Clients&FriendsMemo

Federal Securities Litigation And Regulation: A Periodic Review And Predictions For The Remainder Of 2019

May 13, 2019

While the past year, or even eighteen months, was short on landmark federal securities law decisions, there was significant activity on the part of private securities litigants. In 2018, plaintiffs filed 403 new federal securities fraud class actions, just short of 2017's record high of 412.[1] This continued a marked uptick in securities filings over the last two years. After 20 years with an average of only 203 new filings per year, the pace has now nearly doubled.[2] This increase was driven in part by the emergence of securities cases relating to mergers and acquisitions. As few as 13 such cases were filed per year in the early 2010s, but 198 were filed in 2017 and 182 in 2018.[3] So far in 2019, there have been 134 securities class actions filed, signaling that the trend is continuing. This increase may have resulted at least in part from decisions by the Delaware Court of Chancery severely restricting the ability of stockholders to resolve breach of fiduciary duty claims against directors in the M&A context with non-monetary settlements whereby the company makes supplemental disclosure, pays the plaintiff's attorney a fee, and defendants receive class-wide releases.[4] Given that this avenue for quick resolution of M&A litigation is now effectively foreclosed in the absence of clearly material supplemental disclosure, it appears that certain stockholders have migrated to federal court asserting federal securities law claims instead.

At the same time, the lower federal courts have been prolific in issuing opinions on a range of important issues affecting private securities litigants. In the process, courts attempted to mediate between their perception that private lawsuits are necessary to protect investors and promote ethical business practices while also recognizing the significant potential for abuse in this area, including the filing of meritless lawyer-driven suits.

---

1 Cornerstone Research & Stanford L. Sch. Sec. Class Action Clearinghouse, Securities Class Action Filings: 2018 Year in Review (2019), https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2018-Year-in-Review.

2 *Id.*

3 *Id.*

4 *See In re Trulia S'holder Litig.*, 129 A.3d 884, 891-99 (Del. Ch. 2016); *see also, e.g.*, *In re Walgreen Co. S'holder Litig.*, 832 F.3d 718, 725-26 (7th Cir. 2016); *In re Xoom Corp. S'holder Litig.*, 2016 WL 4146425, at *3-5 (Del. Ch. Aug. 4, 2016); *KT4 Partners LLC v. Palantir Techs. Inc.*, 203 A.3d 738, 759 n.97 (Del. 2019).

- The Supreme Court issued two significant decisions in 2018, clarifying that the statute of limitations for a successive class action is not tolled by a prior class action (*China Agritech, Inc. v. Resh*) and that plaintiffs may bring class actions asserting claims under the Securities Act of 1933 (Securities Act) in state courts (*Cyan, Inc. v. Beaver County Employees Retirement Fund*). In addition, the Supreme Court opened 2019 by holding that an individual who is not the "maker" of a fraudulent statement may nonetheless be held primarily liable under the federal securities laws for disseminating the fraudulent misstatement (*Lorenzo v. Securities and Exchange Commission*)—a decision that, according to Justice Thomas in dissent, renders the Court's landmark 2011 decision in *Janus Capital Group, Inc.* "dead letter."

- The federal courts of appeal decided what state law class actions may be brought in federal courts (*Brink v. Raymond James & Assocs., Inc.* (11th Cir.)); a defendant's burden in rebutting a presumption of market efficiency on class certification (*Arkansas Teachers Ret. Sys. v. Goldman Sachs Grp., Inc.* (2d Cir.)); the state of mind necessary for liability under Section 14(e) of the Securities Exchange Act of 1934 (Exchange Act) (*Varjabedian v. Emulex Corp.* (9th Cir.)); and whether a securities action must be dismissed when a plaintiff loses standing, or the court retains jurisdiction to substitute a new plaintiff to cure the defect (*Klein v. Qlik Techs., Inc.* (2d Cir.)).

- The federal district courts have been particularly active, issuing decisions on a wide range of issues, including: what triggers the tolling of the limitations period under the Exchange Act; federal preemption of state law securities fraud class actions; the parties' burden in establishing—or defeating—a presumption of class-wide reliance on class certification; selection of lead plaintiff and class representative in securities class actions; what types of traders may be included in the definition of a plaintiff class in a securities class action; what allegations are sufficient—and not—in order to meet pleading standards under the Private Securities Litigation Reform Act (PLSRA); and whether a putative class action must be dismissed when the named plaintiff loses standing.

The federal courts also issued significant decisions impacting entities and individuals facing regulatory issues or potential government investigations. The Supreme Court narrowed the definition of who qualifies as a whistleblower in a decision (*Somers v. Digital Realty Trust*) that may impact employees' willingness to report potential misconduct internally before "reporting out" to the Securities and Exchange Commission (SEC) or other regulator. The Second Circuit also revisited a significant decision addressing the personal benefit requirement in insider trading cases (*U.S. v. Martoma*). The Second Circuit also revisited a significant decision addressing the personal benefit requirement in insider trading cases (*U.S. v. Martoma*). The Second Circuit amended its earlier decision in *Martoma* and left *Newman's* "meaningfully close" personal relationship test intact but concluded that the test can be met where the tipper gives the information to the tippee with the intent to benefit. On petition to the Supreme Court, Martoma challenges the Second Circuit's holding that a mere intent to benefit without a meaningfully close personal relationship is sufficient to establish liability.

Meanwhile, the SEC continued its regulatory focus on retail investors and cyber issues. Enforcement activity by the SEC unexpectedly increased in FY 2018, particularly in the second half of the year. Overall, the SEC filed 821 total actions in FY 2018, a significant increase from FY 2017.[5] Consistent with the agency's focus on retail investors, this included substantial increases in the number of securities offering cases, cases against investment advisers and investment companies, and cases against broker dealers. During the second half of FY 2018, the SEC filed a record-setting 55 new actions against public companies and subsidiaries,[6] compared with only 15 in the first half of 2018.[7] At the same time, the number of issuer reporting and disclosure actions—often the largest and most complex cases the SEC brings—decreased significantly in FY 2018.

We discuss these developments, and look ahead to the remainder of 2019, below.

I. Timeliness of Securities Class Actions

In recent years, the Supreme Court has focused on clarifying the circumstances under which the statute of limitations applicable to federal securities law claims is tolled in light of prior-filed suits. In the seminal case of *American Pipe & Construction Co. v. Utah*,[8] the Supreme Court held that the commencement of a class action extends (or tolls) the statute of limitations applicable to claims by individual class members, allowing them to intervene in the action if class certification is ultimately denied. In *Crown, Cork & Seal Co., Inc. v. Parker*,the Court extended *American Pipe* to allow tolling for individual suits by class members, regardless of whether they intervene in the prior action or commence new individual suits following denial of class certification. In 2017, however, the Supreme Court put limits on what seemed to be a situation where tolling could go on nearly endlessly. In *California Public Employees' Retirement System v. ANZ Securities, Inc.*,[9] the Court held that *American Pipe* tolling only applies to the one-year statute of limitations under the Securities Act; it does not apply to the three-year statute of repose, which was intended to be an absolute bar to suits brought more than three years after the challenged fraud.

In 2018, the Supreme Court again revisited the concept of *American Pipe* tolling, and again came down in favor of imposing absolute time limits. In *China Agritech, Inc. v. Resh*,[10] the Supreme Court

---

5 U.S. Sec. & Exch. Comm'n, Division of Enforcement, Annual Report FY 2018 (Nov. 2, 2018), https://www.sec.gov/files/enforcement-annual-report-2018.pdf.

6 Cornerstone Research & NYU Pollack Center for Law & Business, SEC Enforcement Activity: Public Companies and Subsidiaries – Fiscal Year 2018 Update (Dec. 11, 2018), https://www.cornerstone.com/Publications/Reports/SEC-Enforcement-Activity-Public-Companies-and-Subsidiaries—Fiscal-Year-2018-Update.

7 Cornerstone Research & NYU Pollack Center for Law & Business, SEC Enforcement Activity: Public Companies and Subsidiaries – Midyear FY 2018 Update (May 15, 2018), https://www.cornerstone.com/Publications/Reports/SEC-Enforcement-Activity-Public-Companies-and-Subsidiaries-Midyear-FY-2018-Update.

8 414 U.S. 538 (1974).

9 137 S. Ct. 2042 (2017).

10 138 S. Ct. 1800 (2018).

considered whether *American Pipe* tolling not only extends the statute of limitations for individual suits but also for new putative class actions. In *China Agritech*, an investor sought to bring a class action outside the two-year statute of limitations under the Exchange Act. The investor argued that the statute of limitations was tolled under *American Pipe* by a prior class action of which he was a class member. The Ninth Circuit accepted the investor's argument, holding that the same equitable considerations that warrant tolling of successive individual suits under *American Pipe* also apply to successive class action suits. But the Supreme Court reversed, holding that the *American Pipe* doctrine does not apply to successive class actions. Writing for eight justices, Justice Ginsburg explained that the *American Pipe* doctrine tolls individual claims because "economy of litigation favors delaying those claims until after a class-certification denial."[11] It would be wasteful to encourage the filing of individual suits when class certification may obviate the need for such suits.[12] In contrast, economy of litigation does not favor encouraging successive class suits. Rather, it would be more efficient for all would-be class representatives to come forward at the outset of a case for a binding, global decision on class representative status.[13] Moreover, unlike individual claims (for which the clock would start running again after class certification denial), there could be no end date for class claims because the statute of limitations would be tolled during the pendency of each successive class action.[14] Justice Ginsburg also explained that the Court's holding was consistent with the policy goals of Rule 23 of the Federal Rules of Civil Procedure and the Private Securities Litigation Reform Act, which each express a preference for early resolution of class certification issues, including the early selection of lead plaintiff and class representative.[15]

Although the case under review in *China Agritech* only involved claims under the Exchange Act, Justice Ginsburg's opinion could be construed to apply not only to Securities Act claims, but to all class actions under Rule 23 of the Federal Rules of Civil Procedure. The possibility that *China Agritech* might apply outside the securities law context prompted Justice Sotomayor to write a concurring opinion. Justice Sotomayor explained that *China Agritech* should only apply to cases under the PSLRA (*i.e.*, federal securities class actions asserting Exchange Act claims), which mandates notice to class members and an express process for selecting representatives.[16] By contrast, in any class action where the PSLRA does not apply, members of a potential class are not given notice of the action until a class has been certified.[17] Thus, superior class representatives may not know they should come forward and replace an unqualified representative until after the

---

11 *Id.* at 1806.

12 *Id.* at 1807.

13 *Id.* at 1811.

14 *Id.* at 1808.

15 *Id.* at 1807.

16 *Id.* at 1812.

17 Fed. R. Civ. Proc. 23(c)(2).

statute of limitations already has run out.[18] To avoid what Justice Sotomayor characterized as an outcome that was not "in the interest of justice," she encouraged courts to "liberally permit amendment of the pleadings or intervention of new plaintiffs and counsel."[19]

Meanwhile, in *In re BP p.l.c. Securities Litigation*,[20] a district court in the Southern District of Texas interpreted *ANZ Securities*—which refused to toll the three-year statute of repose under the Securities Act—to apply to claims under the Exchange Act. In *In re BP*, a group of investors sought to bring individual suits more than five years after the challenged misstatements notwithstanding the five-year statute of repose provided in the Exchange Act, 28 U.S.C. §1658(b)(2). The investors argued that the time limit was a statute of limitations, not a statute of repose, and therefore was tolled by the pendency of a prior class action. The court disagreed, holding that the five-year period under the Exchange Act is a statute of repose that was intended as the outside limit for commencing an action and thus cannot be tolled. The court based its decision on the language and structure of 28 U.S.C. § 1658(b), which sets forth limitations periods applicable to Exchange Act claims. Like its analogue under the Securities Act, 15 U.S.C. §77m, the provision contains two time limits: a two-year period following discovery of the alleged fraud, and a five-year period following the actual violation.[21] The court concluded that, as with the Securities Act, Congress intended the shorter period to be a statute of limitations, which can be equitably tolled, but intended the longer period to be a statute of repose, which is absolute, final, and not subject to equitable tolling.[22]

These decisions make clear that courts are serious about setting time limits on securities actions. In particular, the three-year and five-year statutes of repose under the Securities Act[23] and Exchange Act,[24] respectively, are strict bars to securities claims. And the widely invoked concept of *American Pipe* tolling is actually limited in scope, applying only to *individual* claims brought within the applicable statute of repose.

