 U.S.C. §§ 78u-4, 78u-5.

Exchange Act to preempt “covered” class actions in state court and permit defendants to remove them to federal court.⁴⁹

SLUSA preemption applies only to a “covered class action” where the plaintiff alleges a “misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security” or “that the defendant used to employ any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security.”⁵⁰ A “covered class action” includes not only a single class action lawsuit, but also any *group* of lawsuits (i) filed in or pending in the same court, (ii) involving common questions of law or fact, (iii) seeking damages for more than 50 persons, and (iv) that “are joined, consolidated, or otherwise proceed as a single action for any purpose.”⁵¹

In *North Sound Capital LLC v. Merck & Co.*,⁵² the Third Circuit held that the SLUSA did not preclude plaintiffs who opted out of a class action from asserting state law fraud claims in follow-on individual actions. In that case, a class action asserting fraud claims under Sections 10(b), 20(a), and 20A was commenced in the District of New Jersey alleging that Merck and Schering-Plough made misstatements concerning efficacy of two popular anti-cholesterol drugs. After the district court approved a class-wide settlement and entered judgment, certain plaintiffs who opted out of the class action brought individual actions asserting claims under the federal securities laws and for common law fraud under New Jersey law. After the plaintiffs’ federal claims were dismissed as time-barred under the Exchange Act’s five-year statute of repose, the district court held the state law fraud claims were preempted under the SLUSA.⁵³ According to the district court, Congress “envisioned the aggregation of opt-out suits with related class actions” under the SLUSA’s mass-action provisions.⁵⁴

On appeal, the Third Circuit disagreed with the district court’s analysis and reinstated the opt-out plaintiffs’ state law claims. In rejecting a broad view of SLUSA preclusion, the Third Circuit held that “at a minimum, suits do not ‘proceed as a single action’ unless they are somehow combined for the joint management of a common stage of the proceedings (such as discovery) or the resolution of a common question of law and fact.”⁵⁵ The court explained that this interpretation is supported by Congress’ repeated refusal—including in the Securities Act, the Exchange Act, the PSLRA, and the SLUSA itself—to broadly preempt state-law securities claims.⁵⁶ It also comports with the Fifth and

⁴⁹ Securities Litigation Uniform Standards Act of 1998, 15 U.S.C. § 78bb(f)(1)-(2).

⁵⁰ 15 U.S.C. § 78bb(f)(1).

⁵¹ 15 U.S.C. § 78bb(f)(5)(B)(ii).

⁵² 938 F.3d 482.

⁵³ 314 F. Supp. 3d 589 (D.N.J. 2018), *rev’d & remanded*, 938 F.3d 482 3d Cir. 2019).

⁵⁴ *Id.* at 611.

⁵⁵ 938 F.3d at 489.

⁵⁶ *Id.* at 491.

Fourteenth Amendments, under which every absent class member must be provided with an opportunity to opt out of a class action seeking predominantly damages. In this case, the court found that there was no “coordination” among the plaintiffs because “Plaintiffs’ suits and the prior class actions never existed at the same time.”⁵⁷ This was so even though the opt-out plaintiffs’ actions were designated as “related” to the class action and their complaints were based nearly verbatim on the class action complaints.⁵⁸

The Third Circuit’s decision arguably runs contrary to the goals of the SLUSA. Under *North Sound Capital*, a plaintiff who opts out of a class action may assert a state law securities fraud claim that is not subject to the federal pleading standards or, notably, federal limitations periods. Thus, the decision unquestionably expands the scope of potential liability for securities fraud and incentivizes plaintiffs to opt out of securities class actions to assert state law claims. Perhaps the most notable aspect of the decision is that it permitted opt-out plaintiffs to proceed with state law claims, even as equivalent claims under federal law were time-barred. Given the implications, we expect plaintiffs to deploy the techniques of *North Sound Capital* more frequently and, as a result, for other courts of appeals (and perhaps the Supreme Court) to eventually weigh in on the issue.

C. Extraterritoriality

In its 2010 decision in *Morrison v. National Australia Bank*,⁵⁹ the Supreme Court established that plaintiffs cannot assert “extraterritorial” claims under Section 10(b). Specifically, the Court held that these provisions apply only to (i) “transactions in securities listed on domestic exchanges” and (ii) “domestic transactions in other securities[.]”⁶⁰ While *Morrison* has proved a boon for defendants in many cases, in 2019, two key decisions refused to recognize defendants’ *Morrison*-based arguments.

First, the Supreme Court left untouched a Ninth Circuit decision rejecting the Second Circuit’s multi-factor approach to the question of extraterritoriality under *Morrison*. In a 2014 decision in *Parkcentral Global Hub Ltd. v. Porsche Automobile Holdings SE*,⁶¹ the Second Circuit held that “while a domestic transaction or listing is necessary to state a claim under § 10(b), a finding that these transactions were domestic would not suffice to compel the conclusion that the plaintiffs’ invocation of § 10(b) was appropriately domestic.”⁶² According to the Second Circuit, the facts of a case may demonstrate that claims are “so predominantly foreign as to be impermissibly extraterritorial,” even if they involve

⁵⁷ *Id.* at 492.

⁵⁸ *Id.* at 493-94.

⁵⁹ 561 U.S. 247 (2010).

⁶⁰ *Id.* at 267.

⁶¹ 763 F.3d 198 (2d Cir. 2014).

⁶² *Id.* at 216 (emphasis omitted).

a domestic transaction.⁶³ In 2018, in *Stoyas v. Toshiba Corp.*,⁶⁴ the Ninth Circuit rejected the Second Circuit's approach, explaining that the *Parkcentral* test "is contrary to Section 10(b) and *Morrison* itself," because it (i) ignores the broad language of Rule 10(b), (ii) speculates "about Congressional intent" which *Morrison* "rebuke[d]," (iii) establishes an "open-ended, under-defined multifactor test . . . akin to the vague" tests criticized by *Morrison*, and (iv) "relies heavily on the foreign location of the allegedly deceptive conduct . . . which *Morrison* held to be irrelevant[.]"⁶⁵ Thus, under *Stoyas*, a finding of a domestic transaction is not only necessary for antifraud liability; it is also sufficient.⁶⁶ On June 24, 2019, the Supreme Court denied a petition for writ of certiorari seeking to resolve the circuit split.

On January 28, 2020, following the Supreme Court's denial of certiorari, the Central District of California in *Stoyas* sustained fraud claims arising from plaintiffs purchase of American Depositary Receipts (ADRs) reflecting ownership of the common stock of Toshiba Corporation, which trades on the Tokyo Stock Exchange.⁶⁷ Citing plaintiffs' allegations that they purchased the ADRs through a broker in New York, via the "OTC Link trading platform" based in New York, and that transfer of title was recorded in Citibank in New York, the court held that "Plaintiffs have plausibly alleged that [they] incurred irrevocable liability 'to take and pay for the ADRs in the United States.'"⁶⁸ Accordingly, the court held that plaintiffs had sufficiently alleged a "domestic transaction" under *Morrison* to defeat a motion to dismiss.⁶⁹

Thus, as it stands, the Ninth Circuit and Second Circuit employ different approaches to the question of extraterritoriality: in the Ninth Circuit, any "domestic" transaction is subject to the antifraud provisions, while in the Second Circuit, even a "domestic" transaction may be beyond the reach of the federal securities laws depending on the results of a fact-based assessment of the foreign nature of a transaction. Until the Supreme Court weighs in, we expect plaintiffs asserting fraud claims with a foreign nexus to steer suits to the Ninth Circuit, whenever possible.

Second, the Tenth Circuit clarified that *Morrison* does not apply to securities fraud claims asserted by the SEC or DOJ, holding that the more expansive standards of Section 929P(b) of the Dodd-Frank Act apply instead. In *SEC v. Traffic Monsoon, LLC*,⁷⁰ the SEC brought a civil suit in the District

⁶³ *Id.*

⁶⁴ 896 F.3d 933 (9th Cir. 2018), *cert. denied*, 139 S. Ct. 2766 (2019).

⁶⁵ *Id.* at 950.

⁶⁶ *Id.*

⁶⁷ *Stoyas v. Toshiba Corp.*, No. 15-cv-4194 DDP (JCx), 2020 WL 466629 (C.D. Cal. Jan. 28, 2020).

⁶⁸ *Id.* at *3.

⁶⁹ *Id.*

⁷⁰ *SEC v. Traffic Monsoon, LLC*, 245 F. Supp. 3d 1275 (D. Utah 2017), *aff'd sub nom. SEC v. Scoville*, 913 F.3d 1204 (10th Cir.), *cert. denied*, No. 18-1566, 2019 WL 5686461 (U.S. Nov. 4, 2019).

of Utah against Traffic Monsoon, an internet traffic exchange business that sold “AdPacks” of fake page views and advertisement click-throughs to make a website appear more popular by artificially inflating its page views. The SEC alleged that Traffic Monsoon’s Adpacks sales constituted an illegal Ponzi scheme in violation of Section 10(b) of the Exchange Act and 17(a) of the Securities Act, and sought a preliminary injunction freezing defendants’ assets and prohibiting defendants from continuing to operate the business. In granting the requested preliminary relief, the district court rejected defendants’ argument that the SEC could not succeed on their claims under *Morrison* because of the absence of “domestic” securities transaction, holding that the “conduct and effects” test under Section 929P(b) of the Dodd-Frank Act—not *Morrison*—applies to the SEC’s claims. Under that test, the SEC may assert a claim for fraud based on “(1) conduct within the United States that constitutes significant steps in furtherance of the violation” or “(2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.”⁷¹

The Tenth Circuit affirmed. On appeal, the defendant argued that *Morrison*, not the “conduct and effects” test, should apply to the SEC’s claims. According to defendant, Congress did not clearly express its intent to override *Morrison*’s default rule because Section 929P(b) is framed as a matter of jurisdiction in the Dodd-Frank Act, while, under *Morrison*, extraterritoriality is not jurisdictional, but rather goes to the merits of a claim. The Tenth Circuit rejected this argument, explaining that “it strains credulity” to assume that Congress “consciously chose to enact Section 929P(b) against the background of the fundamental shift in securities law brought about by *Morrison*,” when *Morrison* was issued in the midst of the legislative process and only a month after the Dodd-Frank Act was enacted into law.⁷² Rather, “given the context and historical background surrounding Congress’s enactment” of Section 929P(b), “Congress undoubtedly intended that the substantive antifraud provisions should apply extraterritorially when the statutory conduct-and-effects test is satisfied.”⁷³ Further, the court found the requirements of the test to be met in this case because the defendant “conceived and created” the Adpack scheme in the U.S. and “promoted the Adpack investments . . . while residing in Utah.”⁷⁴ The Supreme Court denied the defendant’s petition for certiorari on November 4, 2019.

Given the strength of the Tenth Circuit’s reasoning, we do not expect any serious challenge to the holding of *Scoville* in other jurisdictions. Rather, under Section 929P(b) of the Dodd-Frank Act, the SEC and DOJ need only show that a fraud defendant engaged in substantial conduct in the United States, or conduct that had an effect in the United States. This gives the SEC and DOJ a powerful

⁷¹ *Id.* at 1294 (quoting Pub. L. No. 111-203, § 929P(b), 124 Stat. 1376, 1864–65 (2010)).