II. Federal Preemption

In 1995, Congress enacted the PSLRA, which created a number of stringent substantive and procedural requirements applicable to Exchange Act claims. For example, the PSLRA created heightened pleadings requirements, established damages caps, and imposed mandatory sanctions

---

[18] China Agritech, 138 S.Ct. at 1815.

[19] *Id.*

[20] 341 F. Supp. 3d 698 (S.D. Tex. 2018).

[21] 28 U.S.C. §1658(b).

[22] *In re BP*, 341 F. Supp. 3d at 705-06.

[23] 15 U.S.C. §77m.

[24] 28 U.S.C. §1658(b).

for frivolous litigation. This prompted certain private litigants to seek to bring securities class actions in state courts. To stem such an end-run, Congress enacted the Securities Litigation Uniform Standards Act of 1998 (SLUSA), which amended portions of the Securities Act and Exchange Act to preempt "covered" class actions in state court and permit defendants to remove such actions to federal court. SLUSA preemption applies only to a "covered class action" in which 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 or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security."[25] A "covered class action" is defined as a lawsuit in which damages are sought on behalf of fifty or more people; a "covered security" is defined as a security listed on a national stock exchange.[26]

In *Cyan, Inc. v. Beaver County Employees Retirement Fund*,[27] a unanimous Supreme Court held that SLUSA does not strip state courts of their jurisdiction over class actions alleging violations only of the Securities Act. The Court grounded its decision in the text of the SLUSA. Under 15 U.S.C. § 77(a), district courts have "concurrent" jurisdiction over Securities Act claims, "except as provided in section 77p of this title with respect to covered class actions."[28] In turn, § 77p bars certain securities class actions based upon "the statutory or common law of any State."[29] Importantly, however, the statute does not expressly purport to deprive courts of jurisdiction under federal law, including the Securities Act.[30] This means that litigants may continue to commence actions asserting Securities Act claims in state court without facing the SLUSA's removal and preemption provisions. As the Court noted, however, such an option is not available for class actions asserting claims under the Exchange Act, which, under 15 U.S.C. § 78bb(f)(1), only may be filed in federal court.[31]

The lower federal courts, in contrast, have been focused not on which federal claims may be brought in state court, but on which state law claims may be brought in federal court. Under SLUSA, "covered class actions" involving "covered securities" that are filed in federal court, invoke state law, and allege that securities fraud are subject to dismissal.[32] In *Brink v. Raymond James & Associates, Inc.*,[33] the Eleventh Circuit held that SLUSA did not require the dismissal of a class

[25] 15 U.S.C. § 78bb(f)(1).

[26] 15 U.S.C. § 78bb(f)(5)(B), (E).

[27] 138 S. Ct. 1061, 1066-80 (2018).

[28] *Id.* at 1068.

[29] *Id.* at 1067.

[30] *Id.* at 1069.

[31] *Id.* at 1073.

[32] 15 U.S.C. § 78bb(f)(1).

[33] 892 F.3d 1142 (11th Cir. 2018).

action in federal court asserting claims for breach of contract and negligence under state law. The plaintiffs there alleged that the defendants misrepresented the true nature of transaction fees charged to customers for use of Raymond James and Associates brokerage services. The defendants sought dismissal of these claims under SLUSA, 15 U.S.C. § 78bb(f)(1)(A), arguing that the claims were actually Exchange Act claims "disguised" as state breach of contract and negligence claims. The Eleventh Circuit disagreed, explaining that the alleged misrepresentations about transaction fees only would have influenced a customer's choice of broker, not the underlying investment decision.[34] This did not constitute a "material" misrepresentation of fact sufficient to state a federal securities fraud claim, and thus was not subject to SLUSA's bar on state law claims equivalent to federal claims.[35]

In contrast, in *North Sound Capital LLC v. Merck & Co.*,[36] a district court in the District of New Jersey held that a state common law fraud claim was preempted by SLUSA. The plaintiffs in that case had opted out of an earlier class action asserting Exchange Act claims against Merck regarding the effectiveness of clinical trials for the cholesterol-lowering drug Vitorin. The defendants sought dismissal of plaintiffs' common law fraud claim under SLUSA. The court held that the action met the test for a "covered class action" in that it was appropriate to group the sixteen individual plaintiffs with members of the earlier class action to meet the 50-person threshold.[37] The court explained that not only were the actions filed in the same court, but there was informal coordination between individual opt-out actions and the lead action sufficient to meet the requirement of being "joined, consolidated, or otherwise proceed[ing] as a single action."[38] The decision is currently on appeal to the Third Circuit. A district court in the Southern District of California came to the same conclusion in *Highfields Capital I, LP v. SeaWorld Entertainment, Inc.*, holding that an individual opt-out action constituted a "covered class action" because it was "sufficiently coordinated" with a class action to "proceed as a single action."[39]

Finally, the Delaware Court of Chancery recently considered whether a corporate charter could require claims brought by a corporation's stockholders under the Securities Act to proceed in federal court, and held that it could not. In *Sciabacucchi v. Salzberg*,[40] a stockholder brought suit in the Court of Chancery alleging that a registration statement filed in connection with an IPO contained material misrepresentations in violation of Section 11 of the Securities Act. The

---

[34] *Id.* at 1148.

[35] *Id.* at 1149.

[36] 314 F. Supp. 3d 589 (D.N.J. 2018).

[37] *Id.* at 603.

[38] *Id.* at 610-11.

[39] 365 F. Supp. 3d 1050, 2019 WL 480495, at *6-8 (S.D. Cal. Feb. 7, 2019).

[40] 2018 WL 6719718 (Del. Ch. Dec. 19, 2018).

defendants contended that the action had to be brought in federal court by virtue of a forum selection clause in the corporation's charter, which provided that federal court would be the exclusive jurisdiction for resolving Securities Act claims. Vice Chancellor J. Travis Laster disagreed, reasoning that "charter and bylaws can only address internal-affairs claims," and the forum-selection clause was therefore invalid because federal securities actions are "external claim[s] that fall[] outside the scope of the corporate contract."[41] The defendants sought to appeal the court's decision, but that appeal was denied for failure to comply with the rules governing interlocutory appeals.[42]

The net result of these decisions is that all "covered class actions" that allege fraud in connection with the purchase of a sale of a "covered security" (*i.e.*, a security traded on a national exchange) must be brought under the federal securities laws, not state law. Although under *Cyan* such actions asserting only claims under the Securities Act may be filed in state court, all other "covered" class actions must be filed in federal court, subject to the requirements of the PSLRA.

III. Theories of Securities Fraud

The PSLRA sets a lofty standard for pleading securities fraud under Section 10(b) of the Exchange Act. First, when a plaintiff alleges a misrepresentation or omission of a material fact, the complaint must "specify each statement alleged to have been misleading [and] the reason or reasons why the statement is misleading."[43] Second, to plead the element of scienter, the complaint must "with respect to each act or omission . . . state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind."[44] 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."[45] What is sufficient to meet these standards is invariably fact-dependent and impossible to reduce to a formula. Nonetheless, there have been notable decisions providing guidance on pleading a viable Section 10(b) claim and, for defendants, offering roadmaps to successfully challenge such claims at the motion to dismiss stage.

Most significantly, the Supreme Court opened 2019 by holding that an individual who is not the "maker" of a fraudulent statement—and thus may not be held liable under Section 10(b)—may nonetheless be held primarily liable for disseminating the fraudulent statement. In *Lorenzo v. Securities and Exchange Commission*,[46] the SEC commenced administrative proceedings against

---

[41] *Sciabacucchi*, 2018 WL 6719718, at *14, 18.

[42] *Salzberg v. Sciabacucchi,* 2019 WL 549039 (Del. Feb. 12, 2019).

[43] 15 U.S.C. § 78u-4(b).

[44] 15 U.S.C. § 78u-4(b)(2).

[45] *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 314 (2007).

[46] No. 17-1077.

the vice president of an investment bank for emailing fraudulent statements to potential investors regarding the value of a company involved in a debenture offering. The SEC determined that the employee's actions violated Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, and imposed sanctions, including a civil penalty and a lifetime industry bar. On appeal, the D.C. Circuit reversed in part. Relying on the Supreme Court's decision in *Janus Capital Group, Inc. v. First Derivative Traders*,[47] a panel of the D.C. Circuit held that the employee could not be liable under Rule 10b-5(b) because he did not "make" the statement in question since he did not have "ultimate authority" over the statements in his investor emails. Rather, 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.[48] Nevertheless, the court concluded that the employee could still be held liable on the basis of the employee's participation in a fraudulent scheme to send the emails.[49] Then-D.C. Circuit Judge Brett Kavanaugh dissented, explaining that permitting liability under these provisions for someone who is not a "maker" of a statement would amount to an "end-run" around the Supreme Court's decision in *Janus*.[50]

On March 27, 2019, a 6-2 majority of the Supreme Court (with Justice Kavanaugh taking no part in the decision), affirmed the D.C. Circuit's decision, holding that, even if an individual is not the "maker" of a misstatement, the individual's participation in disseminating the misstatement falls within the scope of other provisions Rule 10b-5.[51] 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."[52] According to Justice Breyer, "the 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."[53] 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 each subsection of 10(b)-5 governs a "separate type of conduct."[54] But the Court rejected this argument, explaining that the Court and SEC "have long recognized considerable overlap among

47 564 U.S. 135 (2011).

48 *Lorenzo v. Sec. & Exch. Comm'n*, 872 F.3d 578, 587-88 (D.C. Cir. 2017).

49 *Id.* at 591.

50 *Id.* at 601.

51 *Lorenzo v. SEC*, 139 S. Ct. 1094 (Mar. 27, 2019).

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

53 *Id.*

54 *Id.* at 1102.

the subsections of [Rule 10b-5] and related provisions of the securities laws."[55] Rather, "Congress intended to root out all manner of fraud in the securities industry," and "gave to the Commission the tools to accomplish that job."[56]

In a dissenting opinion joined by Justice Gorsuch, Justice Thomas cautioned that the majority's "sweeping holding" "eviscerates" *Janus* and renders that decision a "dead letter."[57] According to Justice Thomas, the majority's decision may subject individuals only "tangentially" involved in the misconduct (like a secretary instructed to send a fraudulent email) to private securities fraud liability, in abrogation of the distinction between primary and secondary liability (for which no private right of action exists under the federal securities laws).[58] While the implications of *Lorenzo* with respect to such conduct remain to be seen, it is clear that *Lorenzo* substantially reduces the force of technical arguments against liability based on one's "ultimate authority" over a subject communication. 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, regardless of whether or not a fraudulent misstatement was involved. We expect the limits of *Lorenzo* to be a prevalent subject of litigation over the coming year.

In another significant development, the Ninth Circuit assessed the standards for pleading fraud under Section 14(e) of the Exchange Act in *Varjabedian v. Emulex Corp.*[59] —a decision on which the Supreme Court first granted, and later denied, certiorari. Section 14(e) prohibits fraudulent, deceptive, or manipulative acts or practices in connection with a tender offer. While the federal courts agree that Section 14(e) confers a private right of action, five circuits, including the Second, Third, Fifth, Sixth, and Eleventh, have held that, to state a claim, a claimant must plead that the defendant acted with scienter—*i.e.*, a mental state embracing an intent to deceive, manipulate, or defraud.[60] In *Varjabedian*, however, the Ninth Circuit broke rank, holding that a private litigant claiming a Section 14(e) violation need only plead that the defendant acted negligently when it misrepresented or omitted a material fact in connection with a tender offer. That case involved the merger between two technonlogy companies (Emulex and Avago) that was approved by their stockholders. Thereafter, a dissatisfied shareholder brought suit under Section 14(e), claiming information omitted from Emulex's tender offer materials rendered them materially misleading. The district court dismissed the complaint, explaining that the "similarities between Rule 10b-5 and

---

[55] *Id.*

[56] *Id.* at 1104.

[57] *Id.* at 1110.

[58] *Id.* at 1110-1111 (Thomas, J., dissenting).

[59] 888 F.3d 399 (9th Cir. 2018).

[60] *See Flaherty & Crumrine Preferred Income Fund, Inc. v. TXU Corp.*, 565 F.3d 200, 207 (5th Cir. 2009); *In re Digital Island Sec. Litig.*, 357 F.3d 322, 328 (3d Cir. 2004); *SEC v. Ginsburg*, 362 F.3d 1292, 1297 (11th Cir. 2004); *Conn. Nat'l Bank v. Fluor Corp.*, 808 F.2d 957, 961 (2d Cir. 1987); *Adams v. Standard Knitting Mills, Inc.*, 623 F.2d 422, 431 (6th Cir. 1980).

§ 14(e) require a plaintiff bringing a cause of action under § 14(e) to allege scienter," and the plaintiff failed to allege facts demonstrating that Emulex knowingly omitted the information.[61] A Ninth Circuit panel reversed, holding that an allegation that the information was negligently omitted is sufficient to state a claim. The panel reasoned that the "rationale regarding Rule 10(b)-5 does not apply to Section 14(e)" because 10(b)-5 is a "regulation promulgated under Section 10(b) of the Exchange Act, which allows the SEC to regulate only 'manipulative or deceptive devices'" while Section 14(e) "is a statute, not an SEC Rule."[62] The court found that a more apt comparison was Section 17(a) of the Securities Act, which "is largely identical to the first clause of Section 14(e) [and] requires a showing of negligence, not scienter."[63] Although the Supreme Court initially granted certiorari on January 4, 2019, it dismissed the petition on April 23, 2019, as "improvidently granted."[64] We anticipate that the Supreme Court may accept a case presenting this issue in the future to the extent the circuit split widens or lower federal courts divide on the question.

District court decisions continued to elucidate the types of allegations that will be deemed sufficient under the PSLRA to plead a Section 10(b) claim. In *Metzler Asset Management GmbH v. Kinglsey*,[65] the plaintiffs alleged that Biogen Inc. and its executives made misleading statements about the business prospects of the company and the safety of Tecfidera, the company's leading multiple sclerosis drug. A district court in the District of Massachusetts granted defendants' motion to dismiss. As an initial matter, the court held that the generalized positive statements about the company and the drug challenged by plaintiffs were not actionable as a matter of law. These statements—for example, that the company is on a "solid trajectory" and the drug has "an attractive safety profile"—amount to generic expressions of corporate optimism, or "puffery," that are immaterial as a matter of law.[66] Although more specific statements about earnings and safety were potentially actionable, the court concluded that plaintiffs had not sufficiently pled a strong inference of scienter as required under the PSLRA. In particular, the court found insufficient general statements of defendants' knowledge attributed to 17 confidential witnesses.[67] The court found that allegations based on confidential witnesses still had to plead specific facts, which was not the case here.[68] Moreover, while allegations of motive and opportunity are sufficient to plead scienter in the First Circuit, the plaintiffs merely alleged that the defendant executives had the opportunity to misrepresent Tecfidera's growth projections and, since Tecfidera was the company's main revenue

---

61 *Varjabedian v. Emulex Corp.*, 52 F. Supp. 3d 1226, 1233 (C.D. Cal. 2016).

62 *Varjabedian*, 888 F.3d at 406 (quoting 15 U.S.C. § 78j(b)).

63 *Id.*

64 *Emulex Corp. v. Varjabedian*, --S.Ct.--, 2019 WL 1768137, at *1 (Apr. 23, 2019).

65 305 F. Supp. 3d 181 (D. Mass. 2018).

66 *Id.* at 209-10.

67 *Id.* at 214.

68 *Id.* at 215.

source, the executives knew the statements were false.[69] Such allegations regarding "the usual concern by executives to improve financial results" did not suffice.[70] The court's decision is currently on appeal to the First Circuit.

In contrast, in *In re Volkswagen "Clean Diesel" Marketing, Sales Practices, and Product Liability Litigation*,[71] a district court in the Northern District of California found that the plaintiff adequately pled Section 10(b) claims. The claims arose from the widely-reported "massive" fraud to use "defeat devices" in Volkswagen's diesel vehicles to deceptively pass emissions tests and sell vehicles that released pollutants up to 40 times above the legal limit.[72] The plaintiffs claimed that Michael Horn, the CEO of Volkswagen Group of America, knowingly omitted from the company's offering documents Volkswagen's scheme to use the defeat devices.[73] The court dismissed the first amended complaint on the grounds that it merely alleged that Horn learned Volkswagen was using the defeat devices on the same day it issued its Offering Memorandum.[74] Such an allegation, according to the court, was insufficient to plead scienter. The court ruled that the plaintiffs' second amended complaint, however, cured that deficiency because it alleged additional facts pleading that Horn learned of Volkswagen's fraud seven weeks earlier.[75] In light of the new allegations, the court found that "Horn's delay" in investigating the "potentially negative information before public disclosure" was unreasonable and thus, "a strong inference arises that [Horn] acted with intent to deceive or with deliberate recklessness when he failed to disclose this information to bond investors who participated in the May 2014 offering."[76]

In *Trahan v. Interactive Intelligence Group, Inc.*,[77] a district court in the Southern District of Indiana dismissed claims under Section 14(a) of the Exchange Act based on an allegedly false and misleading proxy statement seeking shareholder approval of a proposed merger. In so holding, the court provided useful guidance regarding materiality and when statements of opinion are actionable. First, the plaintiffs alleged that the proxy was misleading because it did not include a broader range of financial projections. But the court held that there was no basis to conclude that additional projections would alter the total mix of information available as viewed by a reasonable

---

69 *Id.* at 218-220.

70 *Id.* at 218.

71 328 F. Supp. 3d 963 (N.D. Cal. 2018).

72 *Id.* at 979-81.

73 *Id.* at 982.

74 *Id.* at 967.

75 *Id.* at 968.

76 *Id.* at 989.

77 308 F. Supp. 3d 977 (S.D. Ind. 2018).

investor.[78] Second, the plaintiffs alleged that the choice of inputs made the company's financial projection model misleading. But the court held that the inputs used in the financial projections were immaterial because the model and assumptions used were clearly stated.[79] Finally, the plaintiffs claimed that statements concerning the directors' reasons for supporting the merger were misleading. The court, however, held that plaintiffs did not plead any facts permitting a plausible inference that the statements were not made in good faith and with a reasonable basis.[80]

IV. Class Certification

Class certification is often make-or-break for plaintiffs and defendants. If a class is certified, the potential damages a defendant faces rise astronomically, often leading to an eventual 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 fact, denial of class certification usually is the death knell for the action. Federal courts recently have issued important decisions on three class certification issues arising in cases asserting federal securities law claims: establishing reliance on a class-wide basis, choosing lead plaintiff and class representative, and defining the class.

A. Establishing Reliance on a Class-Wide Basis

Under Rule 23(b) of the Federal Rules of Civil Procedure, it is the plaintiff's burden on class certification to establish "that the questions of law or fact common to class members predominate over any questions affecting only individual members[.]"[81] "An individual question is one where 'members of a proposed class will need to present evidence that varies from member to member,' while a common question is one where 'the same evidence will suffice for each member to make a *prima facie* showing [or] the issue is susceptible to generalized, class-wide proof.'"[82] Class action plaintiffs often face difficulty in meeting this requirement with respect to the "reliance" element of a Section 10(b) claim. So the theory goes, it is difficult if not impossible to determine whether individuals in a wide, amorphous class of investors directly relied on misstatements in deciding whether to purchase or sell stock.

To avoid a situation in which no Section 10(b) securities class action can ever be certified, the Supreme Court has articulated two "presumptions" of reliance if certain conditions are satisfied. First, under the *Basic* (or fraud-on-the-market) presumption, plaintiffs can invoke a presumption of reliance if they traded in securities of a company that made material misrepresentations to the

---

[78] *Id.* at 989-90.

[79] *Id.* at 995.

[80] *Id.* at 998-99.

[81] Fed. R. Civ. P. 23(b)(3).

[82] *Tyson Foods, Inc. v. Bouaphakeo*, 136 S. Ct. 1036, 1045 (2016) (quoting 2 W. RUBENSTEIN, NEWBERG ON CLASS ACTIONS § 4:50, pp. 196-197 (5th ed. 2012)).

public and whose securities are traded on an efficient market.[83] It is recognized, however, that a defendant may rebut the presumption and defeat class certification by showing that the misrepresentations did not actually affect the price of the stock.[84] Second, plaintiffs also can invoke the *Affiliated Ute* presumption of reliance. This is available "if there is an omission of material fact by one with a duty to disclose."[85]

In *Arkansas Teachers Retirement System v. Goldman Sachs Group, Inc.*,[86] the Second Circuit clarified a defendant's burden in seeking to rebut the *Basic* presumption. There, the plaintiffs alleged that Goldman Sachs and several of its directors made material misstatements about Goldman's efforts to avoid conflicts of interest, causing its stock price to drop once the "truth" allegedly became known. In opposing class certification, the defendants sought to rebut the *Basic* presumption with evidence that the bank's stock did not decline in response to various press reports disclosing information about conflicts of interest. Judge Paul A. Crotty of the Southern District of New York nonetheless certified the class, holding that defendants did not provide "conclusive evidence that no link exists between the price decline [of Goldman stock] and the misrepresentation[s]."[87] The Second Circuit vacated the order, however, holding that the district court applied the wrong standard. A defendant need not present "conclusive evidence" of no price impact. Rather, a defendant seeking to rebut the *Basic* presumption must do so "by a preponderance of the evidence."[88] In other words, it is defendant's burden to show that it is more likely than not that misrepresentations did not affect the price of the company's stock.[89] (As noted in Section IX, *infra*, this matter is returning to the Second Circuit in 2019.)

In *Colman v. Theranos, Inc.*,[90] the plaintiffs asserted claims for fraud, misrepresentation, and market manipulation against Theranos, Inc., alleging that Theranos promoted a highly-publicized blood testing technology that in fact did not exist. Plaintiffs sought to certify of a class of "indirect investors" that purchased interests in entities that had bought Theranos stock during the class period. A district court in the Northern District of California declined to certify the putative class, holding that individualized questions of reliance predominated. In particular, the court refused to apply the *Basic* presumption, finding that Theranos stock did not trade in an efficient market. Rather, the plaintiffs were private investors who used private channels to purchase the stock in

---

83 *Basic Inc. v. Levinson*, 485 U.S. 224, 250 (1988).

84 *Id.* at 229-30.

85 *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 552 U.S. 148, 159 (2008) (citing *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153-54 (1972)).

86 879 F.3d 474 (2d Cir. 2018).

87 *In re Goldman Sachs Grp., Inc. Sec. Litig.*, 2015 WL 5613150, at *7 (S.D.N.Y. Sept. 24, 2015).

88 *Arkansas Teachers*, 879 F.3d at 485.

89 *Id.* at 485.

90 325 F.R.D. 629, 641-46 (N.D. Cal. 2018).

discrete offerings.[91] Unlike in an efficient market, the stock did not trade with high weekly volumes in a fluid market monitored by market makers and arbitrageurs.[92]

Although *Arkansas Teachers* and *Theranos* were wins for defendants, other recent decisions addressing this issue came out in favor of plaintiffs. So long as plaintiffs presented evidence of market efficiency, federal courts were reluctant to find the presumption rebutted absent strong, affirmative proof to the contrary, typically involving conclusive evidence that the stock price did not move in response to corrective disclosure. For example, in *Pirnik v. Fiat Chrysler Automobiles, N.V.*,[93] a district court in the Southern District of New York rejected the defendants' attempt to rebut the *Basic* presumption by simply criticizing the analysis and event study conducted by the plaintiffs' expert. The court explained that the defendants' failure to prepare their own event study, alone, was sufficient basis for rejecting defendants' argument at that stage.[94] Two district courts in the Central District of California came to the same conclusion in *Angley v. UTi Worldwide Inc.*[95] and *In re Banc of California Securities Litigation*.[96] In both cases, the defendants' sole argument for rebutting the presumption was to discredit the plaintiffs' expert, including whether the stock traded in an efficient market based on the rate at which the stock responded to news reports concerning the securities at issue. These courts explained that criticism, without affirmative evidence of a lack of price impact, is not enough.[97] Likewise, in *Bing Li v. Aeterna Zentaris, Inc.*,[98] the defendants attempted to rebut the *Basic* presumption by criticizing the statistical confidence level of plaintiffs' expert's event study showing price impact—it was 84%, while standard industry practice is 95%. A district court in the District of New Jersey rejected the defendants' argument, holding the defendant must affirmatively demonstrate no price impact to meet its burden.[99]

A district court in the Western District of Texas was similarly not receptive to defendants' efforts to rebut the *Basic* presumption. In *Rooney v. EZCORP, Inc.*,[100] the court concluded that the plaintiffs were entitled to the *Basic* presumption because, among other reasons, the defendant corporation's stock traded on the NASDAQ. Defendants then attempted to rebut the presumption with an expert study purporting to show a lack of price impact following issuance of corrective disclosures. The

---

91 *Id.* at 647.