⁷² *Scoville*, 913 F.3d at 1218 (quoting 245 F. Supp. 3d at 1291).

⁷³ *Id.*

⁷⁴ *Id.* at 1219.

tool to reach defendants that private litigants cannot when there is not a “domestic” securities transaction.

D. What Qualifies as a “Security”?

By definition, the securities laws apply only to “securities.” Whether an instrument is deemed a “security” will often turn on whether it qualifies as an “investment contract” under the Securities Act’s definition of a “security.”⁷⁵ The Supreme Court established the requirements for an “investment contract” in its 1946 decision *SEC v. W.J. Howey Co.*⁷⁶: (1) an investment, (2) in a common enterprise, (3) with a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others.⁷⁷

In two significant decisions in 2019, courts applied the *Howey* test to find that investment vehicles involving new technologies qualified as “securities.” In *Scoville*, discussed above, the defendant contended that Traffic Monsoon’s Adpacks did not qualify as securities because the purpose of Adpacks was to provide purchasers’ advertising for their websites by artificially inflating page views, not to serve as an investment. The Tenth Circuit rejected this argument, reasoning that the vast majority of Adpacks purchasers bought Adpacks “not to receive advertising services . . . but instead to have the opportunity to share in Traffic Monsoon’s revenue and earn significant returns.”⁷⁸ In addition, the court disagreed with the defendant’s contention that revenue is not “solely” derived by defendants’ efforts given that it also depends on purchasers’ clicking on each other’s websites. The court noted that the company’s efforts were a significant factor, since a purchaser could “qualify to share revenue . . . by spending only four minutes a day” clicking on ads and the purchasers were primarily motivated by the chance to receive a “return on their investment”—not the promise of receiving additional “clicks” on their website.⁷⁹

In *Balestra v. ATBCOIN LLC*,⁸⁰ the Southern District of New York held that cryptocurrency called an “ATB Coin” was an investment contract. In considering whether the coin qualified as a “security,” the court found that plaintiff alleged a common enterprise because the “primary goal” of the coin offering “was to raise capital to create and launch a new blockchain that would “deliver blazing fast, secure and near-zero cost payments to anyone in the world.”⁸¹ According to the court, this demonstrated that “the funds raised through the ICO were pooled together to facilitate the launch of

⁷⁵ 15 U.S.C. § 77e.

⁷⁶ 328 U.S. 293 (1946).

⁷⁷ *Id.* at 301.

⁷⁸ *Scoville*, 913 F.3d at 1221.

⁷⁹ *Id.* at 1222.

⁸⁰ 380 F. Supp. 3d 340.

⁸¹ *Id.* at 353 (citations omitted).

the ATB Blockchain, the success of which, in turn, would increase the value of Plaintiff's ATB Coins."⁸² The court specifically observed that "Defendants launched a marketing campaign for ATB Coins that highlighted the potential profits that would result simply from holding those coins" in press releases and on defendants' website.⁸³

These decisions demonstrate that courts will apply the 74-year-old *Howey* test—which was originally developed in relation to the sale of tracts of a citrus grove—to emerging forms of investments in the modern economy. In particular, *Balestra* should dispel the notion that purveyors of increasingly popular cryptocurrencies are exempt from the securities laws and their registration requirements.

III. Class Certification

An area where plaintiffs had almost across-the-board success in 2019 was class certification. This is notable because class certification is often make-or-break for plaintiffs and defendants. If a class is certified, the potential damages a defendant faces rise astronomically, which unsurprisingly often leads to settlement. By contrast, if certification is denied, the leverage tips decidedly to the defendants against individuals who typically lack the resources or incentive to effectively litigate a complex securities case.

In 2019, as in past years, much of the activity in class certification focused on the question of predominance. Under Rule 23(b)(3) of the Federal Rules of Civil Procedure, plaintiffs have the burden of establishing "that the questions of law or fact common to class members predominate over any questions affecting only individual members" in order to achieve class certification.⁸⁴ In numerous cases, defendants argued that plaintiffs failed to demonstrate that class members relied on fraudulent misstatements or omissions or could show that they suffered damages on a class-wide basis. In almost all instances, defendants' efforts failed.

A. Reliance on a Class-Wide Basis

In theory, plaintiffs have a significant challenge in establishing that common questions of reliance predominate on a class-wide basis, because in a large, diffuse class, each member may have a different story as to why he or she purchased a particular security. Some may have relied on public statements and disclosures, some on price, some on reputation of the company, and so on. To ease this burden and avoid a result where no mass securities fraud class actions can be certified, the Supreme Court has established two "presumptions" of reliance that arise if certain conditions are satisfied. First, under the *Basic* (or fraud-on-the-market) presumption, a plaintiff can invoke a

⁸² *Id.*

⁸³ *Id.* at 355.

⁸⁴ Fed. R. Civ. P. 23(b)(3).

presumption of reliance if he or she traded in securities of a company that made material misrepresentations to the public and whose securities are traded on an efficient market,⁸⁵ subject to an opportunity for the defendant to rebut the presumption and defeat class certification by showing that the misrepresentations did not actually affect the price of the stock.⁸⁶ Second, the Court in *Affiliated Ute* articulated a presumption that plaintiffs may invoke “if there is an omission of material fact by one with a duty to disclose[.]”⁸⁷

Importantly, the Supreme Court has explained that both presumptions may be rebutted at the class certification stage, in which case class certification would be defeated. Specifically, a defendant may rebut the presumption by “sever[ing] the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price.”⁸⁸ For example, a defendant could present evidence that “the . . . misrepresentation did not, for whatever reason, actually affect the market price, or that a plaintiff would have bought or sold the stock even had he been aware that the stock’s price was tainted by fraud[.]”⁸⁹

The lesson of cases involving the *Basic* presumption in 2019 is, if plaintiffs make a threshold showing of market efficiency entitling them to the presumption, defendants will have an extremely difficult time rebutting it on class certification. In *Roofers’ Pension Fund v. Papa*,⁹⁰ for example, plaintiffs sought certification of a class of investors in the stock of Perrigo Company plc, which trades on both the New York Stock Exchange (NYSE) and Tel Aviv Stock Exchange (TASE). Although defendants did not challenge the applicability of the *Basic* presumption for the NYSE class, they argued that it had been rebutted by a showing that plaintiffs relied on information other than alleged misstatements, including their own assessments. The District of New Jersey rejected this argument, holding that defendants did not show that plaintiffs relied “solely” on other factors or that their reliance on such other factors outweighed their reliance on the stock’s market price.⁹¹ In any event, the court held that evidence of certain class members’ reliance would not defeat predominance because individual issues of reliance would not “overwhelm” the class.⁹² With respect to the TASE class, the court held that the market was efficient, rejecting defendant’s criticism of plaintiff’s expert’s event study, which defendants asserted did not to account for changes in TASE stock price that were tied to the U.S.

⁸⁵ *Basic Inc. v. Levinson*, 485 U.S. 224, 249-50 (1988).

⁸⁶ *Id.* at 229-30.

⁸⁷ *Stoneridge Inv. Partners, LLC v. Sci.-Atlanta*, 552 U.S. 148, 159 (2008) (citing *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 153-154 (1972)).

⁸⁸ *Basic*, 485 U.S. at 248.

⁸⁹ *Halliburton Co. v. Erica P. John Fund, Inc.*, 573 U.S. 258, 269 (2014).

⁹⁰ 333 F.R.D. 66 (D.N.J. 2019), *appeal filed*, No. 19-8047 (3d Cir. Nov. 29, 2019).

⁹¹ *Id.* at *80.

⁹² *Id.* at *80-81.

markets (a supposed sign of inefficiency).⁹³ According to the court, alleged deficiencies in the expert's event study were not enough to overcome other evidence of market efficiency, such as "over thirty investment firms that issued 'over 600 analyst reports' covering Perrigo's stock during the Class Period," "at least seventeen market makers for Perrigo stock on the TASE during the Class Period," and the fact that "Perrigo filed an S-3 registration statement with the SEC shortly before the Class Period."⁹⁴

In *Monroe County Employees' Retirement System v. Southern Co.*,⁹⁵ plaintiffs sought certification of a class of investors in the stock of The Southern Company, which trades on the NYSE. The Northern District of Georgia found that the *Basic* presumption applied based on evidence of the market's efficiency, including high weekly trading volume, significant analyst coverage, market makers, and a cause and effect relationship between release of unexpected company news and movements in stock price. The court rejected defendants' criticisms of plaintiff's expert's model, expressly stating its "disinclination to engage in a battle of the experts at this stage."⁹⁶ Defendants argued that they had rebutted the presumption due to plaintiffs' expert's failure to find statistically significant stock price declines on certain dates of corrective disclosure. The court explained, however, that this does not prove the absence of price impact: "[i]f a price movement is not statistically significant, one cannot rule out random volatility, but neither can one rule out information as the cause of the price movement or at least a contributing factor."⁹⁷

In *Villella v. Chemical and Mining Co. of Chile, Inc.*,⁹⁸ plaintiffs sought certification of a class of investors in the stock of Chemical and Mining Company of Chile, Inc., which trades on the NYSE. The defendants argued that the *Basic* presumption did not apply based on plaintiffs' expert's failure to establish that stock price movement on three of five release dates was statistically significant. The Southern District of New York rejected this argument, holding that only "some evidence" of market efficiency was necessary, and, although plaintiff's expert's study evidence was imperfect, it was sufficient to meet that standard.⁹⁹ The court was also unpersuaded by another flaw in plaintiff's experts model: that its changes in stock price one day were correlated with prices another day, a sign of supposed inefficiency. In contrast to its ruling that "some evidence" of efficiency was all that was required to qualify for the *Basic* presumption, the court held that "some evidence" of inefficiency

⁹³ *Id.* at *84-85.

⁹⁴ *Id.* at 82, *83-84 (citation omitted).

⁹⁵ 332 F.R.D. 370 (N.D. Ga. 2019).

⁹⁶ *Id.* at 388.

⁹⁷ *Id.* at 393 (citation omitted).

⁹⁸ 333 F.R.D. 39 (S.D.N.Y. 2019).

⁹⁹ *Id.* at 52-53.

was not enough to rebut it.¹⁰⁰ Thus, *Villella* clearly illustrates that, where the *Basic* presumption is at issue, plaintiffs and defendants are not on equal footing; plaintiffs have a lower evidentiary burden.