92 *Id.*

93 327 F.R.D. 38 (S.D.N.Y. 2018).

94 *Id.* at 45.

95 311 F. Supp. 3d 1117 (C.D. Cal. 2018).

96 326 F.R.D. 640 (C.D. Cal. 2018).

97 *Angley*, 311 F. Supp. 3d at 1126; *Banc*, 326 F.R.D. 640 at 650.

98 324 F.R.D. 331, 345 (D.N.J. 2018).

99 *Id.* at 345.

100 2019 WL 691205, at *7 (W.D. Tex. Feb. 19, 2019).

court held that this was insufficient. According to the court, the Supreme Court in its second decision in *Halliburton Co. v. Erica P. John Fund, Inc. (Halliburton II)*,[101] allowed "defendants to rebut the *Basic* presumption by showing a lack of price impact following a misrepresentation, and not following a corrective disclosure."[102] Because the defendants failed to provide "any evidence that the alleged *misrepresentations* did not affect the stock price," the court held that the plaintiffs were "entitled to rely on the presumption at the class certification stage."[103] The district court's analysis, however, appears inconsistent with *Halliburton II* which noted that the presumption may be rebutted with "evidence that the asserted misrepresentation (*or its correction*) did not affect the market price of the defendant's stock."[104] The district court's decision is on appeal to the Fifth Circuit.

In addition to these decisions regarding the *Basic* presumption, federal courts considered the scope of the *Affiliated Ute* presumption applicable to cases that primarily involve omissions. For example, in *Schwab v. E*TRADE Financial Corp.*,[105] plaintiffs asserted that E*TRADE violated Section 10(b) of the Exchange Act in connection with its disclosure regarding a duty of "best execution"—*i.e.*, the duty to buy or sell a security in the market that will achieve the most favorable price for the customer.[106] The plaintiffs did not seek to invoke the *Basic* presumption. Rather, they relied exclusively on the *Affiliated Ute* presumption on the ground that the case primarily involved E*TRADE's failure to disclose its non-compliance with best execution regulations. The district court disagreed, finding that "the plaintiff's allegations were primarily misrepresentation claims rather than omission claims."[107] The Second Circuit affirmed, rejecting the plaintiffs' theory as simply verbal gymnastics. The court stated that the plaintiffs alleged that E*TRADE made many statements during the class period affirming its commitment to executing orders in compliance with the duty of best execution. In light of these challenged misstatements, the court characterized plaintiffs' attempt to frame the action as involving primarily omissions as relying on "simply the inverse" of a misrepresentation claim: the "only omission is the truth that the statement misrepresents."[108] Notably, the court also emphasized that the rationale for the *Affiliated Ute* presumption is to give plaintiffs a mechanism for establishing reliance when it is impossible as a practical matter to prove

---

[101] 573 U.S. 258 (2014).

[102] *Id.* at *7.

[103] *Id.* at *8 (emphasis added).

[104] 573 U.S. at 280-81 (emphasis added).

[105] 752 Fed. App'x. 56 (2d Cir. Oct. 26, 2018).

[106] FINRA Manual Rule 5310(a)(1).

[107] *Schwab v. E*Trade Fin. Corp.*, 285 F. Supp. 3d 745, 753 (S.D.N.Y. 2018).

[108] *Schwab,* 752 Fed. Appx. at 59.

that they relied on the alleged omissions.[109] In view of the many affirmative misstatements at issue, this was not the case here.[110]

On the other hand, a district court in the District of Minnesota upheld the applicability of the *Affiliated Ute* presumption in *West Virginia Pipe Trades Health and Welfare Fund v. Medtronic, Inc.*[111] In that case, the plaintiffs alleged that Medtronic, Inc., a medical device company, engaged in a scheme to conceal the adverse results of clinical studies of INFUSE—a device designed to induce development of new bone tissue in patients. The plaintiffs alleged that Medtronic forged financial relationships with physician authors, who, in exchange for Medtronic's financial backing, omitted the dangers of INFUSE from articles published in medical journals. Claiming that the case primarily involved omissions, the plaintiffs sought to invoke *Affiliated Ute* presumption (not the basic presumption). The defendants opposed the plaintiffs' efforts to employ the presumption, arguing that the claims were actually "based on the journal articles' statements downplaying risks associated."[112] The court disagreed, finding that the "statements in the journal articles" were not the focus of the pleadings. Rather, "the crux of Plaintiffs' scheme liability claims is that Medtronic *paid physicians* to conceal adverse events and side effects associated with the use of INFUSE."[113] Therefore, the relevant inquiry was whether "Medtronic's failure to disclose that the authors were allegedly paid to induce their complicity in concealing adverse events related to INFUSE was an affirmative representation or an omission."[114]

Likewise, a district court in the District of Nebraska held that a retail equity trader's complaint contained facts sufficient to plead a Section 10(b) fraud claim for purposes of class certification related to omissions involving a "best execution theory" of liability. In *Klein v. TD Ameritrade Holding Corp.*,[115] the plaintiffs claimed that TD Ameritrade algorithmically routed customer orders to venues that paid the company the most money regardless of whether the venue provided the most efficient execution of those orders. The plaintiffs claimed that this practice violated "best execution" principles, which require brokers to "use reasonable efforts to maximize the economic benefit to the client in each transaction."[116] The court held that the *Affiliated Ute* presumption of reliance applied: "Like a securities dealer's failure to disclose its policy of overcharging investors, defendants' execution of investors' trades at the NBBO price, when better prices may have been available from

---

[109] *Id.*

[110] *Id.*

[111] 325 F.R.D. 280 (D. Minn. 2018).

[112] *Id.* at 289.

[113] *Id.* at 288 (emphasis in original).

[114] *Id.* at 289.

[115] 327 F.R.D. 283 (D. Neb. 2018).

[116] *Id.* at 295.

alternative services, constitutes a potentially fraudulent common course of conduct from which reliance can be presumed."[117] The court thus granted class certification, noting that the plaintiffs demonstrated that they could show on a class-wide basis that class members suffered economic loss by relying on omissions about TD Ameritrade's failure to provide best execution.[118]

Finally, a district court in the Southern District of New York considered a related defense to class-wide reliance applicable to Section 11 claims (relating to misleading statements in registration statements) in *Yi Xiang v. Inovalon Holdings, Inc.*[119] It is an absolute defense to a Section 11 claim if the purchaser of a security "[knows] about the false statement at the time of acquisition."[120] In a class certification context, predominance can be defeated if defendants demonstrate that class members had "differing levels of knowledge regarding the misleading nature of the statements or omissions when they invested sufficient to outweigh common issues."[121] In *Yi Xiang*, the plaintiffs alleged that the defendants failed to disclose in Inovalon Holdings, Inc.'s registration statement and prospectus that the company derived significant revenue from New York-based customers and thus would be subject to increased taxes in New York. The defendants contended that individualized inquiries into investor knowledge would be necessary because (i) the company's public filings disclosed relevant information concerning its tax burden and (ii) certain investors conducted independent research into the company before purchasing its securities. The court, however, rejected this argument, explaining that, where the defense has been held to be viable, defendants have shown that certain class members either participated in or had knowledge of the alleged conduct.[122] The defendants in this case did not make such a showing, or even establish that the class consisted of an identifiable group of sophisticated investors such that it could be inferred.[123] Notably, the court rejected the notion that publicly available information could support such a defense, as such information merely raises issues of knowledge "subject to generalized proof."[124]

While these decisions defy generalized observations about a pro-plaintiff or defendant trend, what is clear is that courts will carefully scrutinize a class plaintiff's opening evidence of market efficiency. This trend follows from the Supreme Court's holding in *Wal-Mart Stores, Inc. v. Dukes* that putative class action plaintiffs must provide "significant proof" at the class certification stage that all the

---

117 *Id.*

118 *Id.* at 297.

119 327 F.R.D. 510 (S.D.N.Y. 2018).

120 *DeMaria v. Andersen*, 318 F.3d 170, 175 (2d Cir. 2003); *see* 15 U.S.C. § 77k(a).

121 *Yi Xiang*, 327 F.R.D. at 528.

122 *Id.*

123 *Id.*

124 *Id.* at 529.

prerequisites to class certification under Rule 23 are satisfied.[125] The decisions discussed above demonstrate that, in order for defendants to maximize their chances of defeating class certification, they need to present affirmative evidence either of a lack of price impact from corrective disclosure in order to rebut the *Basic* presumption or establish that *Affiliated Ute* is inapplicable in a case truly about misstatements.

B. Choosing the Lead Plaintiff and Class Representative

Under the PSLRA, after a plaintiff files a class action, it must issue public notice and, within 60 days, any class member may move the court to serve as lead plaintiff.[126] The PSLRA directs the court to appoint as lead plaintiff the member of the class the court determines to be the "most adequate plaintiff," *i.e.*, the member the court determines to be "most capable of adequately representing the interests of class members."[127] While lead plaintiff often becomes the class representative, that result is not mandated by the PSLRA and is not always the outcome.[128] Given the stakes, the battle among class members (and, in particular, their counsel) for these roles is often fierce.

Recent decisions confirm that the overriding factor in selecting the lead plaintiff is the financial interest of the prospective lead plaintiff, typically quantified as financial losses during the alleged class period. Once superior losses are established, it is difficult for challengers to overcome, even if the difference is slight. For example, in *Hessefort v. Super Micro Computer, Inc.*,[129] a district court in the Northern District of California conferred lead plaintiff status on a pension fund that had $180,622 in losses during the class period over a challenger whose losses were $172,826. The court explained that, although the difference was small, "any financial difference is meaningful in determining a lead plaintiff."[130] Likewise, in *Shenk v. Mallinckrodt PLC*,[131] a district court in the District of Columbia conferred lead plaintiff status on the pension fund with the greatest losses. In so ruling, the court rejected the challenger's argument that the fund was subject to a unique defense because its counsel made political contributions to the Ohio Attorney General, who in turn selected counsel. The court explained that there was no basis for finding that political contributions by law firms were illegal, or any nexus between the contributions and selection of counsel.[132] In *In*

---

125 564 U.S. 338 (2011); *see also EQT Prod. Co. v. Adair*, 764 F.3d 347 (4th Cir. 2014); *Rodriguez v. Nat'l City Bank*, 726 F.3d 372, 376 (3d Cir. 2013); *M.D. ex rel. Stukenberg v. Perry*, 675 F.3d 832, 839, 841-44 (5th Cir. 2012); *Ellis v. Costco Wholesale Corp.*, 657 F.3d 970, 974 (9th Cir. 2011).

126 15 U.S.C. § 78u-4(a)(3)(A).

127 15 U.S.C. § 78u-4(a)(3)(B)(i).

128 Fed. R. Civ. P. 23(a)(4).

129 317 F. Supp. 3d 1056 (N.D. Cal. 2018).

130 *Id.* at 1060.

131 300 F. Supp. 3d 279 (D.D.C. 2018).

132 *Id.* at 285.

re Sequans Communications S.A. Securities Litigation,[133] a district court in the Eastern District of New York chose as lead plaintiff individuals who demonstrated greater losses than a competing institutional investor. While recognizing that some courts have found a preference for institutional investors as lead plaintiff, the court held that "the preference is not embodied in the statutory text [of the PSLRA] in any respect."[134]

Notably, courts recognized that, for the purpose of establishing financial interest, it is permissible for a group of individuals to apply collectively. A district court in the Eastern District of New York considered this question in *Brady v. Top Ships Inc*.[135] There, the court granted lead plaintiff status to the "Top Ships Investor Group," which consisted of three individuals who collectively had the largest financial losses in the class period. The court explained that, in deciding whether to aggregate individuals for consideration as lead plaintiff, courts consider (1) the existence of a pre-litigation relationship, (2) involvement in the litigation to date, (3) plans for cooperation, (4) sophistication, and (5) whether members chose outside counsel and not vice versa.[136] The court found that these considerations weighed in favor of selecting the Top Ships Investor Group, citing the group's small size (three in number) and a declaration submitted by the group providing evidence of its ability to cohesively manage the litigation.[137] Likewise, in *In re Sequans*, *supra*, the court saw no issue with grouping the losses of two individuals seeking to act as a collective lead plaintiff.[138]

After a lead plaintiff's motion for class certification is granted, there remains a question of who will serve as class representative under Rule 23. Typically, it will be lead plaintiff. But in *City of Cape Coral Municipal Firefighters' Retirement Plan v. Emergent Biosolutions, Inc.*,[139] a district court in the District of Maryland explained that it need not always be the case and, in any event, a lead plaintiff may continue on in a case even if it is not appointed class representative. In *City of Cape Coral*, the lead plaintiff filed a motion for class certification seeking to appoint itself and another class member (Geoffrey Flagstad) as class representatives. The court granted the motion for class certification, but shortened the class period so that it excluded lead plaintiff but not Flagstad from the class. The question for the court was whether someone who is not lead plaintiff may nonetheless be an adequate class representative. The court's answer was yes. Nothing in the PSLRA prohibits appointment of a class representative who has not been previously appointed as

---

133 289 F. Supp. 3d 416 (E.D.N.Y. 2018).

134 *Id.* at 422.

135 324 F. Supp. 3d 335.

136 *Id.* 345.

137 *Id.* at 347.

138 289 F. Supp. 3d at 422.

139 322 F. Supp. 3d 676 (D. Md. 2018).

lead plaintiff.[140] In addition, the court found that Flagstad would serve the class fairly and adequately in light of evidence that he had reviewed the complaint when it was filed, received regular reports and communications from counsel about the case, and was committed to participating in the case.[141] Finally, the court held that lead plaintiffs would "remain in the case and retain their obligations under the PSLRA and Rule 23 even when they are not appointed class representatives"—although the court did not specify what "obligations" would remain post-class certification.[142]

These cases demonstrate that courts are reluctant to allow a class action to become bogged down over questions concerning the lead plaintiff and class representative. Instead, courts will endeavor to move the process along using the simplest method possible to choose lead plaintiff (financial losses), and not crediting attacks on the presumptive choice absent serious evidence of inadequacy.

C. Defining the Class

In 2005, in *Dura Pharmaceuticals, Inc. v. Broudo*, the Supreme Court held that, to adequately allege the loss causation element of a Section 10(b) claim, a plaintiff must allege *both* that the stock price was inflated at the time of purchase *and* that the price "fell significantly after the truth became known in order to allege a cognizable loss."[143] *Dura* thus blocks "in-and-out traders," who purchase stock during a class period but sell before the truth is revealed to the market, from asserting a Section 10(b) claim.

The question in *In re Twitter Inc. Securities Litigation*[144] was whether in-and-out traders must be expressly excluded from the definition of the class. A district court in the Northern District of California answered that question in the negative. The court explained that *Dura* only relates to how loss causation has to be pled in the complaint; it does not affect the class definition at the certification stage.[145] Moreover, the court could revisit the issue after discovery is complete pursuant to Federal Rule of Civil Procedure 23(c)(1)(C).[146] In any event, whether or not the class is defined to exclude in-and-out traders is largely an academic question, as *Dura* suggests that they cannot recover damages if an action reaches such a stage.

---

140 *Id.* at 685.

141 *Id.* at 684.

142 *Id.* at 682.

143 544 U.S. 336, 347 (2005).

144 326 F.R.D. 619 (N.D. Cal. 2018).

145 *Id.* at 625.

146 *Id.*

A district court in the Southern District of New York recently reaffirmed a court's flexibility to modify class definitions and create sub-classes when it deems appropriate. In *In re SunEdison, Inc. Securities Litigation*,[147] the plaintiffs sought certification of a class of "[a]ll persons or entities who (i) purchased . . . SunEdison [] common stock between September 2, 2015 and April 4, 2016" in reliance on allegedly false statements published in Bloomberg about SunEdison's liquidity "or (ii) purchased shares of SunEdison [] preferred stock pursuant or traceable to the registered public offering on or about August 18, 2015[.]"[148] Rather than certify the class as proposed, the court exercised its discretion under Rule 23 to split the class into two subclasses—one alleging violations of the Securities Act and one alleging violations of the Exchange Act. The court explained that these modifications were justified because there was "little to no factual overlap" between the claims and the proposed class period for the Securities Act claims "extends beyond the date of statements that plaintiffs themselves have described as disclosures of the omitted material information."[149]

V. Standing to Sue

What happens when the only active plaintiff in a securities action loses standing mid-way through the action? Two decisions addressed this situation in 2018, with different results.

In *Klein v. Qlik Technologies, Inc.*, [150] the plaintiff brought a derivative suit alleging that insiders of Qlik Technologies engaged in short-swing transactions in violation of Section 16(b) of the Exchange Act. While the action was pending, Qlik was bought out in an all-cash merger, causing the plaintiff to lose its financial interest in the company. The defendants then moved to dismiss the case for lack of standing. In turn, the plaintiff moved to substitute Qlik as plaintiff under Rule 17(a)(3) of the Federal Rules of Civil Procedure, which provides that "[t]he court may not dismiss an action for failure to prosecute in the name of the real party in interest until . . . a reasonable time has been allowed for the real party in interest to ratify, join, or be substituted into the action." A district court in the Southern District of New York granted defendants' motion to dismiss, holding that it lost jurisdiction over the case the moment the plaintiff lost a financial interest. A panel of the Second Circuit, however, disagreed. The court explained that standing and mootness are two separate concepts: The former is an inquiry at the beginning of the case to ensure that the resources of federal courts are devoted to disputes in which parties have a concrete stake.[151] The latter, by contrast, is an inquiry once a case is pending, and raises different concerns given that

147 329 F.R.D. 124 (S.D.N.Y. 2019).

148 *Id.* at 133.

149 *Id.* at 130.

150 906 F.3d 215 (2d Cir. 2018).

151 *Id.* at 222.

numerous parties may be relying on the outcome of the case.[152] Considering these differences, the court held that, when a representative plaintiff loses its stake in a litigation, a federal court retains jurisdiction long enough to determine whether the substitution of another party could avoid mootness.[153] In this case, the Second Circuit found that the substitution of Qlik would avoid having to find the claims moot, and should have been ordered under Rule 17(a) of the Federal Rules of Civil Procedure. Judge Raymond Lohier dissented, explaining that the plaintiff's action "became moot and the District Court lost jurisdiction the moment she ceased to have any financial stake in Qlik."[154] In this regard, Judge Lohier's view is consistent with Delaware law (albeit in a different context), under which "[a] plaintiff who ceases to be a shareholder, whether by reason of a merger or for any other reason, loses standing to pursue a derivative suit."[155]

In *Hering v. Walgreens Boots Alliance, Inc.*,[156] the plaintiff brought a putative class action alleging fraudulent misrepresentations in connection with the Rite Aid-Walgreens merger. After defendants moved to dismiss, the only claims that remained were based on statements made after the plaintiff already owned stock. Thereafter, Walgreens moved for judgment on the pleadings, arguing that the plaintiff had lost standing to sue. A district court in the Middle District of Pennsylvania granted the motion. The court recognized that, after a class is certified, mooting a class representatives' claims does not moot the entire action because the class has achieved a separate legal status.[157] Even before the class is certified, mooting the lead plaintiff's claims does not necessarily moot the action, or else it would incentivize defendants to evade litigation by endlessly mooting the representative's claims (*e.g.*, through settlement offers).[158] Here, though, the situation was different because there were no claims to moot, given that plaintiff could not assert any actionable misstatements.[159] Given that there were no viable claims, the court concluded that there was no case or controversy before the court in which to intervene, and dismissed the case in its entirety.[160]

The *Klein* and *Herring* approaches appear to be inconsistent. Under the reasoning of *Klein*, the *Herring* court should have retained jurisdiction at least long enough to determine whether another party could be substituted to assert the same claims, instead of outright dismissing the action.

152 *Id.*

153 *Id.* at 225.

154 *Id.* at 228.

155 *Lewis v. Anderson*, 477 A.2d 1040, 1049 (Del. 1984); *see also In re First Interstate Bancorp Consol. S'holder Litig.*, 729 A.2d 851, 867-68 (Del Ch. 1998); *In re Straight Path Commc'ns Inc. Consol. S'holder Litig.*, 2018 WL 3599809, at *1 n.3 (Del. Ch. July 26, 2018).

156 341 F. Supp. 3d 412 (M.D. Penn. 2018).

157 *Id.* at 417.

158 *Id.* at 418.

159 *Id.*

160 *Id.* at 419.

Given the range of opinions about this issue, including within the same Second Circuit panel, we would expect it to be an area for further development in the remainder of the year.

VI. Whistleblower Actions

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 2018, the SEC received over 5,200 whistleblower tips – a nearly 76% increase since FY 2012. The SEC also awarded over $168 million to 13 individuals, an amount that exceeded the combined amount awarded in all prior years. More recently, in March 2019, the SEC reported that it has now awarded approximately $376 million to 61 individuals since issuing its first award in 2012.[161]

Although Dodd-Frank defines a "whistleblower" only as a person who provides "information relating to a violation of the securities laws *to the Commission*,"[162] the SEC's implementing regulations broadly define a "whistleblower" as anyone who "possess[es] a reasonable belief that the information [they] are providing relates to a possible securities law violation."[163] In the SEC's view, this would apply to an employee's internal reporting of alleged securities violations, even if the employee never reported the violations to the SEC.[164]

Since then, a federal circuit split developed regarding the scope of Dodd-Frank's anti-retaliation provisions: the Second and Ninth Circuits accepted the SEC's position—applying the anti-retaliation provision to employees who reported possible securities violations internally but never to the SEC[165]—while the Fifth Circuit held that the provision protected only those who report possible violations to the SEC.[166] On February 21, 2018, the Supreme Court addressed this split in *Digital Realty*, holding that the anti-retaliation provision does not extend to individuals who have not reported securities law violations to the SEC.[167]

---

161 SEC Release No. 2019-42, SEC Awards $50 Million to Two Whistleblowers (Mar. 26, 2019), https://www.sec.gov/news/press-release/2019-42.

162 15 U.S.C. § 78u-6(a)(6) (emphasis added).

163 17 C.F.R. § 240.21F-2(b)(1).

164 *Id.*

165 *Berman v. Neo@Ogilvy LLC*, 801 F.3d 145 (2d Cir. 2015); *Somers v. Digital Realty Tr. Inc.*, 850 F.3d 1045 (9th Cir. 2017).

166 *Asadi v. G.E. Energy (USA), LLC*, 720 F.3d 620 (5th Cir. 2013). *See also Martensen v. Chicago Stock Exchange*, Case No. 17-cv-1494 (N.D. Ill. 2017), *aff'd* Case No. 17-2660 (7th Cir. Feb. 20, 2018) (Easterbrook, J.).

167 *Digital Realty Trust, Inc. v. Somers*, 138 S. Ct. 767, 772 (2018).

In the opinion, written by Justice Ginsburg, the Court relied on what it found to be clear statutory language: "Dodd-Frank's text and purpose leave no doubt that the term 'whistleblower' in §78u-6(h) carries the meaning set forth in the section's definitional provision. . . . The definition section of the statute supplies an unequivocal answer: A 'whistleblower' is 'any individual who provides . . . information relating to a violation of the securities laws to the Commission.'"[168] The opinion also noted that the "core objective" of Dodd-Frank's robust whistleblower program is "to motivate people who know of securities law violations to tell the SEC."[169]

The Court's ruling that internal whistleblowers are not afforded anti-retaliation protection under Dodd-Frank may be a victory for employers facing anti-retaliation claims by internal whistleblowers, but the practical effect of this ruling may wind up being detrimental for many companies.[170] When issues are first reported internally, employers have the opportunity to investigate the claims first, assess their legitimacy, and take pro-active remedial action where necessary—possibly even voluntarily self-disclosing to the SEC. *Digital Realty* creates a clear incentive to report in the first instance to the SEC, rather than first reporting internally. Of course, it remains to be seen whether the decision, in fact, will result in a corresponding decrease in internal reporting of alleged misconduct.

VII. Insider Trading

The Second Circuit revisited its decision in *United States v. Martoma*. In 2017, in *United States v. Martoma (Martoma I)*,[171] the Second Circuit held that tippees may be convicted for trading on material, non-public information conveyed to the tippee as a gift (and therefore in the absence of a *quid pro quo*) even if the tipper and tippee did not share a "meaningfully close relationship," as had been required by the Second Circuit in *United States v. Newman*.[172] The *Martoma I* decision was based on the Supreme Court's decision in *Salman v. United States*,[173] which rejected *Newman* "[t]o the extent the Second Circuit held that the tipper must also receive something of a 'pecuniary or similarly valuable nature' in exchange for a gift to family or friends." Instead, *Salman* held, "*Dirks* specifies that when a tipper gives inside information to 'a trading relative or friend,' the jury can infer that the tipper meant to provide the equivalent of a cash gift. In such situations, the

168 *Id.* at 777.