In *Vizirgianakis v. Aeterna Zentaris, Inc.*,¹⁰¹ plaintiffs sought certification of a class of investors in the stock of Aeterna Zentaris, Inc., which trades on the NYSE. The District of New Jersey certified the class, finding that the *Basic* presumption applied. On appeal, defendants argued that they had rebutted the *Basic* presumption because plaintiffs' expert did not prove a price impact to a 95% confidence level.¹⁰² The Third Circuit rejected this argument, holding that plaintiffs do not have a burden to prove price impact for class certification purposes, and their failure to do so does not establish the opposite.¹⁰³ The court also declined to find that the lower court had abused its discretion in weighing conflicting expert testimony at the class certification stage, explaining that "[w]eighing conflicting expert testimony is a normal task of the district court at the certification stage."¹⁰⁴

Although not as frequently litigated, plaintiffs had similar success in certifying a class under the *Affiliated Ute* presumption. In *Gruber v. Gilbertson*,¹⁰⁵ for example, plaintiffs sought to certify a class against various stakeholders of Dakota Plains Holdings, Inc. for securities fraud. Plaintiffs alleged that defendants engaged in a scheme to manipulate the company's stock price while concealing that they had amassed a large equity stake in excess of 5% of the company. To contest application of the *Affiliated Ute* presumption, defendants argued that it was not primarily an omissions case because the company had made an affirmative misstatement in a Form 8-K that no one in the company owned more than 5% of the company. The Southern District of New York rejected this argument, holding that identification of certain representations alone does not make a case about misrepresentations. The key in this case, according to the court, was that defendants did not disclose their specific equity stake.¹⁰⁶ In addition, the court rejected defendants' effort to rebut the *Affiliated Ute* presumption by showing that corrective disclosures had no impact on the company's stock price. The court explained that price impact relates to the materiality of the alleged omissions, and an assessment of materiality is not appropriate at the class certification stage.¹⁰⁷

¹⁰⁰ *Id.* at 54-55.

¹⁰¹ 775 F. App'x 51 (3d Cir. 2019).

¹⁰² *Id.* at 53.

¹⁰³ *Id.*

¹⁰⁴ *Id.* at 54.

¹⁰⁵ No. 16-CV-9727, 2019 WL 4439415 (S.D.N.Y. Sept. 17, 2019).

¹⁰⁶ *Id.* at *7.

¹⁰⁷ *Id.* at *8.

In sum, these cases show the difficulty defendants face in defeating class certification where (a) plaintiffs have presented “some evidence” of market efficiency or (b) the case involves primarily omissions. Courts have made clear that they will not closely scrutinize the evidence of market efficiency offered by plaintiffs, or engage in a “battle of the experts.” Rather, “some evidence” of efficiency is likely enough. Moreover, in no significant decision this year did a court find defendants’ evidence of lack of price impact sufficient to rebut the presumption.

In consistently rejecting defendants’ price impact evidence, these decisions are arguably inconsistent with the Supreme Court’s 2011 decision in *Wal-Mart Stores, Inc. v. Dukes*¹⁰⁸ and 2013 decision in *Comcast Corp. v. Behrend*¹⁰⁹ (discussed in the next section), which directed district courts to conduct an in-depth analysis into whether plaintiff has satisfied Rule 23 prerequisites at the class certification stage, even if those questions are implicated by the merits of plaintiffs’ claims. In *Dukes*, the Court emphasized that it “‘may be necessary for the court to probe behind the pleadings before coming to rest on the certification question,’ and that certification is proper only if ‘the trial court is satisfied, after a rigorous analysis, that the prerequisites of Rule 23(a) have been satisfied.’”¹¹⁰ Although lower courts frequently have relied on *Dukes* and *Comcast* to deny class certification in other contexts, it is not clear that courts are applying the same “rigorous analysis” to market efficiency and price impact evidence at the class certification stage.

While it is still black letter law that defendants may defeat certification by “severing” the link between a misrepresentation and stock price, it remains an open question how this may be accomplished in practice, given the high burden that courts have placed on defendants. Despite these difficulties, and lack of track record of success, we expect defendants to continue to try, given the stakes.

B. Damages on a Class-Wide Basis

In its 2013 decision *Comcast Corp. v. Behrend*,¹¹¹ the Supreme Court held that “a model purporting to serve as evidence of damages in [a] class action must measure only those damages attributable to [the] theory [of liability].”¹¹² The Court explained that “[i]f the model does not even attempt to do that, it cannot possibly establish that damages are susceptible of measurement across the entire class for purposes of Rule 23(b)(3).”¹¹³ On that basis, the Court denied class certification for antitrust claims where an expert’s model “assumed the validity of all four theories of antitrust impact initially advanced by respondents” and therefore “failed to measure damages resulting from the particular

¹⁰⁸ 564 U.S. at 350-51.

¹⁰⁹ 569 U.S. at 35.

¹¹⁰ 564 U.S. at 350-51 (quoting *Gen. Tel. Co. of Sw. v. Falcon*, 457 U.S. 147, 160-61 (1982)).

¹¹¹ 569 U.S. at 35.

¹¹² *Id.*

¹¹³ *Id.*

antitrust injury on which petitioners' liability . . . is premised."¹¹⁴ While defendants have frequently raised a "*Comcast*" defense in opposing certification in securities class actions, these efforts have rarely succeeded, and 2019 was no exception.

In *In re Snap Inc. Securities Litigation*,¹¹⁵ defendants opposed certification of securities fraud claims by arguing that plaintiffs failed to show that damages are capable of measurement on a class-wide basis. The Central District of California disagreed, finding that "the theory of price inflation that undergirds [plaintiffs' expert's] damages model for the Section 11 claims is expressly linked to his proposed model for calculating Section 10(b) damages" and the expert's "damages model under Section 10(b) relies on an event study, where an expert estimates company-specific price movement caused by other factors such as overall market conditions or dissemination of other material but non-fraudulent information relayed by the company."¹¹⁶ The court further noted that the expert's report "describes how an event study would enable him to assess price inflation in Snap's stock and describes how the five alleged corrective partial disclosures during the Class Period would be analyzed using that methodology to determine how potential price inflation was impacted by each round of corrective disclosures."¹¹⁷

In *Roofers' Pension Fund v. Papa*,¹¹⁸ discussed above, the District of New Jersey also rejected a *Comcast* defense, holding that the lead plaintiff's proposal to determine price inflation on each day during the class period and to use that information to determine damages based on individual class members' trading activity satisfied the predominance requirement and was consistent with the lead plaintiff's theory of liability.¹¹⁹ Casting doubt on whether *Comcast* may ever be raised in a securities class action, the court pointed out that "the Third Circuit has explicitly cautioned that *Comcast*'s damages 'predominance analysis was specific to the antitrust claim at issue.'¹²⁰ The court further explained that, even if *Comcast* were to apply, the proposed damages model was sufficient because it did not "'fail[] to measure damages resulting from the particular injury on which [the plaintiffs'] liability in this action is premised'."¹²¹

¹¹⁴ *Id.* at 36.

¹¹⁵ No. 2:17-cv-03679-SVW-AGR, 2019 WL 6270291 (C.D. Cal. Nov. 20, 2019), *appeal filed*, No. 19-80157 (9th Cir. Dec. 4, 2019).

¹¹⁶ *Id.* at *4.

¹¹⁷ *Id.*

¹¹⁸ 333 F.R.D. at 87.

¹¹⁹ *Id.*

¹²⁰ *Id.* (citation omitted).

¹²¹ *Id.* (quoting *Comcast*, 569 U.S. at 36).

Likewise, in *Monroe County Employees' Retirement System v. Southern Co.*,¹²² the Northern District of Georgia rejected a *Comcast* challenge to plaintiffs' expert's damages methodology. The court explained that "nothing in Rule 23(b) requires Plaintiffs to prove predominance separately as to both liability and damages."¹²³ The court articulated a plaintiff-friendly, two-step inquiry into the damages calculation at the certification stage: "[I]f damages cannot be ascertained by a methodology applicable to all class members, the Court must then consider whether questions of individual damages overwhelm the questions of liability that are subject to common proof."¹²⁴ In light of this standard, the court held that plaintiffs' inexact description of their proposed damages calculations was a sufficient articulation of a class-wide damages model to warrant certification.¹²⁵

Finally, in *Gruber v. Gilbertson*,¹²⁶ the Southern District of New York rejected defendants' argument under *Comcast* that plaintiffs' expert's damages methodology did not match plaintiffs' theory of liability. According to defendants, "Gruber's expert makes a faulty assumption that class members would not have purchased the stock had they known the information Defendants omitted" and "different plaintiffs would have relied on different omissions before making purchases."¹²⁷ The court, however, dismissed these arguments as "miss[ing] the point" because "[t]he [plaintiffs'] damages model is generally the same—inflated price minus actual price" across all plaintiffs.¹²⁸ The court further explained that while the damages calculation may be individualized for each plaintiff, that does not necessarily mean that individual issues will overwhelm the issues common among the class.¹²⁹

In short, in 2019, *Comcast* defenses were not fruitful for securities defendants opposing class certification, and that likely will not change absent further guidance by courts of appeals or the Supreme Court.

IV. Theories of Fraud

While many important decisions favored plaintiffs in 2019, one area where defendants found some success was in dismissing fraud claims on the merits. To state a claim under Section 10(b) of the Exchange Act and Rule 10b-5, a plaintiff must plead "(1) a material misrepresentation or omission by the defendant[,], (2) scienter[,], (3) a connection between the misrepresentation or omission and the

¹²² 332 F.R.D. at 397-99.

¹²³ *Id.* at 397.

¹²⁴ *Id.* at 398.

¹²⁵ *Id.* at 399.

¹²⁶ 2019 WL 4439415, at *8.

¹²⁷ *Id.*

¹²⁸ *Id.*

¹²⁹ *Id.*

purchase or sale of a security[,] (4) reliance upon the misrepresentation or omission[,] (5) economic loss[,] and (6) loss causation.”¹³⁰ These elements are coupled with heightened pleading standards, including the requirement under Rule 9(b) of the Federal Rules of Civil Procedure that fraud claims be pled with “particularity,” and the mandate under the PSLRA that the complaint establish a “strong inference” of scienter. In 2019, courts were willing to closely scrutinize plaintiffs’ allegations of fraud, and dismiss claims outright when they did not suffice under these standards.

A. Material Misrepresentations vs. Mere “Puffery”

The first element of a Section 10(b) claim—whether a material misrepresentation or omission occurred—was litigated frequently in 2019. The question often was not whether someone made a misrepresentation, but whether the misrepresentation was “material”—that is, whether there is a “substantial likelihood” that it “would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.”¹³¹ Where courts categorized the alleged misrepresentation as mere “puffery,” a generic expression of corporate optimism that is immaterial as a matter of law, they dismissed the claims.

In *Carvelli v. Ocwen Financial Corp.*,¹³² the Eleventh Circuit accepted a “puffery” defense for the first time in the securities fraud context. There, the Puerto Rico Retirement System asserted violations of Sections 10(b) and 20(a) of the Exchange Act against Ocwen Financial Corporation, a mortgage servicer. It alleged that Ocwen materially misled investors about the likelihood that Ocwen would achieve regulatory compliance with certain state and federal laws governing the mortgage servicing process. The Southern District of Florida dismissed the complaint, holding that each of the alleged misrepresentations was immaterial puffery, exempt forward-looking statements, or not sufficiently alleged to have been false. The Eleventh Circuit affirmed. Because Section 10(b) “prohibits untrue statements of a *material* fact,” the court reasoned that a puffery defense is “a particularly good fit in the securities context.”¹³³ As such, the court held that Ocwen’s alleged misrepresentations—including statements that the company had “continued ‘to devote substantial resources’” to regulatory compliance, felt “‘good about [its] progress’” towards compliance, and had taken a “‘leading role’” to stabilize communities affected by the financial crisis—were immaterial “puffery” insufficient to constitute securities fraud.¹³⁴

¹³⁰ *Stoneridge*, 552 U.S. at 157.