169 *Id.*

170 Jodi L. Avergun, Kyle DeYoung, Lex Urban & Kendra Wharton, *SCOTUS Blows the Whistle: Internal Whistleblowers Take Note*, THE NAT'L LAW REVIEW, (Feb 22, 2018), https://www.natlawreview.com/article/scotus-blows-whistle-internal-whistleblowers-take-note.

171 869 F.3d 58 (2d Cir. 2017).

172 773 F.3d 448, 452-55 (2d Cir. 2014).

173 137 S. Ct. 420 (2016).

tipper benefits personally because giving a gift of trading information is the same thing as trading by the tipper followed by a gift of the proceeds." [174]

Salman, however, did not expressly address whether a "meaningfully close personal relationship" between the tipper and tippee is *required* to infer that the tipper received a personal benefit when the information is conveyed as a gift.[175] On June 25, 2018, a divided Second Circuit panel revisited its decision in *Martoma I* and, in an amended opinion (*Martoma II*), declined to decide whether *Newman's* "meaningfully close personal relationship" standard was inconsistent with *Salman* for purposes of assessing whether a tipper personally benefitted from a gift of information.[176] Instead, the Second Circuit concluded that "there are many ways to establish a personal benefit," including showing that the tipper and tippee had a "*quid pro quo*" relationship, or that the tipper had an "intent to benefit" the tippee, both of which have been long-recognized by Second Circuit case law.[177] The panel affirmed Martoma's conviction, concluding that the government presented compelling evidence that one of the doctors who received information from Martoma shared consulting fees with Martoma, establishing a *quid pro quo*.[178]

The Second Circuit declined to rehear the case *en banc* in August. On January 24, 2019, Martoma filed a petition for a writ of certiorari seeking review by the Supreme Court.[179] Briefing is currently ongoing.

The Second Circuit's decision in *Martoma II* may not resurrect *Newman*, but it at least takes a nail out of the coffin by vacating the express abrogation of that decision's "meaningfully close personal relationship" requirement. Even so, the decision does not offer much clarity as to if or when a "meaningfully close personal relationship" is required to establish a personal benefit for the purposes of insider trading liability.[180]

---

174 *Id.* at 427-28.

175 *Id.* at 428.

176 *United States v. Martoma*, 894 F.3d 64, 71 (2d Cir. 2017) (as an amended opinion, *Martoma II* is technically a 2017 decision).

177 *Id.* at 77-78.

178 *Id.* at 78.

179 *U.S. v. Martoma*, Case No. 14-3599, Doc. No. 262 (2d Cir. Aug. 27, 2018).

180 Since *Martoma II*, little clarity has been provided by the lower courts. In December 2018, Judge Jed Rakoff ruled in *United States v. Pinto-Thomaz* that the government's failure to allege a "meaningfully close relationship" between the tipper and tippee was irrelevant under *Martoma II* because the indictment expressly alleged that the defendant had an "intention to benefit" the tippee. 352 F. Supp. 3d 287, 300-01 (S.D.N.Y. 2018).

VIII. SEC Regulation & Enforcement

A. Continued Focus on Cryptocurrencies

The SEC stepped up enforcement efforts in connection with cryptocurrencies in 2017 and that trend continued in 2018 and to date. The SEC's focus has included initial coin offerings (ICOs) and the regulation of cryptocurrency exchanges and exchange traded funds (ETFs).

On November 15, 2018, Maksim Zaslavskiy pled guilty to criminal charges of conspiracy to commit securities fraud.[181] Zaslavskiy had offered the sale of tokens in two ICOs for REcoin Group Foundation, LLC and DRC World, Inc.[182] In his one-page allocution, Zaslavskiy admitted that he had not in fact developed a cryptocurrency at the time he marketed REcoin and had made no purchases of real estate or diamonds, which were supposedly the investments backing the tokens.[183] Zaslavskiy also admitted to falsely promoting REcoin tokens by untruthfully claiming existing sales of over 2.8 million tokens.[184]

Earlier in the year, Zaslavskiy had asked the court to dismiss the charges, arguing that federal securities laws do not apply to cryptocurrency coins/tokens, and that the securities laws are unconstitutionally vague as applied to cryptocurrencies and token sales. The court rejected these arguments in an opinion issued on September 11, 2018.[185] The ruling reinforces the SEC's view that most ICOs are securities and that the *Howey* test is appropriate for making that factual determination.[186]

The SEC also has rejected several ETFs based on underlying ownership of coins in cryptocurrencies. For instance, on July 26, 2018, the SEC for the second time officially rejected the proposed Winklevoss Bitcoin Trust, associated with the high-profile twins Cameron and Tyler Winklevoss.[187] Among other reasons, the Commission has expressed concern that the proposed

---

181 Press Release, U.S. Attorney's Office E. Dist. of N.Y., Brooklyn Businessman Pleads Guilty to Defrauding Investors through Two Initial Coin Offerings (Nov. 15, 2018), https://www.justice.gov/usao-edny/pr/brooklyn-businessman-pleads-guilty-defrauding-investors-through-two-initial-coin.

182 *Id.*

183 *United States v. Zaslavskiy*, Case No. 1:17-cr-00647, Doc. No. 42-1 (Criminal Complaint) (E.D.N.Y. Nov. 15, 2018).

184 *Id.*

185 *United States v. Zaslavskiy*, Case No. 1:17-cr-00647, 2018 WL 4346339 (E.D.N.Y. Sept. 11, 2018). *See also SEC v. Blockvest LLC*, Case No. 18-cv-2287, 2018 WL 6181408 (S.D. Cal. Nov. 27, 2018) (Court imposed the burden of persuasion on the SEC to make a *prima facie* showing that the tokens at issuer were securities and determined that the SEC had not met that burden).

186 The *Howey* test states that: a security is "(1) an investment of money (2) in a common enterprise (3) with an expectation of profits produced by the efforts of others." *SEC v. W.J. Howey Co.*, 328 U.S. 293, 301 (1946).

187 SEC Release No. 34-83723 (July 26, 2018), https://www.sec.gov/rules/other/2018/34-83723.pdf. The SEC had previously rejected the Winklevoss proposal in 2017. *See* SEC Release No. 34-80206 (Mar. 10, 2017), https://www.sec.gov/rules/sro/batsbzx/2017/34-80206.pdf.

cryptocurrency ETFs will lack adequate surveillance for market manipulation and the underlying assets, including bitcoin, are themselves subject to illiquid markets and manipulation.[188] Chairman Clayton has also said that cryptocurrency exchanges must address the SEC's concerns about the risk of manipulation and inadequate custody solutions, noting that they currently lack safeguards similar to those employed by the NYSE and Nasdaq, before he can become comfortable with proposed cryptocurrency ETFs.[189]

Currently, market participants await a decision regarding VanEck SolidX Bitcoin Trust (VanEck), a cryptocurrency ETF announced on June 6, 2018.[190] If approved, VanEck would issue shares to be traded on the CBOE BZX Equities Exchange, reflecting the value of the Trust's portfolio of Bitcoin investments. On December 6, 2018, the SEC announced it would seek additional public input on the VanEck proposal, delaying approval or decisive disapproval until February 27, 2019.[191] However, the VanEck proposal was withdrawn during the recent government shutdown and was refiled on January 30, 2019. The SEC announced again on February 13, 2019, that it was seeking public comment on the proposal and a decision is expected in September 2019.[192]

B. Resolution of Legitimacy of Administrative Law Judges

In January 2018, the U.S. Supreme Court announced it would consider a challenge to the SEC's practice of hiring administrative law judges (ALJs) in *Lucia v. SEC*.[193] The question in *Lucia* was whether ALJs constitute "officers of the United States" or if they are mere employees who do not fall under the Appointments Clause of the U.S. Constitution. "Inferior officers" must be appointed by the President, or if an applicable statute provides, by a court or a department head.[194] SEC ALJs had been selected without any Presidential or Commission appointment, calling into question whether they were unconstitutionally appointed.

On June 21, 2018, in a divided opinion, the Supreme Court ruled that SEC ALJs were officers of the United States within the meaning of the appointments clause.[195] Justice Kagan, writing for the Court, relied on the Court's previous ruling in *Freytag v. Commissioner*, which held that adjudicative

---

188 SEC Release No. 34-83723 (July 26, 2018), https://www.sec.gov/rules/other/2018/34-83723.pdf,

189 *See* Fireside with SEC Chairman Jay Clayton and Glenn Hutchins, Consensus: Invest 2018 (Nov. 28, 2018), https://www.coindesk.com/sec-jay-clayton-consensus-invest-video.

190 VanEck SolidX Bitcoin Trust, Registration Statement (Amendment No. 5 to Form S-1), Registration No. 333-212479 (June 5, 2018).

191 SEC Release No. 34-84731 (Dec. 6, 2018), https://www.sec.gov/rules/sro/cboebzx/2018/34-84731.pdf.

192 SEC Release No. 34-85119 (Feb. 13, 2018), https://www.sec.gov/rules/sro/cboebzx/2019/34-85119.pdf.

193 *Lucia v. SEC*, 868 F.3d 1021 (D.C. Cir., June 26, 2017), *cert. granted*, 86 U.S.L.W. 3356 (U.S. Jan. 12, 2018) (No. 17-130).

194 U.S. Const., art. II, § 2, cl. 2.

195 *Lucia v. SEC*, 138 S. Ct. 2044 (2018).

officials known as "special trial judges" of the U.S. Tax Court were "inferior officers" within the meaning of the Appointments Clause under a "significant authority" test. Here, Justice Kagan found that SEC ALJs similarly bear the characteristics of inferior officers, including that they serve on an ongoing, rather than temporary, basis and they exercise "significant discretion" while carrying out "important functions."[196] Justice Kagan observed that the SEC's ALJs possess significant discretion as they have "nearly all the tools of federal trial judges" to ensure fair and orderly adversarial hearings.[197] The Court ordered a new proceeding for the petitioner, Raymond Lucia, with a properly appointed ALJ and specified that the new ALJ cannot be the one who originally heard the case.[198]

In the wake of *Lucia*, the SEC placed a two-month hold on administrative proceedings (APs), which was lifted by SEC order on August 22, 2018.[199] In that order, the Commission also reaffirmed its November 30, 2017 order ratifying the constitutional appointment of certain ALJs in an attempt to validate their ability to adjudicate cases. Moreover, the order granted all respondents in the proceedings previously on hold the "opportunity for a new hearing before an ALJ who did not previously participate in the matter" and remanded all pending cases before the Commission to the Office of the ALJs "for this purpose." Additionally, the order vacated "any prior opinion" issued by the Commission in over 125 pending matters, so those which had not exhausted their appeal rights could be afforded a new hearing with a different ALJ.[200]

While the appointments issue has now been addressed for future APs, there are other challenges to the SEC's AP process that remain unresolved, including claims that APs are constitutionally invalid because they violate the equal protection clause, the due process clause, and the Seventh Amendment's jury trial right. Although no litigant has had much success based on these arguments, it is likely that defendants will continue to pursue these challenges.

C. SEC's Undertakings and Creative Remedies

The SEC continues to utilize creative ways to impose remedies—other than large financial penalties—to further its enforcement goals. One of the most closely watched recent SEC enforcement actions involved an August 2018 tweet by Tesla founder and CEO Elon Musk: "Am considering taking Tesla private at $420. Funding secured." Musk's cryptic statement caused a 6% stock jump for Tesla, and quickly drew the SEC's attention.

---

196 *Id.* at 2052-3 (*citing Freytag v. Commissioner*, 501 U.S. 868 (1991)).

197 *Id.* at 2053.

198 *Id.* at 2055.

199 *See* Securities Exchange Act Release No. 83907, *In re: Pending Administrative Proceedings* (Aug. 22, 2018), https://www.sec.gov/litigation/opinions/2018/33-10536.pdf.