¹³¹ *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

¹³² 934 F.3d 1307.

¹³³ *Id.* at 1320 (emphasis in original).

¹³⁴ *Id.* at 1321 (citation omitted).

Likewise, the Second Circuit affirmed dismissal of Section 10(b) claims on a theory of “puffery” in two cases. In *Gross v. GFI Group, Inc.*,¹³⁵ plaintiffs alleged that a corporation’s chairman materially misrepresented the value of a proposed merger by stating that the proposal represented “‘a singular and unique opportunity to return value.’”¹³⁶ The district court granted the defendants’ motion for summary judgment, holding that, while a reasonable juror could find the chairman’s statement qualified as a material misrepresentation, the investors failed to adduce evidence that defendants acted with scienter or that their economic losses were foreseeably caused by the misstatement. On appeal, the Second Circuit agreed with the result, but disagreed that the statement was material. The court held that the statement—which was made without “any elaboration or contextual cabining” of what a “singular” or “unique” transaction means—amounted to “no more than a generic endorsement of the proposed merger” that no investor would reasonably rely upon.¹³⁷

Similarly, in *Singh v. Cigna Corp.*,¹³⁸ the Second Circuit held that generic statements in a corporation’s code of ethics could not serve as the basis for a securities fraud claim. There, plaintiffs alleged that Cigna misrepresented in its code of ethics and various SEC filings that it had “established policies and procedures” and allocated “substantial resources” towards achieving regulatory compliance when, in fact, Cigna had received over 75 notices of compliance violations from the Centers for Medicare and Medicaid Services in a one-year period. The District of Connecticut granted Cigna’s motion to dismiss, holding that the alleged misrepresentations were mere puffery. On appeal, the Second Circuit affirmed, explaining that the alleged misstatements were “textbook” examples of “general statements about ‘reputation, integrity, and compliance with ethical norms . . . that . . . are too general to cause a reasonable investor to rely upon them.’”¹³⁹ The court thus rejected plaintiffs’ “creative attempt to recast corporate mismanagement as securities fraud.”¹⁴⁰

Seizing on the Second Circuit’s holding in *Singh*, defendants raised “puffery” defenses in two subsequent Southern District of New York securities fraud cases, but with opposite results. In *Schiro v. Cemex, S.A.B. de C.V.*,¹⁴¹ a putative class of investors claimed that a multinational building materials company, Cemex, materially misled investors by claiming in its SEC filings and internal code of ethics that the company “‘reject[ed] corruption’” and was committed to conducting business with “‘transparency and integrity,’” while simultaneously paying bribes in connection with several

¹³⁵ 784 F. App’x 27.

¹³⁶ *Id.* at 28 (citation omitted).

¹³⁷ *Id.* at 30.

¹³⁸ 918 F.3d 57.

¹³⁹ *Id.* at 63 (quoting *City of Pontiac Policemen’s & Firemen’s Ret. Sys. v. UBS AG*, 752 F.3d 173, 183 (2d Cir. 2014)).

¹⁴⁰ *Id.* at 59-60.

¹⁴¹ 396 F. Supp. 3d 283 (S.D.N.Y. 2019).

construction projects in Colombia.¹⁴² Relying on *Singh*, the *Schiro* court held that Cemex's "statements are classic puffery" because they "unmistakably signal[] that they were statements about goals, not statements of fact."¹⁴³

Conversely, in *In re Signet Jewelers Ltd. Securities Litigation*,¹⁴⁴ a different Southern District of New York judge rejected a *Singh* defense and held that alleged misrepresentations contained in a jeweler's code of conduct were actionable. According to the class action complaint, in order to assuage investor fears following a 2008 sex-discrimination suit, which had alleged that Signet "suffered from rampant sexual harassment," Signet misrepresented in its code of conduct that (i) it made hiring decisions "solely on the basis of merit," (ii) "discipline[d] misconduct," (iii) provided employees a "means to report sexual harassment," and (iv) required its executives to "engage in . . . honest and ethical conduct."¹⁴⁵ The court rejected Signet's argument that *Singh* created "a bright line rule" that statements in a corporation's code of conduct are *per se* immaterial puffery, holding that "determining whether certain statements constitute puffery entails looking at 'context'" in which the statements are made.¹⁴⁶ Because a reasonable investor "concerned about grave allegations concerning rampant sexual misconduct" from that prior lawsuit could have relied on Signet's assurances that "it did not, in fact, have a toxic workplace," the court determined that the complaint sufficiently pleaded an actionable misrepresentation.¹⁴⁷

In view of these decisions, and the affirmation of two courts of appeals, a "puffery" defense likely will remain a powerful and popular defense in securities fraud lawsuits. If a statement is deemed too "generic" to be material, then a securities fraud lawsuit will be stymied at the outset. Nevertheless, as the *Signet* court stated, there is no "bright line" rule between non-actionable puffery and a material misstatement or omission; rather, it will depend on the context and the allegations. Given the success of the defense in 2019, we expect it to be more frequently litigated in 2020, and courts to provide further guidance on the line between a material misstatement and mere "puffery."

B. Scierter

In addition to a material misstatement or omission, a plaintiff asserting violations of Section 10(b) and Rule 10b-5 must establish that the defendant acted with "scierter"—that is, an intent to deceive. To plead scierter, the complaint must "with respect to each act or omission . . . state with particularity

¹⁴² *Id.* at 298 (citation omitted).

¹⁴³ *Id.* at 298 & n.5.

¹⁴⁴ 389 F. Supp. 3d 221 (S.D.N.Y. 2019).

¹⁴⁵ *Id.* at 226, 231 (citation omitted).

¹⁴⁶ *Id.* at 229-30.

¹⁴⁷ *Id.* at 231.

facts giving rise to a strong inference that the defendant acted with the required state of mind.”¹⁴⁸ A “strong inference” is “more than merely plausible or reasonable—it must be cogent and at least as compelling as any opposing inference of non-fraudulent intent.”¹⁴⁹

Scienter was fertile ground for dismissal in 2019. In *Metzler Asset Management GmbH v. Kingsley*,¹⁵⁰ plaintiffs alleged that Biogen Inc. and its executives made misleading statements about the company’s business prospects and the safety of Tecfidera, its leading multiple sclerosis drug. The District of Massachusetts dismissed the claims on scienter grounds.¹⁵¹ On appeal to the First Circuit, the plaintiffs argued that they established a “strong inference” of scienter with respect to two categories of misstatements: statements pertaining to Tecfidera’s safety profile, and statements pertaining to Tecfidera’s usage rate.¹⁵² Regarding the first category, the First Circuit found that even if the statements were “plausibly misleading,” the complaint failed to allege that the statements were made with the intent to deceive investors.¹⁵³ Regarding the second category of misstatements, the court ruled against plaintiffs because the status of the discontinuation rates was disclosed to investors and the plaintiffs failed “to identify any allegations in the complaint that show that anyone in the company had knowledge regarding the drug’s safety profile and sales that contradicted the company’s public representations.”¹⁵⁴ Accordingly, the court affirmed dismissal of the claims.

Similarly, in *Tung v. Bristol-Myers Squibb Co.*,¹⁵⁵ the Second Circuit held that a complaint failed to adequately allege scienter in accordance with the controlling standard in the Second Circuit: “(1) that defendants had the motive and opportunity to commit fraud, or (2) strong circumstantial evidence of conscious misbehavior or recklessness.”¹⁵⁶ In *Tung*, plaintiffs brought claims under Sections 10(b) and 20(a) of the Exchange Act, alleging that the defendants had made public statements overstating the likelihood of success of a clinical trial for Bristol-Myers’s newest anticancer drug.¹⁵⁷ Plaintiffs claimed to identify two motives supporting a strong inference of scienter: first, the motive to protect competitively sensitive information and, second, the motive to sell stock while the price

¹⁴⁸ 15 U.S.C. § 78u-4(b)(2).

¹⁴⁹ *Tellabs, Inc. v. Makor Issues & Rts., Ltd.*, 551 U.S. 308, 314 (2007).

¹⁵⁰ 928 F.3d 151.

¹⁵¹ *Metzler Asset Mgmt. GmbH v. Kingsley*, 305 F. Supp. 3d. 181, 190 (D. Mass. 2018), *aff’d*, 928 F.3d 151 (1st Cir. 2019).

¹⁵² 928 F.3d at 158.

¹⁵³ *Id.* at 159-60.

¹⁵⁴ *Id.* at 160-61, 165.

¹⁵⁵ 412 F. Supp. 3d at 458-59 (quoting *ECA & Local 134 IBEW Jt. Pension Tr. of Chi. v. JP Morgan Chase Co.*, 553 F.3d 187, 198 (2d Cir. 2009)).

¹⁵⁶ *Id.*

¹⁵⁷ *Id.* at 457.

was artificially inflated as a result of the defendants' alleged misstatements.¹⁵⁸ The Second Circuit rejected the first as insufficient, holding that "the protection of proprietary information is [the] quintessence of a 'generalized' business motive" that does not satisfy the PSLRA's pleading standard.¹⁵⁹ As to the second, the court held that such a motive can be established at the pleadings stage only "if [p]laintiffs first demonstrate that the stock sales were 'unusual' or suspicious," and here, the court viewed the plaintiffs' allegations "wholly inconsistent" with the fact that defendants had actually increased, not reduced, their stock holdings during the class period.¹⁶⁰

In *Schiro v. Cemex, S.A.B. de C.V.*, moreover, the Southern District of New York held that allegations that the CEO of a subsidiary of Cemex resigned on the same day that Cemex disclosed that it had made a misrepresentation in its public filings were insufficient to establish a strong inference of scienter. Although noting that a resignation can raise an inference of scienter where it is "highly unusual and suspicious," the *Schiro* court found that the complaint failed to "even remotely suggest that the CEO's conduct rose to this level[.]"¹⁶¹ Rather, the "competing, non-culpable inference" raised by the CEO's resignation—an acknowledgement that the CEO was negligent in "overseeing the responsible employees" or thought that "the optics of changing management" would reassure investors and regulators—was more plausible than an inference that the CEO knowingly or recklessly misled investors.¹⁶² In any event, the court held that the subsidiary's CEO was "one or two rungs below senior management" and thus, "any scienter on the part of" the CEO could not be "attributed to Cemex."¹⁶³

A counterpoint to these decisions was the Southern District of New York's decision in *In re Barclays Liquidity Cross and High Frequency Trading Litigation*.¹⁶⁴ There, a group of investors sought class certification in an action asserting violations of Section 10(b) against seven stock exchanges. The plaintiffs alleged that the exchanges developed products and services that were sold to high-frequency trading (HFT) firms and the HFT firms then used the exchanges' technology to employ manipulative schemes at investors' expense. The plaintiffs claimed that the exchanges failed to fully disclose how HFT firms might be able to use certain products and services on the exchanges' trading platforms—an omission which, the plaintiffs alleged, induced them to fall victim to the HFT firms.¹⁶⁵ According to the complaint, the exchanges "developed complex order types . . . knowing that those

¹⁵⁸ *Id.* at 459.

¹⁵⁹ *Id.* (citation omitted).

¹⁶⁰ *Id.*

¹⁶¹ 396 F. Supp. 3d at 303-04.

¹⁶² *Id.* at 303.

¹⁶³ *Id.* at 304.

¹⁶⁴ 390 F. Supp. 3d 432 (S.D.N.Y. 2019).

¹⁶⁵ *Id.* at 440-41, 448.

order types would permit the HFT firms to exploit” investors, then aligned their interests with the HFT firms after realizing the “exploitative potential of” their services.¹⁶⁶ Taking these allegations “collectively,” the court found that the investors raised a “cogent and compelling” inference that the exchanges “acted with scienter.”¹⁶⁷ Although the exchanges countered that the circumstantial evidence supported “the plausible alternative inference” that they acted to increase their profits—not to commit fraud—the court rejected this argument, holding that “the competing inference of a mere profit motive is not enough to defeat the inference of scienter” because profit is “the goal of any financial fraud.”¹⁶⁸

Few lessons can be drawn from these cases, except the fact-driven nature of the scienter inquiry. Clearly, a plaintiff must advance allegations that go beyond general claims of intent and motive, but what constitutes a “strong inference” is open to interpretation on a case-by-case basis. Since a decision on scienter can be case-dispositive, litigants should pay close attention to this element at all stages of a fraud lawsuit.

C. Loss Causation

Loss causation describes the “causal link between the alleged misconduct and the economic harm ultimately suffered by the plaintiff.”¹⁶⁹ As the Supreme Court explained in *Dura Pharmaceuticals, Inc. v. Broudo*,¹⁷⁰ at the pleadings stage, a plaintiff’s allegations must “provide a defendant with some indication of the loss and the causal connection that the plaintiff has in mind.”¹⁷¹

In *Mineworkers’ Pension Scheme v. First Solar, Inc.*,¹⁷² the Ninth Circuit considered the following certified question from the District of Arizona: “[W]hat is the correct test for loss causation in the Ninth Circuit? Can a plaintiff prove loss causation by showing that the very facts misrepresented or omitted by the defendant were a substantial factor in causing the plaintiff’s economic loss, even if the fraud itself was not revealed to the market or must the market actually learn that the defendant engaged in the fraud and react to the fraud itself?”¹⁷³ The Ninth Circuit rejected the more restrictive view of the test, explaining that “loss causation is a “context dependent” inquiry as there are an

¹⁶⁶ *Id.* at 451.

¹⁶⁷ *Id.*

¹⁶⁸ *Id.* at 451-52 (emphasis omitted).

¹⁶⁹ *Emergent Cap. Inv. Mgmt., LLC v. Stonepath Grp., Inc.*, 343 F.3d 189, 197; 15 U.S.C. § 78u-4(b)(4).

¹⁷⁰ *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336 (2005).

¹⁷¹ *Id.* at 347.

¹⁷² 881 F.3d 750 (9th Cir. 2018), *cert. denied*, 139 S. Ct. 2741 (2019).

¹⁷³ *Id.* at 753 (citations omitted)

“infinite variety” of ways for a tort to cause a loss.”¹⁷⁴ Thus, the court held that a plaintiff may prove loss causation “by showing that the stock price fell upon the revelation of an earnings miss, even if the market was unaware at the time that fraud had concealed the miss.”¹⁷⁵ On August 6, 2018, the defendants filed a petition for writ of certiorari seeking review of the case to consider whether loss causation may be established absent a showing that the event that triggered that decline did not reveal the alleged fraud. On June 24, 2019, the Supreme Court denied certiorari.

We do not believe the Ninth Circuit’s decision will be of great importance in securities lawsuits. Even under the test, it likely will be difficult—if not impossible—for plaintiffs to show the necessary “causal link” between fraud and loss if the fraud itself is not revealed to the market. Indeed, the Supreme Court’s decision in *Dura* suggests that such a corrective disclosure is required to state a securities fraud claim, holding that the complaint was insufficient because it did not “claim that *Dura*’s share price fell significantly after the truth became known.”¹⁷⁶

V. Securities Enforcement

A. Asset Management

The SEC’s continued focus on retail investors led to significant enforcement activity against asset managers. Much of this activity resulted from the SEC’s Share Class Selection Disclosure Initiative (SCSD Initiative). The SEC announced the SCSD Initiative in February 2018. Under the initiative, the Division of Enforcement agreed to recommend favorable settlement terms—including no civil penalties—to firms that “self-reported failures to disclose conflicts of interest associated with the selection of fee-paying mutual fund share classes when a lower- or no-cost share class of the same mutual fund was available.”¹⁷⁷ The Initiative led to the SEC filing two series of enforcement actions in 2019 resulting in 95 investment advisory firms being ordered to return over \$135 million to mutual fund investors in 2019—the majority of whom were retail investors.¹⁷⁸

The SEC stepped up its enforcement of investment advisers’ failure to disclose conflicts of interest outside the SCSD initiative as well. The SEC brought an enforcement action against an investment adviser for failing to disclose material conflicts of interest in connection with revenue-sharing

¹⁷⁴ *Id.* (citations omitted).

¹⁷⁵ *Id.* at 754.

¹⁷⁶ 544 U.S. at 347.

¹⁷⁷ 2019 Annual Report, at 2; see also Press Release, U.S. Sec. & Exch. Comm’n, *SEC Launches Share Class Selection Disclosure Initiative to Encourage Self-Reporting and the Prompt Return of Funds to Investors* (Feb. 12, 2018), <https://www.sec.gov/news/press-release/2018-15>.

¹⁷⁸ Press Release, U.S. Sec. & Exch. Comm’n, *SEC Orders an Additional 16 Self-Reporting Advisory Firms to Pay Nearly \$10 Million to Investors* (Sept. 30, 2019), <https://www.sec.gov/news/press-release/2019-200>.

agreements pertaining to mutual fund transactions.¹⁷⁹ According to the SEC Commonwealth Equity Services did not sufficiently disclose to its clients that it received hidden material economic benefits on certain fund investments it selected for clients, and failed to disclose that there were other funds for which the adviser did not receive any revenue sharing and thus “had an incentive not to select.” Although Commonwealth had disclosed that certain of its arrangements with the clearing broker *may* create a conflict of interest, the SEC alleged that the adviser received over \$135 million in revenue sharing payments over a period of approximately 4-1/2 years which amounted to an actual, not merely potential, conflict of interest. In addition to fiduciary duty and disclosure violations, the SEC alleged that Commonwealth violated the Investment Advisers Act of 1940 (the “Advisers Act”) by failing to adopt and implement policies and procedures reasonably designed to prevent fiduciary duty and disclosure violations. The litigation is ongoing.

Continuing the trend, the SEC brought enforcement proceedings against two investment advisers for allegedly failing to disclose conflicts of interest concerning a retail investment advisory program they advised.¹⁸⁰ The SEC found that BMO Harris Financial Advisors and BMO Asset Management, units of Bank of Montreal, failed to disclose two material conflicts of interest dating back to 2012. First, the SEC found that between July 2012 and March 2016 the investment advisers invested almost 50% of client assets in proprietary mutual funds despite the availability of lower-cost alternatives, which resulted in additional fees, without disclosing this conflict to investors. Second, the SEC found that from 2012 through 2015, BMO Harris Financial Advisors invested client assets in higher-cost share classes of mutual funds when lower-cost share classes were available. This resulted in the investment adviser receiving compensation pursuant to revenue sharing agreements that it would not have received if other classes had been selected. In a settlement with the Commission, the BMO entities agreed to pay a civil penalty and disgorgement totaling over \$37 million.

B. Broker Dealers

While the number of enforcement actions against broker-dealers was down overall, the SEC brought a number of significant cases in the second half of 2019. In December, the SEC brought an enforcement action against two broker-dealers for tendering a number of shares greater than their net long positions in a partial tender offer for shares of common stock.¹⁸¹ The SEC alleged that the broker-dealers violated Rule 14e-14 of the Exchange Act (the “short tender rule”) by separately

¹⁷⁹ Litigation Release, U.S. Sec. & Exch. Comm’n, *SEC Charges Investment Adviser for Failing to Disclose Conflicts Arising from Receiving Revenue Sharing On Client Investments* (Aug. 1, 2019), <https://www.sec.gov/litigation/litreleases/2019/lr24550.htm>.

¹⁸⁰ Press Release, U.S. Sec. & Exch. Comm’n, *Two BMO Advisory Firms Pay Over \$37 Million to Harmed Clients for Failing to Disclose Conflicts of Interest* (Sept. 27, 2019), <https://www.sec.gov/news/press-release/2019-199>.

¹⁸¹ Press Release, U.S. Sec. & Exch. Comm’n, *SEC Charges Broker-Dealers With Illicitly Profiting in Partial Tender Offer* (Dec. 18, 2019), <https://www.sec.gov/news/press-release/2019-268>.

tendering 75,000 shares and 50,000 shares in excess of each broker-dealer's net long position. The SEC Order found that, because the partial tender offer was oversubscribed, the broker-dealers caused the company to accept more shares from them and fewer from other participants. As a part of the settlement, the broker-dealers agreed to be censured, cease and desist from future violations of Rule 14e-14, pay disgorgement and prejudgment interest, and pay a civil penalty.

The SEC also brought a series of settled enforcement actions against broker-dealers for improperly obtaining the pre-release of American Depositary Receipts (ADRs). ADRs are securities that represent foreign shares and require a corresponding number of foreign shares to be held in custody at a depository bank. The SEC actions alleged that the settling broker-dealers improperly borrowed pre-released ADRs from other brokers when they should have known that those brokers did not own sufficient foreign shares to support the ADRs.¹⁸² The SEC found that the broker-dealers violated Section 17(a)(3) of the Securities Act and failed to supervise their employees, with a view to preventing and detecting violations of the securities laws, under Section 15(b)(4)(E) of the Exchange Act. The SEC has brought 14 of these actions dating back to 2018.

Broker-dealers were not immune from the SEC's focus on protecting retail investors. In September, the SEC brought a settled enforcement action against three Raymond James entities for charging excessive fees and commissions on retail accounts.¹⁸³ This included allegations that a Raymond James broker-dealer made unsuitable recommendations to retail investors that they sell certain unit investment trusts (UITs) before their maturity and buy new UITs, which resulted in greater sales commissions than would have been charged had the investors held the UITs to maturity. As a part of the settlement, the broker-dealer agreed to be censured, cease and desist from future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act, pay disgorgement and prejudgment interest, and pay a civil penalty.

C. Cyber and Digital Assets

This was another busy year for cyber enforcement, particularly related to initial coin offerings (ICOs) and digital currency. The SEC brought a number of cases against companies for conducting ICOs without filing registration statements with the Commission, including two cases which are currently

¹⁸² Press Release, U.S. Sec. & Exch. Comm'n, *Jefferies to Pay Nearly \$4 Million for Improper Handling of ADRs* (Dec. 9, 2019), <https://www.sec.gov/news/press-release/2019-256>; Press Release, U.S. Sec. & Exch. Comm'n, *Cantor Fitzgerald and BMO Capital Charged for Improper Handling of ADRs* (Aug. 16, 2019), <https://www.sec.gov/news/press-release/2019-155>.

¹⁸³ Press Release, U.S. Sec. & Exch. Comm'n, *Raymond James Agrees to Pay \$15 Million for Improperly Charging Retail Investors* (Sept. 17, 2019), <https://www.sec.gov/news/press-release/2019-178>.

being litigated.¹⁸⁴ The threshold issue in these cases is whether the coins at issue qualify as securities under the *Howey* test and therefore should have been registered with the SEC.