200 *Id.*

The following month, on September 27, 2018, the SEC filed a complaint against Musk in the Southern District of New York alleging that at the time of Musk's tweet no funding had, in fact, been secured at any price and Musk had no concrete plans to make a proposal to Tesla's public stockholders to take the company private.[201] Both Co-Directors of the SEC's Enforcement Division issued public warnings in connection with the filing, stating that the requirements to disclose truthful and non-misleading information "applies with equal force when the communications are made via social media or another non-traditional form."[202]

The SEC, Musk, and Tesla quickly reached a settlement on September 29, 2018, which required Musk and Tesla to each pay a separate $20 million civil penalty.[203] The settlement is noteworthy because in addition to the civil penalties, Musk and Tesla agreed to significant undertakings including: Musk stepping down as Tesla's Chairman for three years; Tesla appointing two new independent directors to its board; Tesla establishing a new committee of independent directors tasked with overseeing implementation of the terms of the settlement agreement; Tesla designating an experienced securities lawyer responsible for reviewing the social media communications of all senior officers; and Tesla putting in place additional controls and procedures intended to oversee all of Musk's communications regarding the Company in any format.[204] More recently, the SEC asked the court to hold Musk in contempt for failing to the comply with Tesla's executive communications policy enacted pursuant to the settlement agreement.[205] On April 26, 2019, the parties settled the dispute with Musk agreeing to refrain from tweeting or otherwise communicate in writing about certain topics without advance approval from a Tesla lawyer.

Similarly, on March 14, 2018, the SEC settled securities fraud charges with Theranos Inc. and its CEO, Elizabeth Holmes.[206] Theranos, a private company, purported to have developed a revolutionary new blood analysis technology.[207] The SEC alleged that, in fact, Theranos' product could only complete a small number of the claimed blood tests, and the company, by and large, was instead using industry-standard equipment manufactured by others.[208]

---

201 SEC Release No. 2018-219, Elon Musk Charged With Securities Fraud for Misleading Tweets (Sept. 27, 2018), https://www.sec.gov/news/press-release/2018-219.

202 *Id.*

203 SEC Release No. 2018-226, Elon Musk Settles SEC Fraud Charges; Tesla Charged With and Resolves Securities Law Charge (Sept. 29, 2018), https://www.sec.gov/news/press-release/2018-226.

204 *SEC v. Tesla, Inc.*, Case No. 1:18-cv-8947, Doc. No. 3 (Consent Motion) (S.D.N.Y. Sept. 29, 2018).

205 *SEC v. Musk*, Case No. 1:18-cv-8865, Doc. No. 18 (Motion for Order to Show Cause) (S.D.N.Y. Feb. 25, 2019).

206 SEC Release No. 2018-41, Theranos, CEO Holmes, and Former President Balwani Charged With Massive Fraud (Mar. 14, 2018), https://www.sec.gov/news/press-release/2018-41.

207 *Id.*

208 *Sec. & Exch. Comm'n v. Holmes*, Case No. 5:18-cv-01602, Doc. No. 1, ¶¶ 53-58, 59-64 (N.D. Cal. Mar. 14, 2018).

Like Musk, Holmes agreed to significant undertakings as part of her settlement with the SEC. In addition to paying $500,000 in civil penalties, under the terms of the settlement, Holmes was required to return 18.9 million Theranos shares, was barred from serving as a public company officer or director for ten years, and agreed to a preference in liquidation or acquisition that would give defrauded investors and other shareholders $750 million before Holmes receives any profit on her investment in the company.[209] Co-Director Avakian commented on the settlement that the "package of remedies exemplifies our efforts to impose tailored and meaningful sanctions that directly address the unlawful behavior charged and best remedies the harm done to shareholders."[210]

The Tesla and Theranos actions demonstrate the SEC's efforts to take quick and decisive action holding an individual executive accountable for his or her public statements and representations. Additionally, the remedies are examples of the SEC's focus on tailoring penalties to the infraction—rather than seeking the largest financial penalty possible—while also minimizing collateral, negative consequences to shareholders.[211]

D. Continued Focus on Data Privacy and Cybersecurity

On February 21, 2018, the SEC adopted a statement and interpretive guidance to assist public companies in preparing disclosures about cybersecurity risks and incidents.[212] The guidance addressed the SEC's views about public companies' disclosure obligations with respect to matters involving cybersecurity risk and incidents. It also addressed the importance of cybersecurity policies and procedures and the application of disclosure controls and procedures.

On April 16, 2019, the SEC's Office of Compliance Inspections and Examinations (OCIE) issued a cybersecurity risk alert for broker-dealers and investment advisers.[213] In the risk alert, OCIE outlined privacy and cybersecurity compliance issues related to Regulation S-P (requiring regulated companies to have policies and procedures in place for protection of customer information) as identified in their examinations over the last two years. It also encouraged registered entities to review their written policies and procedures and their implementation of those policies and procedures to ensure compliance with the regulatory requirements.

209 SEC Release No. 2018-41, Theranos, CEO Holmes, and Former President Balwani Charged With Massive Fraud (Mar. 14, 2018), https://www.sec.gov/news/press-release/2018-41.

210 *Id.*

211 *See, e.g.*, Stephanie Avakian, Co-Director, Division of Enforcement, U.S. Sec. & Exch. Comm'n, Measuring the Impact of the SEC's Enforcement Program (Sept. 20, 2018), https://www.sec.gov/news/speech/speech-avakian-092018.

212 SEC Release No. 2018-22, SEC Adopts Statement and Interpretive Guidance on Public Company Cybersecurity Disclosures (Feb. 21, 2018), https://www.sec.gov/news/press-release/2018-22.

213 Risk Alert, Investment Adviser and Broker-Dealer Compliance Issues Related to Regualtion S-P – Privacy Notices and Safeguard Policies (Apr.16, 2019), https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20Regulation%20S-P.pdf.

The SEC continued to bring enforcement actions against public companies in connection with cybersecurity concerns. On April 24, 2018, Altaba Inc., the company formerly known as Yahoo! Inc. (Yahoo), agreed to pay $35 million to settle SEC charges that the company misled investors by failing to disclose a massive data breach.[214] According to the SEC, Yahoo first disclosed the breach in September 2016 during due diligence for the sale of Yahoo's main operating units to Verizon, despite having discovered the hack within days of its occurrence in December 2014.[215] During the intervening two-year period, Yahoo's public filings warned that the business faced a risk of data breaches but failed to mention the company was actually aware of this massive breach and its legal and business consequences.[216] The SEC also stated that Yahoo failed to disclose the breach to its auditors or outside counsel when they reviewed the adequacy of the company's public filings.[217] This was the SEC's first enforcement action against a public company for failing to properly disclose a cyber event and put public companies on notice that the SEC will take enforcement action for failures to disclose cyber events under the appropriate circumstances.

Additionally, the SEC brought its first enforcement action for a violation of the five-year old Identity Theft Red Flags Rule, reinforcing the SEC's aggressive stance toward cybersecurity enforcement.[218] The Identity Theft Red Flags Rule requires certain SEC-regulated entities to adopt a written identity theft program that includes policies and procedures designed to (i) identify relevant types of identity theft red flags, (ii) detect the occurrence of those red flags, (iii) respond appropriately to the detected red flags, and (iv) periodically update the identity theft program. On September 26, 2018, Voya Financial Advisors Inc. agreed to pay $1 million to settle SEC charges related to a data breach in 2016.[219] According to the SEC, intruders obtained access by impersonating Voya contractors over telephone calls and requesting password resets from the company's technical support line, which allowed them to obtain the passwords and personal information for 5,600 customers.[220] The SEC found that Voya failed to maintain adequate cybersecurity policies and procedures as required by the SEC's Safeguards Rule and the Identity Theft Red Flags Rule, and had failed to follow its own procedures implemented after prior data breaches.[221] Voya, like Yahoo, neither admitted nor denied fault in connection with its resolution, but the SEC order requires Voya to retain an independent consultant to re-evaluate its policies and

214 SEC Release No. 2018-71, Altaba, Formerly Known as Yahoo!, Charged With Failing to Disclose Massive Cybersecurity Breach; Agrees To Pay $35 Million (Apr. 24, 2018), https://www.sec.gov/news/press-release/2018-71.

215 *Id.*

216 *Id.*

217 *Id.*

218 SEC Release No. 2018-213, SEC Charges Firm With Deficient Cybersecurity Procedures (Sept. 26, 2018), https://www.sec.gov/news/press-release/2018-213.

219 *Id.*

220 *Id.*

221 *Id.*

procedures. Given that cybersecurity is consistently listed as a priority in public commentary by the Commission, the SEC will likely continue with its aggressive enforcement of this, and other, cybersecurity rules in 2019 and beyond.[222]

E. SEC's Focus on Retail Investors

In keeping with Chairman Clayton's commitment to protect retail investors, the SEC has continued to focus significant enforcement activity on investment advisers who sell mutual funds to retail investors. After bringing a series of enforcement actions against investment advisors towards the end of 2017, on February 12, 2018, the SEC announced the Share Class Selection Disclosure Initiative (the SCSD Initiative).[223] The SCSD Initiative was created in response to what the SEC views as the widespread failure of investment advisors to make proper disclosures concerning their selection of mutual fund share classes that paid the adviser a fee when a lower cost share class of the same fund was available to the advisors' clients. Under the SCSD Initiative, the Division of Enforcement will recommend that the SEC "accept favorable settlement terms for investment advisers that self-report to the Division possible securities law violations relating to their failure to make necessary disclosures concerning mutual fund share class selection."[224]

The SCSD Initiative is meant to remedy this issue by encouraging investment advisors to self-report violations of their fee disclosure duties. An advisor who self-reports a conflict of interest concerning the receipt of 12b-1 fees (annual marketing or distribution fees charged on mutual funds) may benefit from the SCSD Initiative's more lenient settlement recommendations, which include that the SEC issue a cease-and-desist order, impose disgorgement of any ill-gotten gains and require various undertakings (such as correcting any misstatements concerning fees and evaluating whether clients should be moved to a lower cost-share class), while avoiding imposition of large civil penalties.[225]

Anthony S. Kelly, then Co-Chief of the SEC Enforcement Division's Asset Management Unit, commented that: "As evidenced by our recently announced Share Class Selection Disclosure Initiative, pursuing these types of actions remains a priority for the Division as we seek to get money back in the hands of harmed investors."[226] Illustrating this commitment, on March 11, 2019, the

---

222 *See, e.g.*, Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n, SEC Rulemaking Over the Past Year, the Road Ahead and Challenges Posed by Brexit, LIBOR Transition and Cybersecurity Risks (Dec. 6, 2018), https://www.sec.gov/news/speech/speech-clayton-120618.

223 SEC Release No. 2018-15, 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.

224 U.S. Sec. & Exch. Comm'n, Division of Enforcement, Share Class Selection Disclosure Initiative, https://www.sec.gov/enforce/announcement/scsd-initiative.

225 *Id.*

226 SEC Release No. 2018-26, SEC Charges Ameriprise With Overcharging Retirement Account Customers for Mutual Fund Shares (Feb. 28, 2018), https://www.sec.gov/news/press-release/2018-26.

Commission announced that it had settled charges against 79 self-reporting investment advisers, who would return more than $125 million to investors.[227]

The SEC has indicated that it will pursue these violations against those who do not opt in to the SCSD Initiative. The SEC brought a number of enforcement actions for these kinds of violations since announcing the initiative in February 2018. These actions included a settled action against Ameriprise Financial Services Inc., alleging that the investment adviser disadvantaged certain investors in retirement accounts by selling them more expensive mutual fund share classes when less expensive share classes were available.[228] Ameriprise also failed to disclose its motivation: that its advisors received greater compensation for selling the more expensive share classes.[229] Approximately 1,791 customer accounts paid a total of $1,778,592.31 in unnecessary fees, including up-front sales charges, contingent deferred sales charges, and higher ongoing fees and expenses.[230] Under the terms of the settlement, Ameriprise was required to switch investments in the affected accounts to the appropriate lower-cost share classes, repay customers charged excess fees with interest, and pay a penalty of $230,000.[231] The SEC also brought recent settled actions against Thoroughbred Financial Services,[232] American Portfolios Advisers Inc., and PPS Advisors Inc. for similar alleged violations[233] that required the advisers to pay significant civil money penalties as part of the settlements.

IX. Looking Ahead: Securities Litigation and Regulation for the Remainder of 2019

2019 has already brought about important developments in federal securities litigation and regulation, including the Supreme Court's decision in *Lorenzo* (discussed above). We expect the remainder of 2019 to be eventful. In particular, we will be watching for noteworthy developments in the following areas:

- ***The application of the Exchange Act to foreign issuers that are not involved in a domestic transaction.*** In *Morrison v. National Australia Bank, Ltd.*, the Supreme

227 SEC Release No. 2019-28, SEC Share Class Initiative Returning More Than $125 Million to Investors (Mar. 11, 2019), https://www.sec.gov/news/press-release/2019-28.

228 SEC Release No. 2018-26, SEC Charges Ameriprise With Overcharging Retirement Account Customers for Mutual Fund Shares (Feb. 28, 2018), https://www.sec.gov/news/press-release/2018-26.

229 *Id.*

230 *Id.*

231 *Id.* Ameriprise also consented to a cease-and-desist order and a censure, while voluntarily identifying the affected accounts.

232 SEC File No. 3-18952, SEC Charges Tennessee Investment Advisory Firm and Two Advisory Representatives with Steering Clients to Higher-Fee Mutual Fund Share Classes (Dec. 21, 2018), https://www.sec.gov/enforce/34-84918-s.

233 SEC Release No. 2018-303, Two Advisory Firms, CEO Charged with Mutual Fund Share Class Disclosure Violations (Dec. 21, 2018), https://www.sec.gov/news/press-release/2018-303.

Court held that the antifraud provisions of the federal securities laws only apply to: (i) "transactions in securities listed on domestic exchanges;" and (ii) "domestic transactions in other securities."[234] Recently, in *Stoyas v. Toshiba Corporation*,[235] the Ninth Circuit held that *Morrison* does not preclude an investor from bringing securities fraud claims under Section 10(b) of the Exchange Act against a foreign issuer, even if it is not involved in a domestic transaction concerning the securities. *Stoyas* involved allegations of accounting fraud against Toshiba, a Tokyo-based corporation, brought by investors who purchased Toshiba American Depository Shares or Receipts (ADRs) in an over-the-counter market in the United States. A district court in the Central District of California dismissed the claims with prejudice under *Morrison*, reasoning that over-the-counter markets are not "domestic exchanges," and, even if the ADRs were purchased in domestic transactions, Toshiba was not involved. The Ninth Circuit reversed, holding that Toshiba did not have to actually participate in the sale of the securities for it to incur liability under the Exchange Act. In so holding, the Ninth Circuit adopted the Second Circuit's "irrevocable liability test," which provides that "a securities transaction occurs when the parties incur irrevocable liability," or, in other words, where the "purchasers incurred the liability to take and pay for the securities, and where sellers incurred the liability to deliver securities."[236] Although the court found that the complaint lacked necessary details concerning where the parties to the ADR transactions incurred irrevocable liability, it allowed the plaintiff to amend its complaint because the entity that operated the over-the-counter market and the executive offices of the Toshiba ADR depositary institutions were all located in the United States. Thus, plaintiff "could almost certainly allege sufficient facts that [it] purchased its Toshiba ADRs in a domestic transaction."[237] On October 11, 2018, Toshiba filed a petition for writ of certiorari asking the Supreme Court to accept the case to consider whether a domestic transaction not involving the foreign issuer is a sufficient condition for the Exchange Act to apply to that issuer. The Supreme Court's review of the petition remains pending.

- ***The correct test for loss causation under the Exchange Act.*** For claims under the Exchange Act, a plaintiff has the burden of establishing "loss causation"—*i.e.*, "that the act or omission of the defendant alleged to violate this chapter caused the loss for which the plaintiff seeks to recover damages."[238] In *Mineworkers' Pension Scheme v. First Solar Inc.*, the district court certified the following question to the Ninth Circuit: "[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 . . . ?"[239] On appeal, the Ninth Circuit rejected the more restrictive view of the test posed by the district court, explaining that "loss causation is a 'context dependent'

[234] 561 U.S. 247, 273 (2010).

[235] 896 F.3d 933 (9th Cir. 2018).

[236] *Id.* (citing *Absolute Activist Value Master Fund Ltd. v. Ficeto,* 677 F.3d 60, 67 (2d Cir. 2012)).

[237] *Id.* at 949.

[238] 15 U.S.C. § 78u-4(b)(4).

[239] 881 F.3d 750, 753 (9th Cir. 2018).

inquiry as there are an 'infinite variety' of ways for a tort to cause a loss."[240] 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."[241] 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. The Supreme Court's review of the petition remains pending.

- ***The duty to correct a statements of historical fact that were accurate when made.*** Rule 10b-5 prohibits the making of an "untrue statement of material fact" in connection with the sale or purchase of a security.[242] Circuit courts, however, are split on whether this duty requires a company to "correct" a statement that was accurate at the time it was made. The Seventh Circuit has declined to impose a duty to update past statements, while the First, Second, Third, Fifth, and Eleventh Circuits have recognized a limited duty to update where the prior statement was forward-looking.[243] Recently, the Ninth Circuit extended the duty to correct, holding that a maker of a statement owes a duty to update a statement of historical fact if subsequent events diminished the "value" or "weight" of that statement.[244] In *Khoja v. Orexigen Therapeutics, Inc.*, investors brought a putative class action against Orexigen, a biotechnology firm, alleging that Orexigen misrepresented the effectiveness of a recently developed cardiovascular drug. The plaintiffs claimed that Orexigen's stock price was artificially inflated after the firm leaked interim testing results that showed the cardiovascular drug reduced the risk of certain heart disease by over 41 percent. The same study, however, later concluded that the drug had no health benefits—a fact that Orexigen did not disclose. At the motion to dismiss stage, a district court in the Southern District of California held that the investors failed to plead a Rule 10b-5 violation because the complaint did not allege that Orexigen mispresented the interim findings of the study and Orexigen "had no duty to update this accurate statement of historical fact."[245] But the Ninth Circuit disagreed, explaining that, even though the interim results were "technically accurate, the issue is whether, having learned new information that diminished the weight of those results, Orexigen was obligated to share that information."[246] Because "subsequent data indicated those earlier interim results were not so promising after all, their value diminished," the Ninth Circuit held that Orexigen was "obligated" to update its earlier statements. On January 31, 2019, certain defendants filed a petition for writ of certiorari to resolve whether an issuer owes a duty to update a then-

240 *Id.* (citation omitted).

241 *Id.* at 754.

242 17 C.F.R. § 240.10b-5(b).

243 *Stransky v. Cummings Engine Co.*, 51 F.3d 1329, 1332 (7th Cir. 1995); *Backman v. Polaroid Corp.*, 910 F.2d 10, 16-17 (1st Cir. 1990); *In re IBM Corp. Sec. Litig.*, 163 F.3d 102, 110 (2d Cir. 1998); *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1431 (3d Cir. 1997); *Rubinstein v. Collins*, 20 F.3d 160, 170 n.41 (5th Cir. 1994) (dicta); *Finnerty v. Stiefel Labs., Inc.*, 756 F.3d 1310, 1317 (11th Cir. 2014).

244 *Khoja v. Orexigen Therapeutics, Inc.*, 899 F.3d 988, 1017 (9th Cir. 2018).

245 *Khoja v. Orexigen Therapeutics, Inc.*, 189 F. Supp. 3d 998, 1018 (S.D. Cal. 2016).

246 *Khoja*, 899 F.3d at 1015.

accurate statement of historical fact.[247] The Supreme Court's review of the petition remains pending.

- ***Rebutting the* Basic *presumption in the Second Circuit—revisited.*** For a second time in under a year, Goldman Sachs has appealed the district court's grant of class certification in *Arkansas Teachers,* arguing that the district court misapplied the standard for rebutting the investor plaintiffs' *Basic* presumption of reliance. As noted in Section II(A), *supra*, the complaint in this case alleges that Goldman Sachs and several directors made material misstatements about Goldman Sachs' efforts to avoid conflicts of interest, causing the price of Goldman Sachs stock to drop once the truth became known. After the Second Circuit remanded the case with instruction that the Court determine by "preponderance of the evidence" whether Goldman Sachs carried its burden of showing the alleged misstatements had no price impact, a district court in the Southern District of New York further considered the defendants' efforts to rebut plaintiffs' efficient-market evidence. The court weighed the opinion of the plaintiffs' expert "demonstrating the price impact of the alleged misstatements" against the "deficiencies inherent in the opinions" of Goldman Sachs' experts, concluding that the defendants "have failed to tip the scale in their favor on this issue."[248] Goldman Sachs once again sought leave to appeal the district court's decision to the Second Circuit, arguing that the court erred in certifying the class because plaintiffs' price maintenance theory "only applies to two types of concrete statements about material facts" that do not include Goldman Sachs' "routine" business statements, and "failed to weigh Defendants' substantial evidence of no price impact."[249] Although Plaintiffs have yet to submit their response brief, they argued in their answer to Goldman Sachs' petition for permission to appeal that the question of whether a reasonable investor would rely on "routine" statements is a materiality argument that is improper to resolve at the class certification stage and that Goldman Sachs is asking the Second Circuit to reweigh evidence that the district court already found lacking.[250] The Second Circuit granted Goldman Sachs' petition seeking leave to appeal on December 11, 2018 and oral argument is scheduled for June 26, 2019.

- ***The continued focus on cyber and retail investors.*** The SEC's focus on cyber and retail investors is unlikely to wane in 2019. Along with more cases involving ICOs and digital assets, investment advisers and broker-dealers will likely see increased attention in these areas, including actions for violations of the Identity Theft Red Flags rules and other failures in cybersecurity policies and procedures. Public companies will likely also continue to face scrutiny of their disclosures related to cybersecurity issues.

- ***The implementation of more tailored remedies.*** The SEC will continue to look for ways to impose remedies – other than large financial penalties – that further its

---

247 *Hagan v. Khoja*, No. 18-1010 (S. Ct.).

248 *In re Goldman Sachs Group, Inc. Sec. Litig.*, 2018 WL 3854757, *4-6 (S.D.N.Y. 2018).

249 Brief for Appellants, *In re Goldman Sachs Group, Inc. Sec. Litig.*, No. 18-3667-cv, Doc. No. 62 at 24 (2d Cir. Feb. 15, 2019).

250 Ans. Opp. to Pet. for Permission to Appeal, *In re Goldman Sachs Group, Inc. Sec. Litig.*, No. 18-3667-cv, Doc. No. 44 (2d Cir. Sept. 7, 2019).

enforcement goals. In particular, look for the SEC to expand its creative use of undertakings, which require a defendant to do certain things in order to remain in compliance with a court order (or similar obligation in administrative proceedings) similar to what it did in the Theranos proceeding (requiring the CEO to relinquish control and preventing her from profiting from a sale of the company until money is returned to investors) and the Tesla matter (requiring the CEO to resign as Chairman and the company to add two new independent directors).

- ***The use of Administrative Proceedings.*** Now that the appointment issue has been resolved, the SEC has resumed bringing contested actions in Administrative Proceedings. The question is how frequently it will do so and in what kinds of cases. Will the SEC return to an aggressive use of APs in all kinds of cases, like it pursued in 2014 and 2015 before the Constitutional challenges to the process, or will it take a more limited approach and only pursue cases against registered persons and entities similar to the pre-Dodd-Frank era?

- ***The limitation of resources.*** Besides the government shutdown in January as well as the SEC's regular mention of its limited resources, the Division of Enforcement's investigative and litigation personnel is actually down 10% and has been diverting resources to litigate administrative proceedings reopened as a result of the *Lucia* decision. It will be a challenge for the SEC's enforcement program to match its recent quantitative and qualitative success in FY 2019 if the resource issues are not addressed.

* * *

If you have any questions, please feel free to contact any of the following Cadwalader attorneys.

Jason M. Halper	+1 212 504 6300	jason.halper@cwt.com
Jodi Avergun	+1 212 862 2456	jodi.avergun@cwt.com
Nathan Bull	+1 212 504 5753	nathan.bull@cwt.com
Kyle DeYoung	+1 202 862 2288	kyle.deyoung@cwt.com
Jonathan Watkins	+1 704 348 5129	jonathan.watkins@cwt.com
Jared Stanisci	+1 212 504 6075	jared.stanisci@cwt.com
Adam K. Magid	+1 212 504 6314	adam.magid@cwt.com
Lex Urban	+1 643 244 6135	lex.urban@cwt.com

Kendra Wharton	+1 202 862 2333	kendra.wharton@cwt.com
James Orth	+1 212 504 6185	james.orth@cwt.com
Rachel Ross	+1 212 504 6165	rachel.ross@cwt.com