In June, the SEC sued Kik Interactive Inc. for allegedly selling digital tokens to investors as part of a \$100 million securities offering without registering their offer and sale.¹⁸⁵ According to the complaint filed in the Southern District of New York, Kik raised more than \$55 million by selling tokens to wealthy investors at a discounted price. In support of its argument that the tokens are securities and should have been registered, the SEC alleged that Kik marketed the token as an investment opportunity, that demand would drive the price of the tokens up, and that Kik would spur that demand by developing services and systems to reward companies that adopted the token but that none of the services or systems existed at the time the tokens were sold. The SEC further alleged that Kik claimed that the tokens would immediately trade on the secondary market. The Complaint charges Kik with violating Section 5 of the Securities Act. Kik disputes the SEC's allegations and the litigation is ongoing.

Similarly, in October the SEC filed an emergency action in the Southern District of New York and obtained a temporary restraining order against Telegram Group, Inc. and its subsidiary TON issuer Inc., preventing the companies from continuing an alleged unregistered digital token offering.¹⁸⁶ According to the SEC's complaint, Telegram and TON began raising capital in January 2018 to finance the companies' business and sold approximately 2.9 billion digital tokens called "Grams" at discounted prices. The SEC alleged that Telegram promised to deliver the Grams to the initial purchasers upon the launch of its blockchain by no later than October 31, 2019, at which time the purchasers and Telegram will be able to "sell billions of Grams into U.S. markets." The SEC claims that Grams are securities and defendants failed to register their offers and sales of Grams in violation of the registration provisions of the Securities Act. Telegram and TON dispute the SEC's allegations and the litigation is ongoing.

The SEC has also been aggressive in policing fraud related to digital currency. In June, the SEC added fraud allegations to a previously filed enforcement action against a cryptocurrency company and its CEO for allegedly conducting a fraudulent public offering.¹⁸⁷ The SEC alleged that Longfin

¹⁸⁴ The SEC also brought three settled actions charging ICO issuers with violating the registration requirements of the federal securities laws. See Press Release, U.S. Sec. & Exch. Comm'n, *Company Settles Unregistered ICO Charges After Self-Reporting to SEC* (Feb. 20, 2019), <https://www.sec.gov/news/press-release/2019-15>; Press Release, U.S. Sec. & Exch. Comm'n, *Two ICO Issuers Settle SEC Registration Charges, Agree to Register Tokens as Securities* (Nov. 16, 2018), <https://www.sec.gov/news/press-release/2018-264>.

¹⁸⁵ Press Release, U.S. Sec. & Exch. Comm'n, *SEC Charges Issuer With Conducting \$100 Million Unregistered ICO* (June 4, 2019), <https://www.sec.gov/news/press-release/2019-87>.

¹⁸⁶ Press Release, U.S. Sec. & Exch. Comm'n, *SEC Halts Alleged \$1.7 Billion Unregistered Digital Token Offering* (Oct. 11, 2019), <https://www.sec.gov/news/press-release/2019-212>.

¹⁸⁷ Press Release, U.S. Sec. & Exch. Comm'n, *SEC Adds Fraud Charges Against Purported Cryptocurrency Company Longfin, CEO, and Consultant* (June 5, 2019), <https://www.sec.gov/news/press-release/2019-90>.

made false representations to the SEC to qualify for a public offering and then fraudulently distributed shares to insiders and affiliates to meet NASDAQ requirements without being paid for the shares and misrepresented the number of qualifying shareholders and number of shares sold in the offering. The Complaint also alleges that Longfin and its CEO engaged in an accounting fraud by recognizing sham income.

In December, the SEC charged a digital asset company and its founder with defrauding investors in an ICO that raised more than \$42 million.¹⁸⁸ According to the Complaint filed in the Southern District of New York, UnitedData, Inc., d/b/a Shopin, and its founder lied to investors in connection with the offering, including making misrepresentations about supposed partnerships with well-known retailers and about the involvement of a prominent entrepreneur. The SEC charged Shopin and its founder with violations of the anti-fraud provisions of the federal securities laws. The litigation is ongoing.

D. Insider Trading

While the number of SEC insider trading cases decreased substantially, there were significant developments in criminal cases last year and federal legislation that passed the House of Representatives could revamp insider trading law if enacted.

1. SDNY Vacates Insider Trading Plea and Resuscitates Newman

The Second Circuit's amended opinion in *Martoma II* resurrected at least a portion of *Newman* by vacating the express abrogation of that decision's "meaningfully close personal relationship requirement" when a tipper conveyed MNPI to a tippee as a gift.¹⁸⁹ Despite the apparent limited application of *Newman*, one aspect of *Newman* remained on solid legal ground: a remote tippee could be liable for insider trading only if (1) the tipper received a personal benefit, and (2) the defendant knew the tipper disclosed MNPI in exchange for a personal benefit. On June 21, 2019, the Southern District of New York vacated a guilty plea of former investment analyst Richard Lee, who had pled guilty to insider trading after obtaining and trading on information from corporate tipsters.¹⁹⁰ Lee moved to withdraw the plea in 2017, contending there was no evidence that Lee knew of any personal benefit the insiders received for divulging confidential information. The Southern District of New York agreed, vacating Lee's guilty plea and proving *Newman's* lasting force.

2. Second Circuits Holds that No Personal Benefit Required for Criminal Insider Trading Cases Brought Under Title 18

¹⁸⁸ Press Release, U.S. Sec. & Exch. Comm'n, *SEC Charges Founder, Digital-Asset Issuer With Fraudulent ICO* (Dec. 11, 2019), <https://www.sec.gov/news/press-release/2019-259>.

¹⁸⁹ *United States v. Martoma*, 894 F.3d 64, 71 (2d Cir. 2017), cert. denied, 139 S. Ct. 2665 (2019) ("*Martoma II*").

¹⁹⁰ *United States v. Lee*, 13 Cr. 539 (S.D.N.Y. June 21, 2019).

In late December 2019, the Second Circuit issued its opinion in *United States v. Blaszcak*¹⁹¹ and held that the personal benefit test does not apply in all insider trading cases. The government has traditionally brought insider trading cases as violations of the general antifraud provisions found in Section 10(b) of the Exchange Act (Title 15 of the US Code). A long line of insider trading cases (*Dirks*, *Newman*, *Salman*, and *Martoma*) have required proof of a direct or indirect personal benefit to the tipper to establish liability. Recently, some criminal prosecutors have brought insider trading cases as violations of the criminal wire fraud and/or securities fraud statutes under Title 18 of the U.S. Code in addition to charging violations of Section 10(b) of the Exchange Act, arguing that the personal benefit requirement does not apply to charges brought under Title 18.¹⁹² The *Blaszcak* case involved allegations that two hedge funds illegally traded on MNPI regarding medical treatment reimbursement rates they received from a consultant (Blaszcak), who got the tip from a friend who worked at the Centers for Medicare and Medicaid Services. In addition to violations of Section 10(b), the prosecutors charged defendants with violations of Sections 641 (conversion), 1343 (wire fraud) and 1348 (securities fraud) under Title 18. At trial, the jury acquitted the defendants on the Section 10(b) charges but convicted them of violations of Title 18. On appeal, the defendants argued that their wire fraud and securities fraud convictions under Title 18 should be overturned because the district court did not apply *Dirks* and require the government to prove that the CMS employee received a personal benefit for tipping the information. In a split decision, the Second Circuit affirmed the convictions and held that the personal-benefit requirement does not apply to the Title 18 wire fraud and securities fraud statutes.¹⁹³

The Second Circuit's decision broadens criminal prosecutors' power in insider trading cases. While decades of case law has established that the government must prove a personal benefit in Section 10(b) cases, prosecutors may now convict a defendant under other criminal statutes without proving that the tipper of MNPI received a personal benefit in exchange for that information. As the mixed verdicts in *Blaszcak* demonstrate, this lower burden can be crucial to the outcome in certain cases. It remains to be seen whether prosecutors will now charge defendants with securities fraud and wire fraud in insider trading cases with less than overwhelming evidence of a personal benefit, but company employees and others with access to MNPI should be on notice about the potentially increased risk of prosecution.

3. Federal Legislators Look to Codify Rules on Insider Trading

Meanwhile, confusion and controversy over the legal standard required to prove insider trading spurred momentum on Capitol Hill in the form of the proposed Insider Trading Prohibition Act. As

¹⁹¹ *United States v. Blaszcak*, 947 F.3d 19 (2d Cir. 2019).

¹⁹² The SEC may only bring civil enforcement actions and does not have the authority to charge violations of criminal statutes. See U.S. Sec. & Exch. Comm'n Div. of Enf't, Enforcement Manual § 5.2 (Nov. 28, 2017), <https://www.sec.gov/divisions/enforce/enforcementmanual.pdf>.

¹⁹³ *Blaszcak*, 947 F.3d at 36-37.

originally drafted, the Act eliminated the personal benefit test and permitted the DOJ and SEC to bring charges against anyone who “was aware, consciously avoided being aware, or recklessly disregarded” that MNPI was “wrongfully obtained or communicated.” However, the version passed by the House requires that a tipper receive a direct or indirect personal benefit. The Act’s latest version will likely reignite debate over the meaning of personal benefit and potentially stymie any momentum as it goes to the Senate for consideration.

E. Disclosure Cases

Several matters in 2019 demonstrate the SEC’s commitment to pursuing public companies for disclosure and internal controls violations. In particular, the SEC’s settlements with Facebook and Mylan illustrate that issuers must continually revisit their disclosures, including Risk Factor disclosures, to ensure that they appropriately reflect material developments. The actions also demonstrate that the SEC is focused on companies with internal controls that fail to ensure that information regarding material developments reaches the individuals responsible for drafting and approving disclosures. Similarly, the SEC’s settlement with Fiat highlights that issuers should have internal controls that reasonably assure that key performance indicators are accurately reported.

In July, the SEC announced a \$100 million settlement with Facebook to resolve charges that the company made misleading Risk Factor disclosures.¹⁹⁴ The SEC alleged that Facebook’s Risk Factor disclosures in 2016 and 2017 presented misuse of user data as a hypothetical risk when Facebook knew that user data had in fact been misused. According to the SEC’s complaint, Facebook discovered by December 2015 that a researcher had improperly sold user information to data analytics firm Cambridge Analytica but Facebook did not correct its existing Risk Factor disclosure for more than two years. Instead, Facebook continued to inform investors that user data “may” be improperly accessed, used or disclosed. The complaint further alleged that Facebook reinforced its misleading disclosures in 2017 when it falsely told news reporters who were investigating Cambridge Analytica’s use of data that it had discovered no evidence of wrongdoing.

The settlement also resolved charges that Facebook’s internal controls around the drafting of its Reports on Forms 10-K and 10-Q, including but not limited to its Risk Factor disclosures, failed to bring the researcher’s misuse of user data to the attention of the individuals with primary responsibility for drafting and approving those reports. According to the complaint, Facebook identified trends and events for possible disclosure through a series of quarterly meetings to prepare for the company’s earnings announcements. Several employees who attended those meetings were aware of the researcher’s misuse, including individuals from Facebook’s legal, policy and communications groups, but the incident was never discussed for the purpose of disclosure. The complaint further alleged

¹⁹⁴ Press Release, U.S. Sec. & Exch. Comm’n, *Facebook to Pay \$100 Million for Misleading Investors About the Risks It Faced From Misuse of User Data* (July 24, 2019), <https://www.sec.gov/news/press-release/2019-140>.

that Facebook failed to share information regarding the incident with its independent auditors or outside disclosure counsel in order to assess its disclosure obligations.

In September, the SEC announced a \$30 million settlement with Mylan N.V. to resolve similar charges that the pharmaceutical company made misleading Risk Factor disclosures and failed to properly disclose or accrue loss contingencies in connection with a two-year DOJ probe.¹⁹⁵ According to the SEC's complaint, Mylan was informed in October 2014 by the Centers for Medicare and Medicaid Services (CMS) that its largest revenue and profit generating product, EpiPen, was misclassified under the Medicaid Drug Rebate Program.¹⁹⁶ Several Mylan executives and in-house counsel, including those involved in the preparation and review of Mylan's public disclosures, as well as external counsel, participated in the October 2014 call, during which a CMS Director stated that EpiPen was misclassified. Shortly thereafter, DOJ opened a civil investigation into possible False Claim Act (FCA) violations resulting from EpiPen's misclassification. Mylan ultimately agreed to pay \$465 million to resolve FCA liability.

The SEC alleged that, despite CMS's statements regarding misclassification, Mylan's Risk Factor disclosures in its 2014 and 2015 annual reports misleadingly stated as a hypothetical that a governmental authority "may" take a contrary position on the company's Medicaid submissions. The SEC also alleged that Mylan failed to disclose or accrue any loss contingency in connection with DOJ's FCA investigation until the company announced a settlement in principle in October 2016. The SEC alleged that a number of factors—including the existence of a tolling agreement and a presentation by Mylan on the question of damages—should have put Mylan on notice that it was required to disclose the investigation and to take a provision for losses under Generally Accepted Accounting Principles.

Finally, the SEC alleged that Mylan failed to devise and maintain a system of internal accounting controls sufficient to disclose and accrue for the loss associated with the DOJ investigation. Although Mylan required quarterly discussions of significant contingencies by its financial and legal teams, certain members of the financial team evaluating the loss contingency relating to Mylan's EpiPen classification were not informed of developments concerning the progress of DOJ's investigation.

Accordingly, cases like Mylan are instructive on when companies should disclose a government investigation and flag "known" risks and processes and procedures around disclosure. Companies should ensure that "material" information is identified and provided to the proper individuals, who

¹⁹⁵ Press Release, U.S. Sec. & Exch. Comm'n, *Mylan to Pay \$30 Million for Disclosure and Accounting Failure Relating to EpiPen*, (Sept. 27, 2019), <https://www.sec.gov/news/press-release/2019-194>.

¹⁹⁶ According to the SEC, Mylan classified EpiPen as a "generic" drug under the Medicaid Drug Rebate Program, which resulted in Mylan paying much lower rebates to the government than if EpiPen had been classified as a "branded" drug. *Id.*

should be made aware of the circumstances giving rise to SEC violations, even if disclosure is not warranted.

On the same day as the Mylan settlement, the SEC announced a \$40 million settlement with FCA US LLC, and its parent company, Fiat Chrysler Automobiles N.V. (collectively, “Fiat”), to resolve charges that the automaker misled investors about the number of new vehicles sold each month to customers in the United States.¹⁹⁷ According to the SEC order, between 2012 and 2016, Fiat issued monthly press releases that were included in SEC filings falsely reporting new vehicle sales and falsely touting a “streak” of uninterrupted monthly year-over-year sales growth. The SEC order found that Fiat inflated new vehicle sales by paying dealers to report fake vehicle sales and maintaining a database of actual but unreported sales, often referred to as a “cookie jar.” The SEC claimed that Fiat was aware of the fake sales reporting—concerns having been raised by internal audit and by ethics hotline complaints and the issue having been internally investigated. Notwithstanding the complaints and internal investigation, Fiat continued to report the false sales figures. The SEC order also found that, with respect to Fiat’s “cookie jar” of unreported sales, the company did not have in place internal controls that could reasonably ensure that new vehicle sales were recorded in the months in which they were actually sold.

F. Foreign Corruption

2019 was a record-setting year for FCPA enforcement by both the SEC and the DOJ. The SEC prosecuted 19 FCPA enforcement actions in 2019, securing the agency more than \$1 billion in monetary recoveries. That was in addition to the single-year record \$1.6 billion recovered by DOJ in more than 30 FCPA cases.

These recoveries were driven in large part by the single largest corporate FCPA resolution in history. In early December 2019, the SEC and the DOJ announced that the Swedish networking and telecommunications company, Telefonaktiebolaget LM Ericsson (Ericsson), agreed to pay over \$1 billion to resolve FCPA charges.¹⁹⁸ The government alleged that Ericsson violated the anti-bribery, books and records, and internal controls provisions of the FCPA by using sham consultants and slush funds to secretly funnel money to government officials in China, Vietnam, Indonesia, Djibouti, Saudi Arabia, and Kuwait. Through its alleged bribery, Ericsson was able to secure hundreds of millions of dollars in profits, approximately \$427 million of which were derived from business in China, Djibouti, and Saudi Arabia alone. To settle the SEC’s charges, Ericsson agreed to pay more than \$539 million in disgorgement and prejudgment interest. The DOJ charges were resolved through a three-year

¹⁹⁷ Press Release, U.S. Sec. & Exch. Comm’n, *Automaker to Pay \$40 Million for Misleading Investors* (Sept. 27, 2019), <https://www.sec.gov/news/press-release/2019-196>.

¹⁹⁸ Press Release, U.S. Dep’t of Justice, *Ericsson Agrees to Pay Over \$1 Billion to Resolve FCPA Case* (Dec. 6, 2019), <https://www.justice.gov/opa/pr/ericsson-agrees-pay-over-1-billion-resolve-fcpa-case>.

deferred prosecution agreement and criminal penalty of more than \$520 million. In addition, Ericsson was required to retain an independent compliance monitor for three years.

Aside from record corporate resolutions, 2019 saw noteworthy developments in the area of FCPA liability for individuals. In November 2019, a federal jury returned a guilty verdict against Lawrence Hoskins.¹⁹⁹ Hoskins is British national and resident who was charged with using consultants to pay bribes in Indonesia to secure a \$118 million power plant contract for the U.S. subsidiary of Alstom S.A. Though he was an Alstom S.A. executive, Hoskins did not work for the U.S. subsidiary and never travelled to the United States during the alleged scheme. The government argued that he was subject to criminal jurisdiction under the FCPA because he acted as an “agent” of the U.S. subsidiary. The parties vigorously debated the meaning of “agency,” and the district court largely adopted the government’s view that agency required: (1) a manifestation by the principal that the agent will act for the principal; (2) an acceptance by the agent of an undertaking for the principal; and (3) an understanding that the principal is in control of those acts or services. Using that definition of agency, the jury convicted Hoskins, apparently based on witness testimony that Hoskins was looped into the negotiations with the consultants and was acting at the direction of the U.S. subsidiary. Though it will potentially bolster future prosecution efforts against individuals, the government’s victory in Hoskins is not secured, as the agency issue will receive further scrutiny in Hoskins’ post-trial motion for judgment of acquittal and in any subsequent appeal.

The government’s success in Hoskins stands in contrast to the result in the trial of Jean Boustani. On December 2, 2019, a federal jury in Brooklyn acquitted Boustani of charges of wire fraud, securities fraud, and money laundering. Boustani had been charged, along with several other individuals, in a bribery scheme involving loans to the government of Mozambique to develop the country’s maritime infrastructure and fishing industry. In what has been called the “tuna bonds” scheme, Boustani and others allegedly organized more than \$2 billion in loans, financed by major international banks, to Mozambique-government-controlled companies while diverting more than \$200 million of the proceeds to themselves, in the form of kickbacks, and to Mozambican officials, in the form of bribes. Prosecutors pinned their theory of the case—and jurisdiction for the charges—on the fact that bribery payments passed through U.S. banks, some located in the Eastern District of New York. The defense countered that Boustani had no reason to know that payments would pass through U.S. banks and, in any event, the U.S. government was “not the world’s policeman.” These defense efforts were successful, as the jury acquitted Boustani. Jurors who later spoke publicly said that their decision came down to a lack of proper “venue” in the Eastern District of New York.

G. Digital Realty Impact on Whistleblowers

¹⁹⁹ Press Release, U.S. Dep’t of Justice, *Former Senior Alstom Executive Convicted at Trial of Violating the Foreign Corrupt Practices Act, Money Laundering and Conspiracy* (Nov. 8, 2019), <https://www.justice.gov/opa/pr/former-senior-alstom-executive-convicted-trial-violating-foreign-corrupt-practices-act-money>.

Following the financial crisis, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), which included new financial incentives for whistleblowers who provide the SEC with original information about violations of federal securities laws, as well as enhanced protections from retaliation for reporting potential violations. In FY 2019, the SEC received over 5,200 whistleblower tips—a nearly 76% increase since FY 2012—but a slight decrease from FY 2018. The SEC also awarded over \$60 million to 8 individuals, an amount that was a significant decrease from the \$168 million distributed in FY 2018. Since the beginning of the whistleblower program, the Commission has awarded approximately \$387 million to 67 individuals since issuing its first award in 2012.

A key focus of FY 2019 was how the Supreme Court's ruling in *Digital Realty Trust, Inc. v. Somers*²⁰⁰ would impact whistleblowers' reporting decisions. In *Digital Realty*, the Court relied on what it found to be clear statutory language to hold that: "A 'whistleblower' is 'any individual who provides information relating to a violation of the securities laws to the Commission.'"²⁰¹ Therefore, individuals who only reported internally would no longer be afforded anti-retaliation protections under Dodd-Frank.

Many commentators were worried that the ruling would discourage internal reporting and deny companies the opportunity to investigate claims first, assess their legitimacy, and take pro-active remedial action where necessary—possibly even voluntarily self-disclosing to the SEC. Surprisingly, seven of the eight whistleblowers who received awards in FY 2019 reported their concerns internally at their respective companies. However, enforcement actions can sometimes take years to complete and therefore the effect of *Digital Realty* on internal reporting may not be fully reflected in FY 2019 numbers.

H. SEC Remedies

The SEC's disgorgement remedy has been a hotly contested issue in recent years. In *Kokesh v. SEC*,²⁰² the Supreme Court concluded that the SEC's ability to seek disgorgement as a remedy in an enforcement action is subject to a five-year statute of limitations.²⁰³ A unanimous Supreme Court held that disgorgement is not available outside the five-year limitations period because disgorgement "bears all the hallmarks of a penalty."²⁰⁴ The Court noted, in passing, that its holding may implicate

²⁰⁰ 138 S. Ct. 767 (2018).

²⁰¹ *Id.* at 777 (quoting 15 U.S.C. § 78u-6(a)(6)).

²⁰² 137 S. Ct. 1635 (2017).

²⁰³ *Id.* at 1644.

²⁰⁴ *Id.* at 1644-45.

“whether courts have properly applied disgorgement principles in this context” and, specifically, “whether courts possess authority to order disgorgement in SEC enforcement proceedings[.]”²⁰⁵

In November 2019, the Supreme Court granted *certiorari* in *Liu v. SEC*, which will determine the SEC’s authority to obtain disgorgement in federal court actions. In 2016, the SEC charged a husband and wife for defrauding Chinese investors by falsely claiming that their investments would support a project that met the requirements of the EB-5 Immigrant Investment Program. The proposed project included funding the development and operation of a cancer treatment center. The SEC alleged that the defendants misappropriated or diverted the funds. The U.S. District Court for the Central District of California granted summary judgment to the SEC, and ordered the couple to disgorge approximately \$26.7 million as well as pay a civil money penalty of over \$8 million. The issue before the Supreme Court is “whether the Securities and Exchange Commission may seek and obtain disgorgement from a court as ‘equitable relief’ for a securities law violation even though the Supreme Court has determined that such disgorgement is a penalty.” In their petition for certiorari, the petitioners argued that disgorgement is not equitable relief under the Court’s reasoning in *Kokesh*, and therefore, the SEC does not have the power to obtain disgorgement in judicial proceedings because it has not been authorized by Congress to do so.

The SEC also continued to look for ways to use remedies—other than large financial penalties—to further its enforcement goals in 2019. Following in the footsteps of its FY 18 cases against Theranos (where it required the CEO to relinquish control and has prevented her from profiting from a sale of the company until the money is returned to investors) and Tesla (where it required the CEO to resign as Chairman and the company to add two new independent directors), the SEC brought a number of enforcement actions in 2019 where it required parties to comply with detailed undertakings to further the SEC’s remedial objectives and address the wrongdoing at issue. One example was the SEC’s settled action against KPMG, which required KPMG to conduct an investigation to identify individuals who violated ethical and integrity requirements related to training programs, conduct ethics and integrity training for all audit professionals and retain an independent consultant.²⁰⁶ Another example was the SEC’s settlement with the Options Clearing Corporation (OCC), which required OCC to retain an independent consultant, provide an annual compliant report to its board provide the board with copies of all deficiency letters, and establish a board-level committee to monitor compliance.²⁰⁷

²⁰⁵ *Id.* at 1642 n.3.

²⁰⁶ Press Release, U.S. Sec. & Exch. Comm’n, *KPMG Paying \$50 Million Penalty for Illicit Use of PCAOB Data and Cheating on Training Exams* (June 17, 2019), <https://www.sec.gov/news/press-release/2019-95>.

²⁰⁷ Press Release, U.S. Sec. & Exch. Comm’n, *SEC and CFTC Charge Options Clearing Corp. With Failing to Establish and Maintain Adequate Risk Management Policies*, (Sept. 4, 2019), <https://www.sec.gov/news/press-release/2019-171>.

VI. Looking Ahead

We expect 2020, like 2019, to be an eventful year in securities litigation and enforcement. In particular, we will be watching for noteworthy developments in the following areas:

- ***Will plaintiffs' success continue?*** In 2019, numerous significant decisions came down in favor of plaintiffs, from endorsing expanded theories of liability to rejecting challenges at the class certification stage. One of the ongoing struggles in securities law is the balance between permitting meritorious claims, on the one hand, and dialing back on frivolous suits and abuses, on the other. We will watch for counter-trends in the year to come.
- ***The evolving scope of "scheme liability" in the wake of Lorenzo.*** The Supreme Court's decision in *Lorenzo*, discussed above, made clear that the question in a securities fraud suit is not whether someone "made" a misstatement, but whether the defendant participated in a fraudulent "scheme." We already have seen courts in multiple jurisdictions sustain fraud claims on this basis. We expect defendants to test the outer limits of "scheme" liability, and courts to offer further guidance, in the year ahead.
- ***Scope of Morrison in predominantly foreign transactions.*** As discussed above, in 2019, the Supreme Court refused to hear an appeal from the Ninth Circuit's decision, in *Stoyas*, concerning the extraterritorial reach of Section 10(b) liability. The Ninth Circuit held that a foreign issuer can be subject to Section 10(b) liability in connection with a purely domestic transaction in its securities in which the foreign issuer had no direct involvement. That parted ways with the Second Circuit, which has held a domestic transaction is not sufficient, in and of itself, for Section 10(b) liability if the transaction is otherwise "predominantly foreign." In declining to review *Stoyas*, the Supreme Court was unmoved by the petitioner's view that the Ninth Circuit's decision opened a split "between the two most important circuits in U.S. securities law, on the crucial question of when application of the U.S. Securities Exchange Act is impermissibly extraterritorial."²⁰⁸ We will watch the impact of this split, including the potential for forum shopping to drive plaintiffs in these close cases of extraterritoriality to the Ninth Circuit.
- ***Duty to update historical information.*** In 2019, the Supreme Court also refused to hear an appeal of a Ninth Circuit decision holding that a biopharmaceutical company had a duty to disclose new information relating to one of its prior disclosures of the early results of clinical tests of one of its drugs.²⁰⁹ The Ninth Circuit held that while the earlier disclosure was "still technically accurate," the company had a duty to disclose the new information

²⁰⁸ Petition for a Writ of Certiorari at 15, *Toshiba Corp. v. Auto. Indus. Pension Tr. Fund*, No. 18-486 (U.S. filed Oct. 15, 2018).

²⁰⁹ *Hagan v. Khoja*, 139 S. Ct. 2615 (2019).

because that new information “diminished” the “weight” and “value” of the previous disclosures.²¹⁰ That decision appears to be in tension with six other circuits, five of which (the First, Second, Third, Fifth, and Eleventh) generally limit the duty to update to two narrow types of prior statements: prior statements that are forward-looking and still “alive” in investors’ minds, and prior statements that deal with a fundamental transaction, like a merger or liquidation.²¹¹ The approach of those circuits seems narrower than the Ninth Circuit’s relatively unconstrained duty that, arguably, would apply any time new information diminishes the “weight” and “value” of prior information. The Seventh Circuit, meanwhile appears to reject any duty to update at all.²¹² In the view of one commentator, this “bewildering case law is in dire need of clarification and consistency,”²¹³ and we will watch how this split plays out in the lower courts.

- **Standard for rebutting presumption of reliance.** In a long-running battle in *Arkansas Teacher Retirement System v. Goldman Sachs*,²¹⁴ Goldman Sachs is challenging before the Second Circuit a district court’s decision to re-certify a class in a suit alleging that Goldman Sachs and several directors made false statements about Goldman Sachs’s conflicts of interest in a major underwriting, which, when revealed, allegedly caused a drop in Goldman Sachs’s stock. The dispute revolves around the evidence necessary to rebut a putative class’s reliance on the “price maintenance” theory at class certification stage—a theory that a misstatement affected a security’s price not by artificially inflating it, but by causing it to remain artificially high until the fraud was finally revealed. In 2018, the Second Circuit held the district court may have imposed too high a bar on the showing a defendant needs to make to rebut that theory and instructed the district court to apply a “preponderance of the evidence” standard to determine whether it was more likely than not that the alleged misstatements caused the security to maintain an artificially-high price. On remand, the district court weighed dueling expert evidence and concluded that, on balance, Goldman Sachs had failed to undercut the evidence the plaintiffs submitted that suggested a link between the misstatements and the price of its stock. Goldman Sachs again appealed, contesting the district court’s view of the evidence and its rejection of Goldman Sachs’s argument that certain of the supposed misstatements were not of the type capable of maintaining price inflation in an issuer’s stock. Oral argument was heard in June 2019, and the decision is pending.

²¹⁰ *Khoja v. Orexigen Therapeutics, Inc.*, 899 F.3d 988, 1015 (9th Cir. 2018), *cert. denied sub nom.*, 139 S. Ct. 2615 (2019).

²¹¹ *See, e.g., Backman v. Polaroid Corp.*, 910 F.2d 10, 16-17 (1st Cir. 1990) (en banc).

²¹² *Stransky v. Cummins Engine Co.*, 51 F.3d 1329, 1332 n.3 (7th Cir. 1995).

²¹³ Jeffrey A. Brill, *The Status of the Duty to Update*, 7 Cornell J.L. & Pub. Pol’y 605, 677 (1998).

²¹⁴ The decision below is *In re Goldman Sachs Grp., Inc. Sec. Litig.*, No. 10 Civ. 3461 (PAC), 2018 WL 3854757 (S.D.N.Y. Aug. 14, 2018), *appeal filed*, No. 18-3667 (2d Cir. Dec. 11, 2018).

- **Disgorgement for securities law violations.** As discussed above, the Supreme Court recently granted certiorari in a case that squarely address the question of whether the SEC has the statutory authority to seek disgorgement in District Court actions. A loss in this case would be a major blow to the SEC. The Commission routinely seeks disgorgement in its enforcement actions and obtained orders for more than \$2.5 billion in disgorgement in FY 2018 alone. While much of this is obtained through settled actions filed as administrative proceedings—where the SEC is authorized by statute to seek disgorgement—losing the ability to obtain disgorgement in enforcement actions brought in federal court would have a significant impact on the SEC's enforcement program. At the same time, the Supreme Court's review of the case also may make Congressional action more likely. The ability of the SEC to make wrongdoers pay back ill-gotten gains is an issue that generally has bipartisan support and Congress has debated providing the SEC with explicit authority to obtain disgorgement in district court cases since *Kokesh*. Given the very real possibility that the Supreme Court takes away this power, it may provide the impetus for Congress to grant explicit authorization in 2020.
- **Regulation Best Interest.** The compliance date for Regulation Best Interest (Reg BI), which was adopted by the SEC in June 2019, is June 30, 2020. Reg BI will require broker-dealers to “act in the best interest” of retail customers when recommending securities transactions or giving advice to retail customers. The SEC's Office of Compliance, Inspections, and Examinations has indicated that it will begin to assess firms' implementation of the Reg BI requirements after the compliance date. How the SEC will approach potential violations of Reg BI is a big question for the end of 2020 and beyond.
- **Cryptocurrency and ETF fund proposals.** The SEC has consistently refused to approve exchange-traded funds (ETFs) based on underlying ownership of cryptocurrency “coins.” In our last update, we noted that we were watching a proposal filed with the SEC by the CBOE BZX Exchange, seeking a proposed rule change that would permit the exchange to list and trade shares issued by the VanEck SolidX Bitcoin Trust. After a number of delays (one of which was driven by the 2019 government shutdown), BZX, in September 2019, withdrew its proposal without explanation. A new proposal, filed in mid-2019 by Wilshire Phoenix, contains a twist on past attempts to launch cryptocurrency ETFs: this proposed product would invest in a mix of Bitcoins and U.S. Treasury bills, in a ratio determined by reference to an underlying index with a Bitcoin component and a Treasury bills component that uses a passive, rules-based methodology to rebalance the two asset classes as the volatility of Bitcoin prices fluctuates. Through that approach, the proposal seeks to reduce the level of volatility normally associated with Bitcoin investments to increase the likelihood of obtaining SEC approval. In December 2019, the SEC announced that it would extend the time for it to deliberate on the proposal until February 2020 to allow for sufficient time to evaluate the proposal.

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